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Series of growth boosting measures fetch confidence in the economic revival

October 2019

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IN THIS ISSUE…

Renewed hopes of reversal in the economic slowdown

The gamut of measures announced by the government recently brought immense hope on the reforms front to the otherwise dismal economic scenario. Though, how these measures influence the economic revival in the long run is still debatable, given the current demand side constraints.

Considering the real slowdown in the economy, particularly after the release of weak Q1 FY20 GDP growth estimates, which fell to 6-year low to 5%, the government announced slew of measures aimed at creating virtual demand and to facilitate supply-side activity by stimulating investments over the long term in the economy. The measures announced in August and September in four tranches include a special window for real estate, export incentives, PSU bank amalgamation and sops for micro, small and medium enterprises (MSMEs) and the automobile sector and corporate tax cut. These measures aim to give a boost to Make in India, attract private investment from across the globe, improve competitiveness of our private sector and to create more jobs.

Weak automobile sales and production and slower pick up in bank credit growth portrays stagnant demand conditions. The jump in Index of Industrial Production (IIP) growth from 2% in June to 4.3% in July supported by renewal in manufacturing activity spark some optimism, but the Eight Core industries, degrowing at -0.5% in August downcast the renewed hopes.

Despite some intermittent rise in crude oil prices in the wake of supply disruption following an attack on a major oil facility in Saudi Arabia, oil prices managed to settle lower. Concerns on higher oil prices which can exert inflationary pressure eased lately. Weighed by rising dollar demand and FPI outflows coupled with global factors like ongoing trade war between US with China and weak domestic growth prospects, rupee depreciated initially, but managed to recover on renewed hopes of economic recovery post government measures, along with benign inflation and reversal in FPI outflows. Despite rising marginally, CPI inflation rate continued to remain benign in August supporting RBI MPC to continue with accommodative monetary policy and cut policy rate by 25 bps to 5.15% on 4th October, taking the cumulative rate cut of 135 bps during the current fiscal so far.

Monetary Policy Committee (MPC) reduced repo rates by 135 basis points cumulatively in 2019 so far, but WALR on fresh rupee loans eased just by 29 bps till July, reflecting lack of monetary transmission. To address this issue, RBI made it mandatory for banks to link all new floating rate personal or retail loans and floating rate loans to MSMEs to an external benchmark effective October 1, 2019.

Government efforts to abate growth slowdown juxtaposed with fear of fiscal slippage (Rs 1,45,000 crore stimulus package by finance minister by way of corporate tax cut) turned bond markets sentiments gloomy and volatile leading to hardening of the bond market yields.

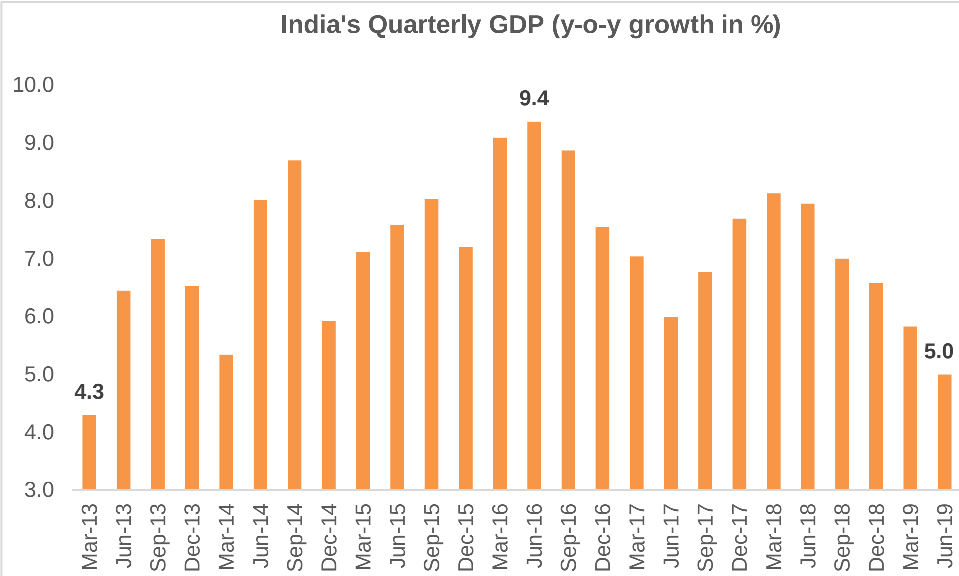
MACRO-ECONOMIC INDICATORS

Economy trends

BWR Views

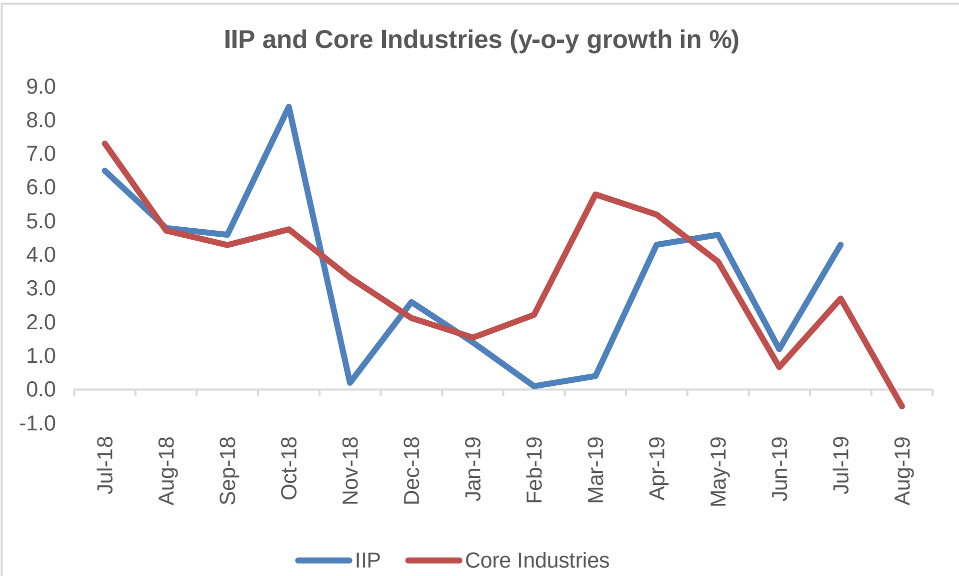
The disappointing GDP growth in the Q1 2019-20 created serious doubts on the possibility of the economy to achieve the earlier projections made by the government agencies. Disappointing core sector growth in August suggests further deterioration in infrastructure activity, negating the slight rise reported in IIP growth during July. Hence, the second quarter too may not see any significant improvement. However, array of measures to boost economic growth announced in the last two months likely to boost economic prospects in the second half of the FY 20 but with limited pace. Hence the full year growth is likely to be around **6.1**% in FY 20.

Weak quarterly GDP growth hints at a gradual weakening of the economic growth prospects in India for the current fiscal. The growth rate in the first quarter of 2019-20 came in 5%, almost 3 percentage points lower compared to the corresponding period last year. Domestic economy slowed to 6- year low (26 quarter low) as can be seen in the charts below.



Source: MOSPI, BWR Research

Performance in Core Industries and IIP



Source: MOSPI, eaindustry.nic.in, BWR Research

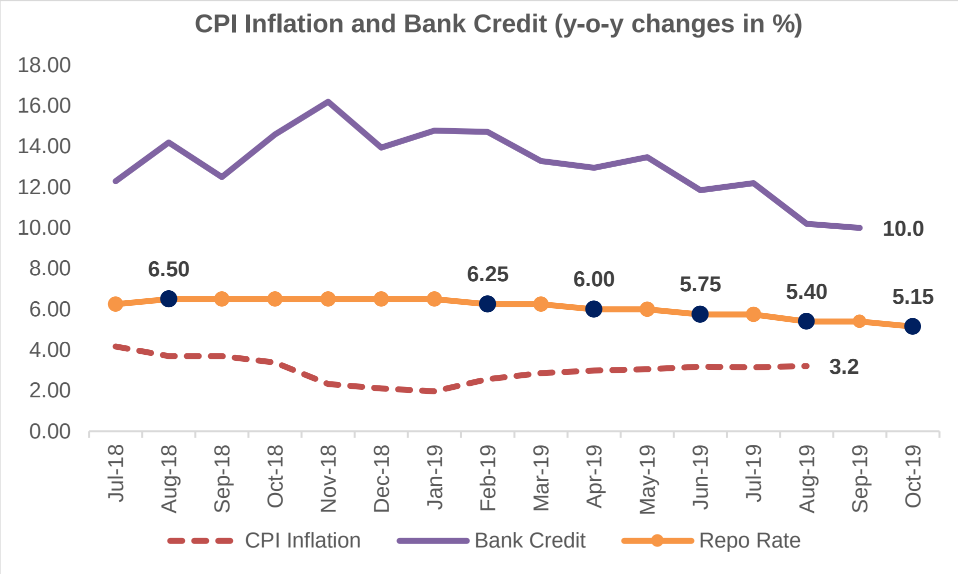
Inflation and low bank credit growth

BWR Views

The decline in crude oil prices helped benign inflation so far, but the recent spikes in oil prices likely to thwart upside pressure on inflation. Yet, the inflation outlook for the current fiscal likely to remain within the mid-point of MPC range, helping the RBI MPC to continue with accommodative monetary stance.

Amid host of measures announced by the government along with RBI making External Benchmark Based Interest Rate mandatory for certain categories of loans effective October 1, 2019, tepid credit growth owing to poor transmission of rate cuts experienced so far may reverse. The recent repo rate cut is also credit positive, and may increase flow of credit to the economy.

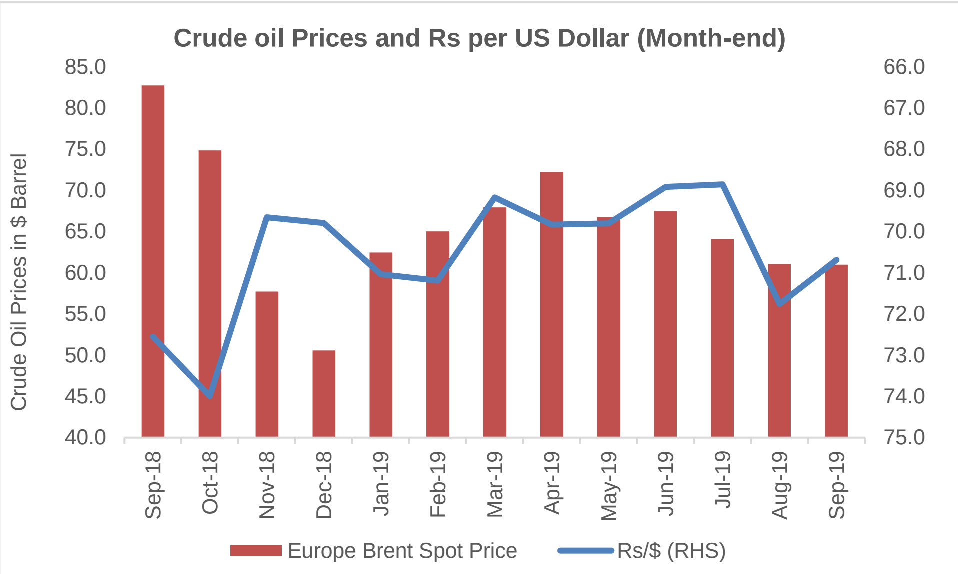
CPI inflation increased marginally to 3.2% in August compared to 3.15% in July on the back of rising food prices particularly of vegetables. Falling fuel prices cushioned the rise in food inflation in August, providing further support to an accommodative monetary policy. RBI MPC cut repo rate by 135 basis points so far in 2019, however, credit growth at around 10% in August (y-o-y) is disappointing.



Source: MOSPI, RBI, BWR Research

Crude oil Prices and INR/USD rates

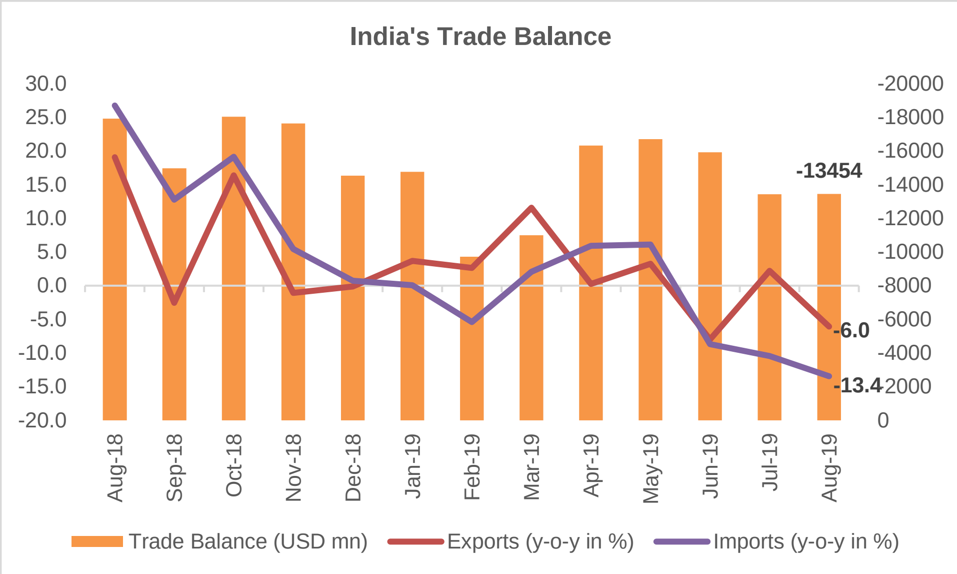
After rising up to USD 68 per barrel in September 16th, in the backdrop of drone attacks on Saudi Arabian Oil Company on 14th September, the crude oil prices settled lower towards the end of the month. Despite volatile oil prices, the domestic rupee remained stable supported by reversal in foreign portfolio outflows post the removal of surcharge on FPIs from the Indian market.



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

Merchandise Trade

The trade deficit narrowed down by 25% (y-o-y) during August 2019 to USD 13.4 billion as imports fell by 13% (in value terms) over the year on account of reduction in both gold and crude oil imports. Merchandise exports also decreased by 6% compared to last year as huge reduction in re-exports of petroleum products and non-petroleum products resulted in fall in export value of goods.



Source: Ministry of Commerce, BWR Research

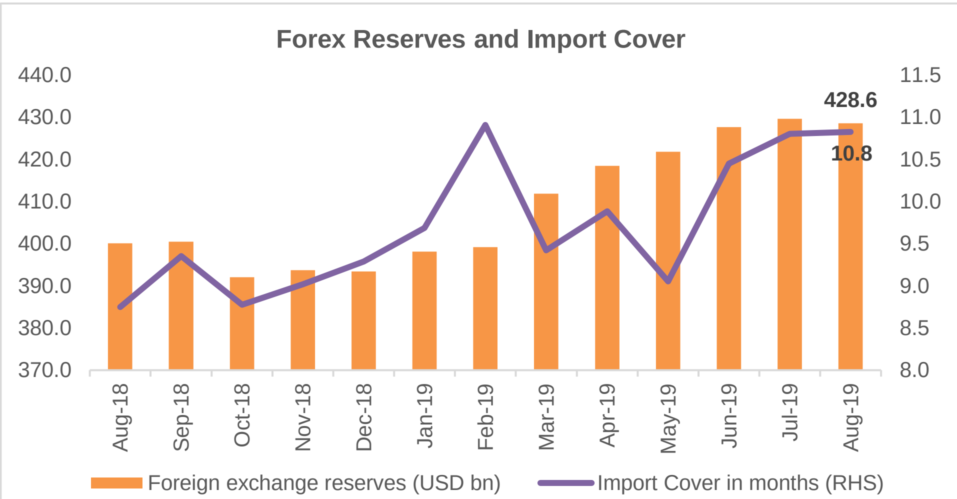
BWR Views

Though, crude oil prices managed to remain firm despite geo political tensions, the underlying concerns on uncertain global economic environment with trade tensions and geo-political risks cannot be ignored. India imports more than 70% of its oil needs in which from Saudi Arabia accounts for nearly 19% of the total oil imports. Any disruption in the supply of global crude oil prices will aggravate India's fiscal situation.

Consequently, the Indian rupee may also suffer as the currency is vulnerable to both domestic and global factors. Volatile oil prices, FPI flows, US dollar's strength and economic concerns expected to keep the rupee under pressure in the coming months.

Forex Reserves and Import Cover

Foreign exchange reserves increased by $28.5 billion to $430 billion towards the end of August 2019 compared with a year ago reserves position. The current level of Forex reserves is sufficient to cover 10.8 months of imports. In July, RBI actively intervened in the forex market (purchased $1.59bn and sold $1.69bn) both in spot market and forward market to arrest rupee depreciation.



Source: Ministry of Commerce, RBI, BWR Research

BWR Views

Adequate forex reserves reflect country's ability to absorb external shocks. The RBI's frequent intervention to stabilise rupee fall may affect accumulation of forex reserves. During July RBI turned net seller of US dollars after a gap of 7 months owing to recent fall in rupee.

SECTORAL INDICATORS

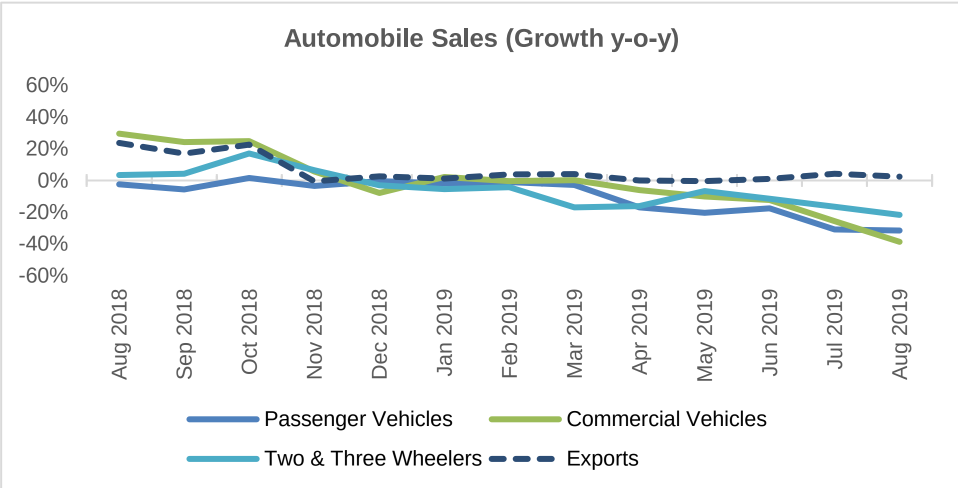
Automobiles

BWR Views

Vehicle sales are expected to pick up from H2 FY20, supported by festive buying and pre-buying by fleet owners before the BS-VI norms kick in from FY21. Recently announced government measures also likely to boost automobile demand. Though, the sales growth may still be slower than the previous year's growth, but is expected to register a healthy month-on-month growth.

Domestic automobile sales fell by 24% y-o-y in the month of August 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 has also resulted in muted demand for automobiles.

Several measures were announced by the government in order to address the slump in automobile sales like deferring the increase in registration fees till June 2020, allowing BS-IV vehicles to remain operational for the entire period of registration, hiking depreciation benefit on all vehicles to 30% from 15% and reversing ban on government purchases. These measures have not yet yielded the desired results, but is expected to improve the overall sentiment in the market.



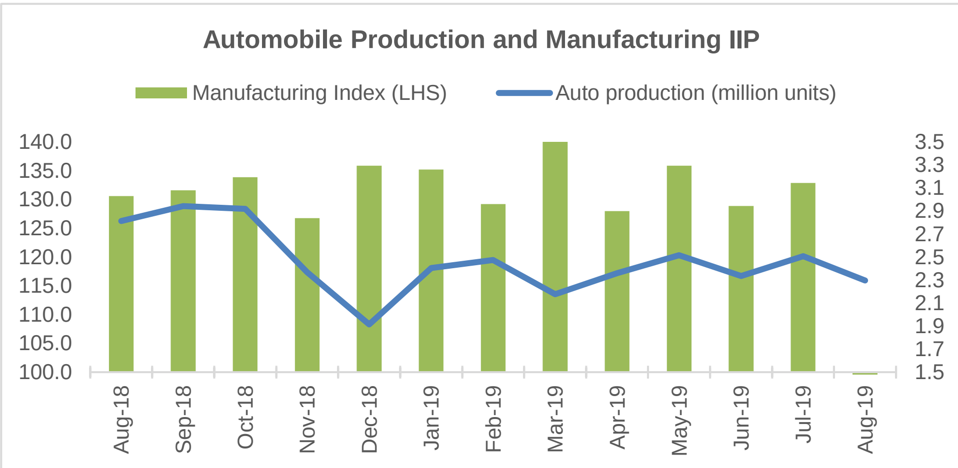
Source: CMIE, BWR Research

Manufacturing Index and Automobiles

BWR Views

Slowdown in vehicle sales has resulted in huge inventory build-up. Therefore, production cut down is expected to continue in the coming months until inventory at the dealer level eases.

Domestic automobiles production declined by 18% y-o-y in the month of August 2019 due to production cut downs by manufacturers on account of huge inventory build-up occurring from falling sales. Slowdown in auto production is in line with overall decline in manufacturing index. This has also adversely affected the ancillaries and automobile dealers.



Source: MOSPI, CMIE, BWR Research

Telecom

BWR Views

Competitive intensity is expected to increase in the coming months. Players to continue to feel pressure on their profitability.

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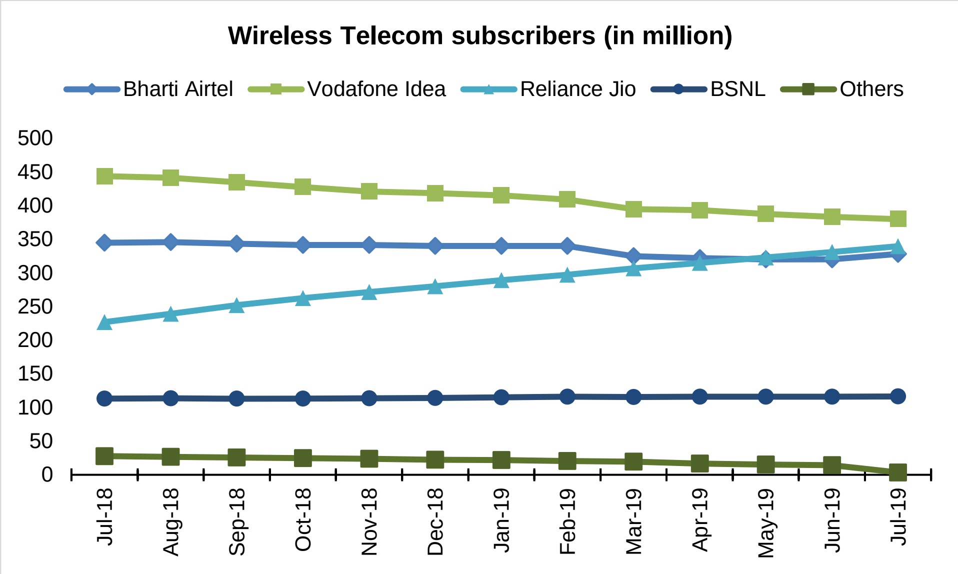
Consolidation of the market continues with Jio increasing its market share and driving the overall subscriber additions in the sector. The increase in subscriber base is likely driven by rise in rural subscribers. The subscriber base is expected to widen further as the penetration increases, especially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



Source: TRAI, BWR Research

The sector currently has only three major players and their Q1 FY20 results are not encouraging for the sector as a whole. While, Reliance Jio continues to be profitable, it has been reporting declining average revenue per user (ARPU) for the last 7-8 quarters. On the other hand, Airtel and Vodafone are struggling with significant losses amid falling subscriber base.

The telecom players have been engaged in a dispute related to minimum ringer time which directly impacts their interconnect usage charges (IUC) revenue. To sort this out, TRAI had floated a consultation paper and expects to make a decision on the same within a month. The competition in the sector has now further intensified with Jio reducing the price of its Jio Phones which clearly aims at feature phones users, essentially the non-data subscribers. While, this means more benefits for the customers, it paints a rather gloomy picture for the incumbents.

Power

Power generation grew by 4.5% y-o-y in July 2019 despite a slump in industrial activity in the country. This growth is on account of expansion of access in the power sector as large number of households are added to the electricity network for the first time. While, conventional power sources recorded a growth of 5.7%, renewable sources witnessed a decline of 4% y-o-y in July 2019. Although, the Government has been promoting and incentivizing to set up renewable energy plants, the investor sentiment has been consistently declining.

BWR Views

Power sector may continue to witness stress due to stalled projects.

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.

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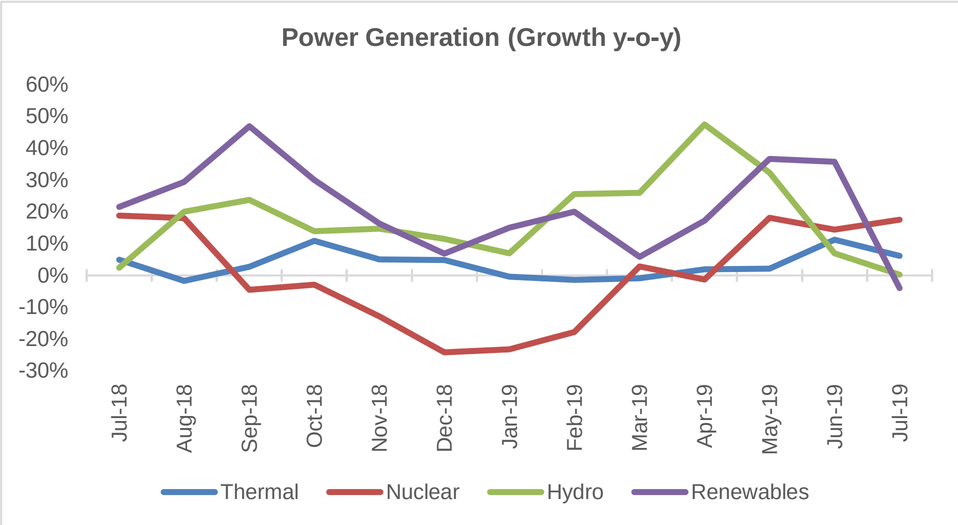
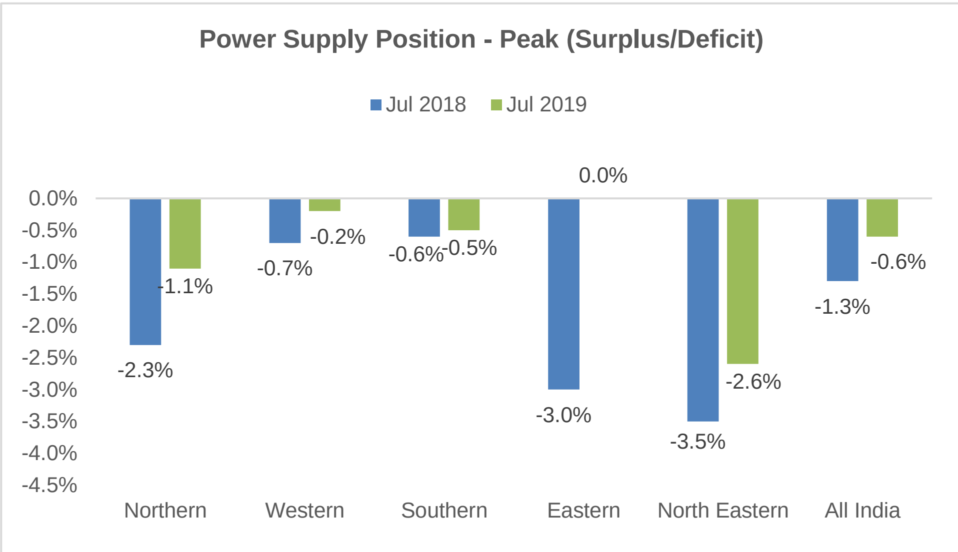


Source: Central Electricity Authority, BWR Research

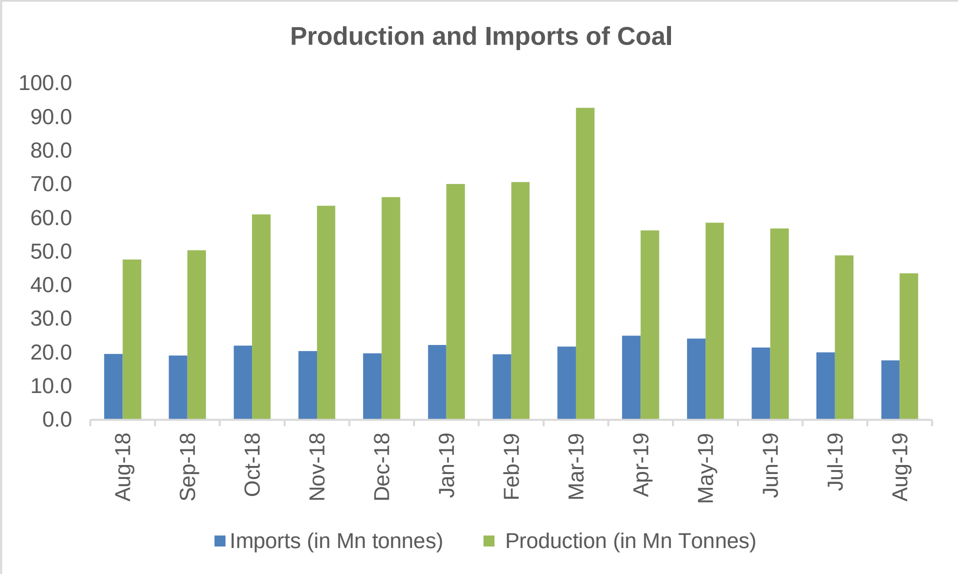
India's power supply position improved in July 2019, but country is still not a power-surplus nation. The deficit is primarily due to DISCOMS stressed financials on account of its mounting losses and huge debt burden.



Source: Central Electricity Authority, BWR Research

Coal

India imports nearly 20 million tonnes of coal compared to 60 million tonnes of domestic production on an average. During August 2019, domestic production of coal declined by 9% whereas imports have gone down by 10% y-o-y. Globally, coal prices have been declining since July 2018, due to weak global growth and lower demand.



Source: CMIE, BWR Research

In a recent development, the Government of India has launched a portal which will help in better coordination of coal supply to power plants. This will enable all stakeholders to monitor coal right from its production in mines to its uses in transportation and power sectors. This will also help in overall inventory and supply chain management for Indian Railways and Power sector. On the other hand, flooding in the Dipka coal mine may temporarily disrupt the coal production as it supplies about 5% of Coal India's output.

BWR Views

In the domestic market, coal-fired power generation capacity is expected to rise due to increase in demand and lack of alternative fuels by power generation companies. The central government is planning to auction more than 41 new coal blocks soon to augment this demand. However, no light seen for the distressed power generators who have stopped producing any power or have low PLFs.

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Steel

BWR Views

The ongoing stress in the automobile and real estate sectors curtailed the demand for steel. Global issues continue to weigh on prices since outlook for the sector continues to remain weak. However, the sector is expected to improve gradually with the expectations of improvement in auto demand due to the advent of festive season. Also, with the withdrawal of monsoon, construction activity is expected to pick up.

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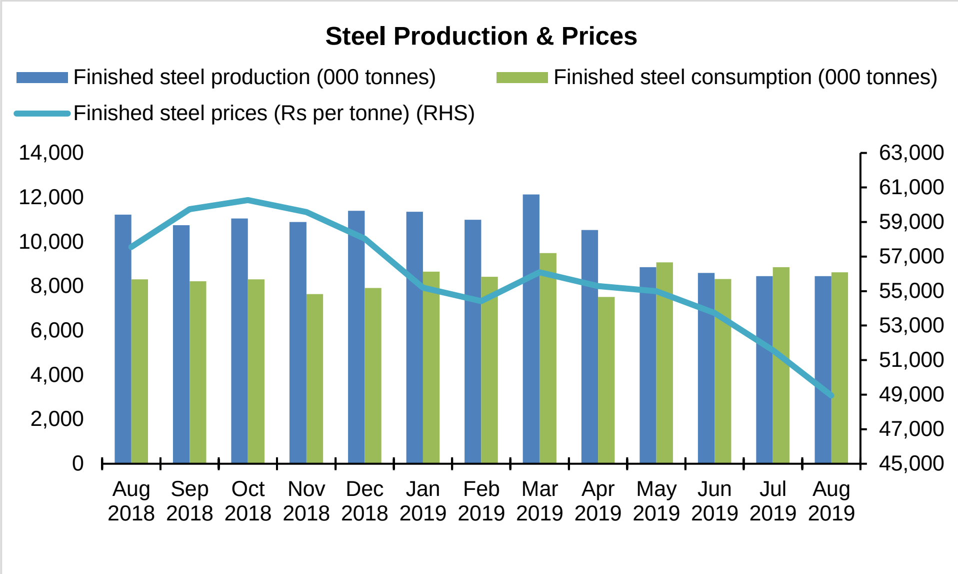
Domestic steel prices are on a declining trend after October 2018 owing to subdued industrial activity in the country visible in declining infrastructure & construction activity and lower automobile sales. Steel prices in the international market is also weak on account of deceleration in global steel demand especially China.



Source: CMIE, BWR Research

Cement

BWR Views

With the continuous focus of the Government on infrastructure and affordable housing, the cement demand is expected to witness an increase from H2 FY20. Various cement manufacturers have been adding capacities to meet the incremental demand and the same is likely to keep the prices stable

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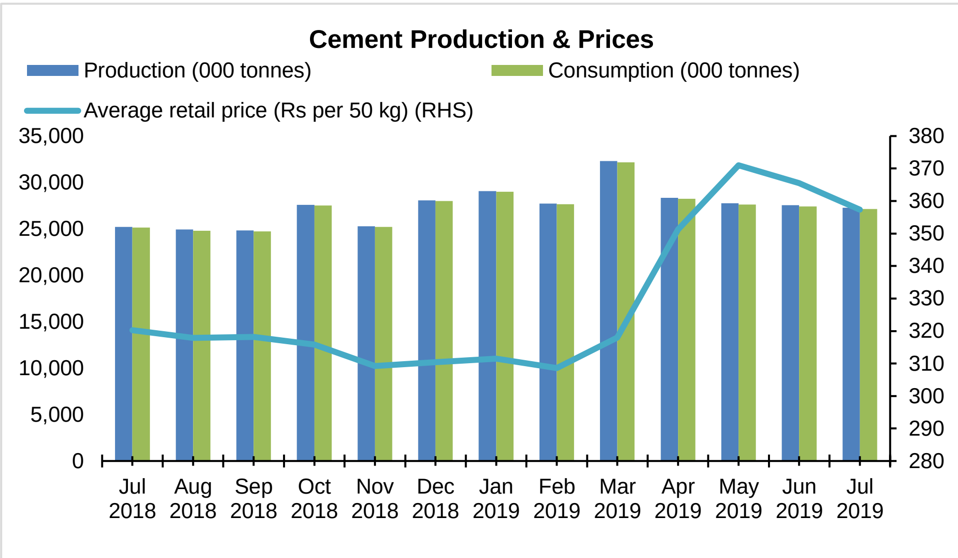
Cement prices have started correcting from June 2019 after witnessing a sharp increase in April & May 2019 as dealers have raised the prices in anticipation of healthy demand going forward. As expected, the prices started coming down reflecting weak demand.



Source: CMIE, BWR Research

Airlines

BWR Views

Domestic air passenger traffic in India is expected to grow in the single digits this fiscal, mainly because of a capacity shortage caused by the grounding of Jet Airways.

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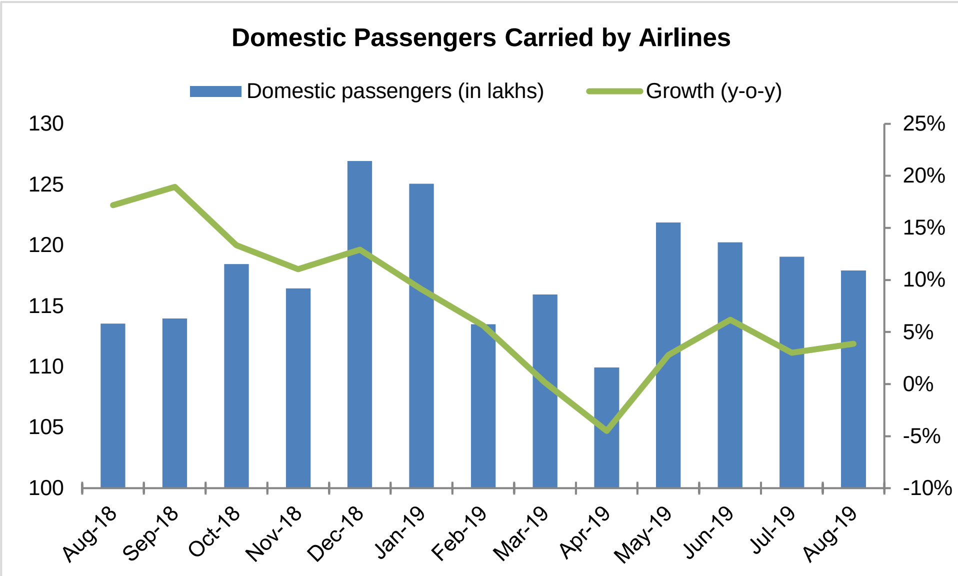
Domestic air passengers grew by 4% y-o-y in the month of August 2019. The revival in growth started from May 2019 after a decline in April 2019 and a slowdown since the start of the year. This revival in growth was aided by capacity additions by the players and also due to other airlines redeploying grounded aircraft of Jet Airways.



Source: DGCA, BWR Research

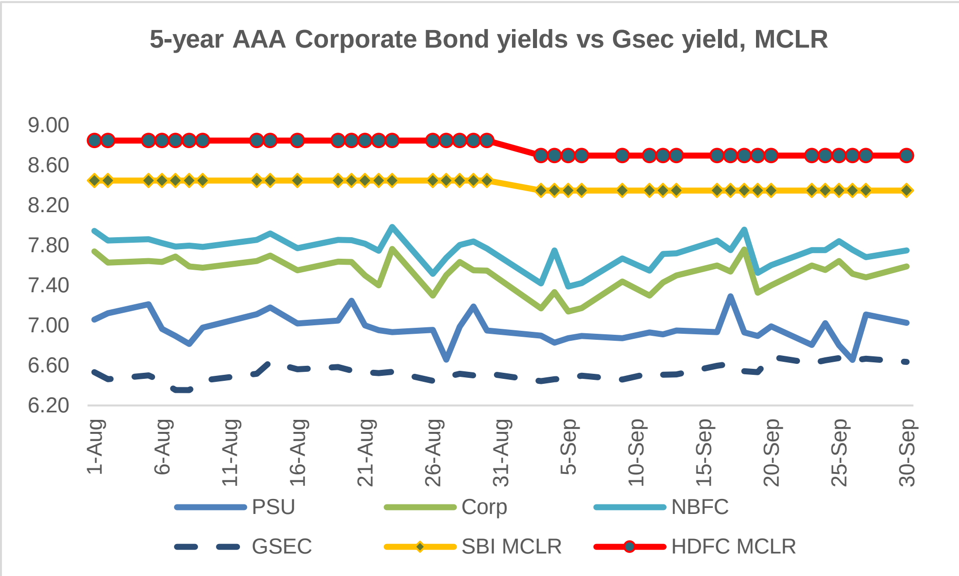
DEBT MARKET INDICATORS

Movements in Bond Yields

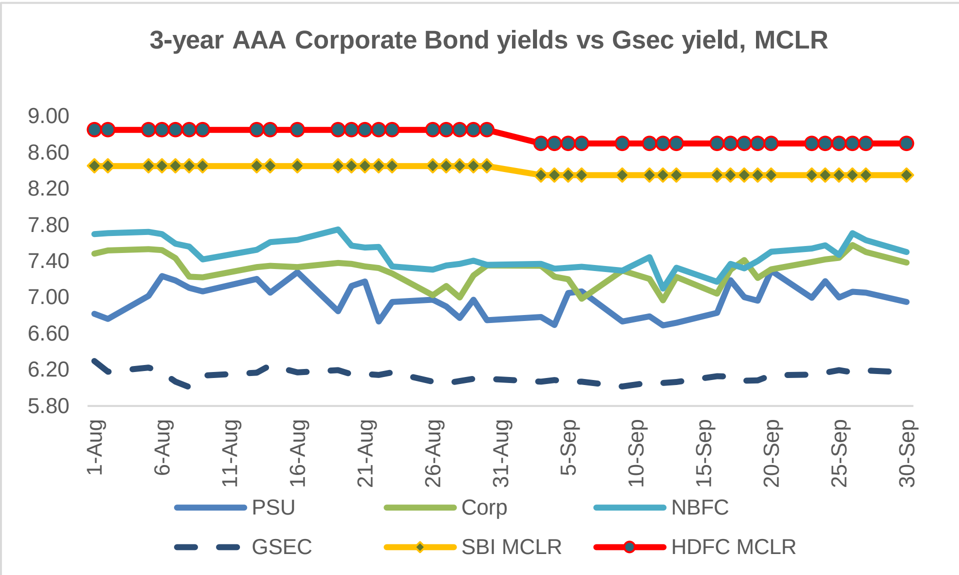
BWR Views

Yields of shorter tenor corporate bond have remained subdued due to various reforms announced by the Finance Minister to improve the economic growth getting offset by rising crude oil prices. Also, expectation of RBI's easing rate cycle continues to support the movements in bond yields.

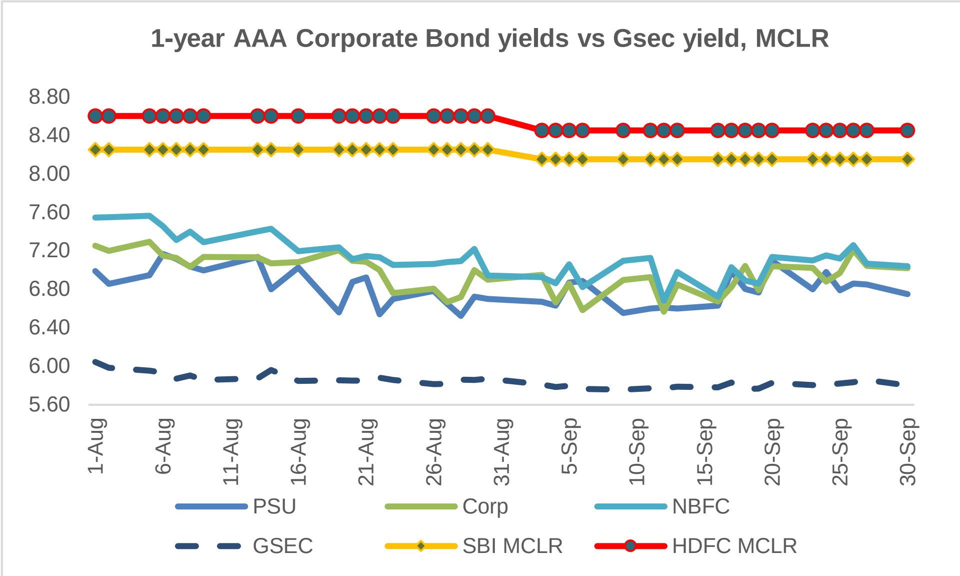
Bond yields (annualised) of Public Sector Units (PSUs), Corporates and Non-Banking Finance Companies (NBFCs) maturing in 5-year, 3-year and 1-year period with corresponding Government Securities and Bank Marginal Cost of funds based Lending Rate (MCLR) are provided below.



Source: FIMMDA, SBI, HDFC, BWR Research



Source: FIMMDA, SBI, HDFC, BWR Research



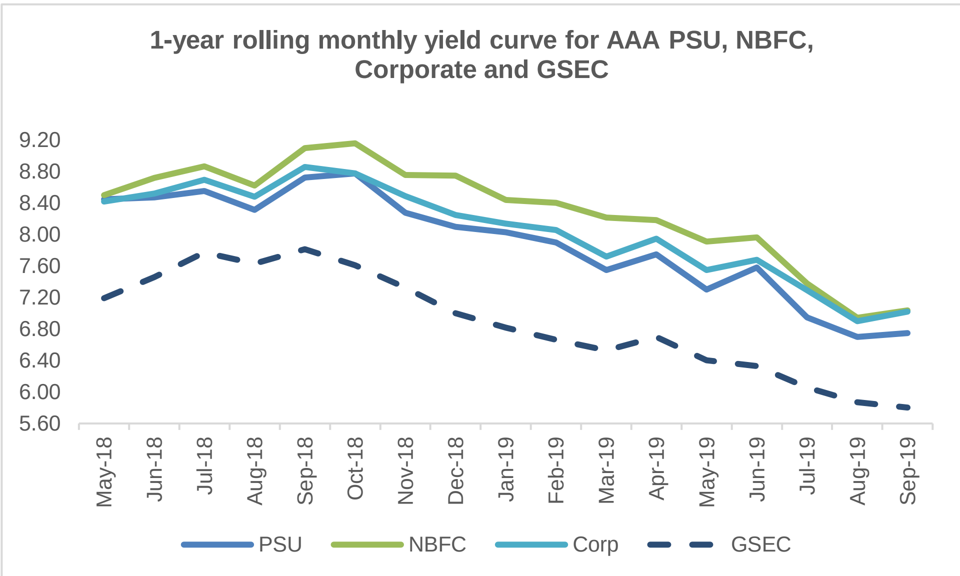
Source: FIMMDA, SBI, HDFC, BWR Research

The yields of AAA rated corporate bonds maturing in 5-year, 3-year and 1-year have marginally eased by 9-15, 3-13 and 8-26 basis points respectively in the month of September compared to August due to investor sentiments turning positive in the bond market due to various measures announced by Finance Minister Nirmala Sitharaman to revive the growth of economy.

The bonds across the said categories witnessed improving investor sentiments on the back of anticipation of further monetary easing policy.

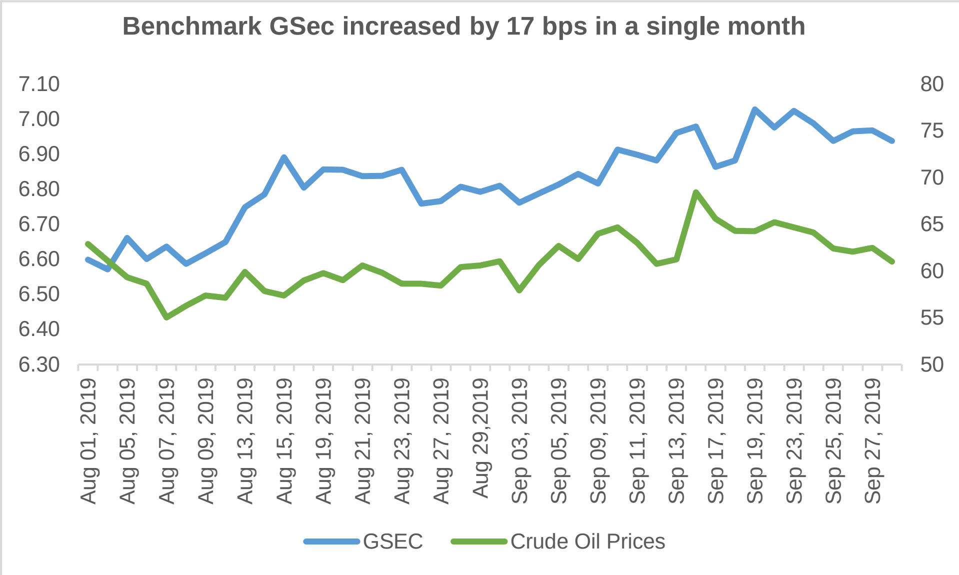
Monthly yield curve of AAA PSUs, NBFCs, Corporates and G-sec

The monthly yields of G-secs maturing in 1 year compared with Corporate bonds yields of PSUs, NBFCs and Corporates with similar maturity time buckets have witnessed retreating downward trend due to slowdown in the economy followed by higher crude oil prices, FPI outflows and global factors like ongoing trade war between US with China and weak domestic growth. However, a revival is expected soon due to cyclical factors and thus, lower the cost of borrowing for Issuers.



Source: FIMMDA, BWR Research

Mirroring the recent spike in Brent crude oil prices due to supply disruption followed by an attack on a major oil facility in Saudi Arabia, the bond yields hardened. The average crude oil prices saw a rise in the month of September to USD 63.04/ barrel as against previous month's average of USD 59.04 per barrel witnessing witnessed a spike of USD 4.94 per barrel in September, whereas benchmark yields increased by 17 bps during the same period.

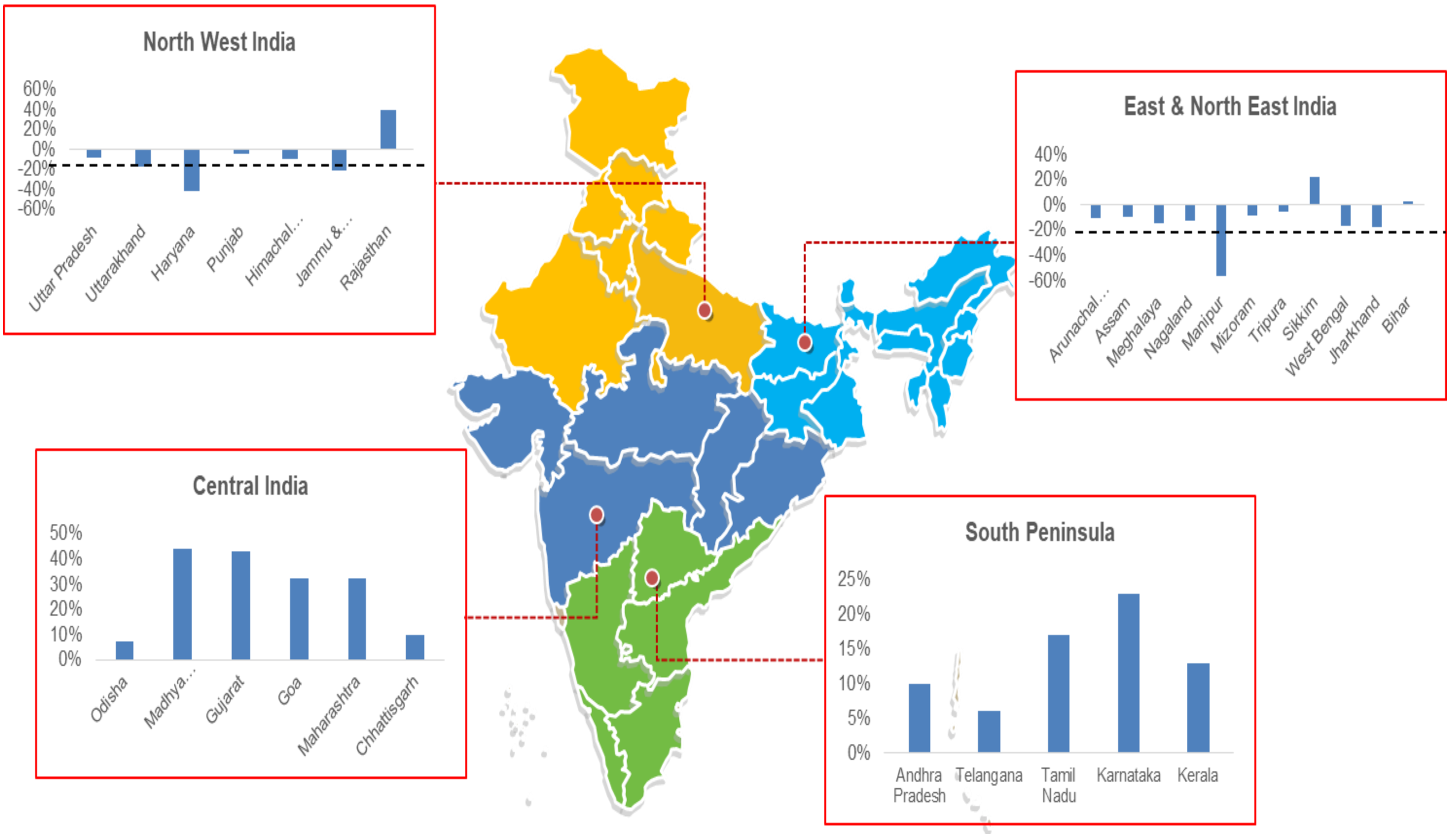


Source: U.S Energy Information Administration, BWR Research

BWR Views

Domestic bond yields may ease after the rate-cut by RBI led MPC coupled with easing crude oil prices.

Percentage Departure from Long Period Average Rainfall
(1st June to 30th Sept 2019)



Note: Rainfall departure between -19% to +19% is considered as normal by IMD
Source: IMD, BWR Research

Rainfall Information

- IMD declared 2019 southwest monsoon to end with above normal rainfall IMD also stated that the withdrawal of monsoon will be delayed and it will be the most delayed withdrawal recorded after 1961. The rainfall has been well distributed across the country with most of the states especially in Central and South India recording above normal rainfall.
- The rainfall was 110% of its Long Period Average. Total rainfall during 1 June 2019 to 30 September 2019 in the country as a whole was 10% more than the normal rainfall, as per India Meteorological Department's (IMD) Report. Amongst the four regions, Central India and South Peninsular India received above normal rainfall (29% and 19% excess than normal). Rainfall in North West India was slightly deficient (2% lower than normal rainfall) and in East and North- East India (lower by 12%).
- On the other hand, a delayed withdrawal bodes well for sowings of rabi crops, moreover abundant rains in August and September have led to improved soil moisture conditions in most parts of the country, particularly central India.
- With better monsoon, the prospects of agriculture have brightened considerably, and the agriculture sector is expected to show an improved growth in 2019-20 compared to 2018-19.
- According to IMD, 54% of the total area of the country received normal seasonal rainfall which is positive for kharif production. However, as per the first advance estimates Production of Foodgrains for 2019-20 by Department of Agriculture and Co-operation (DAC), kharif foodgrains production in 2019-20 is likely to be 140.57 million tonne, which is 1.1 million tonnes lower than the output in 2018-19, largely due flood like situation experienced by many parts of the country during August and September and the late onset of monsoon. On the other hand, a delayed withdrawal bodes well for sowings of rabi crops and is anticipated that a good rabi harvest will partially offset the losses suffered during the kharif season.

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