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# Budget Proposals: A Booster Shot for the Economy

July 2019

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## Liquidity, CAD and Macroeconomic Stability

India managed to maintain macroeconomic stability by containing inflation within 4% and current account deficit (CAD) to GDP ratio at 2.1% during 2018-19. However, due to slowdown in the domestic economy on account of lower farm output witnessed in the fourth quarter (Q4) of 2018-19, the full year GDP growth rate was revised downwards to 6.8% compared to 7.2% reported in the previous year. Along with agriculture, manufacturing sector also witnessed deceleration in growth as evident from weak IIP numbers. Manufacturing sector was affected by the slowdown in the auto sector as well, where the production growth for all categories apart from commercial vehicles declined. The constant slowdown in auto sales is expected to continue in 2019-20 as well, given the credit constraints faced by auto industries on account of ongoing liquidity crisis of NBFCs in addition to rise in the cost of vehicle ownership due to change in insurance norms. Government's push towards electric vehicles may alter the household preferences towards conventional fuel vehicles.

The Economic Survey and the Union Budget both exude confidence in the economy by propelling growth estimates to 8% per year to achieve the aspirational goal of a USD 5 trillion economy. Economic survey considers the challenge of creating a virtuous cycle of savings, investments, job creation and exports while meeting Budget's commitment to fiscal consolidation to restrict the fiscal deficit at 3.3% for 2019-20.

Debt market indicators suggest improved sentiments reflecting positive economic and market scenario. Global cues like crude oil prices, US treasury yields direct the market. Bond markets have witnessed a sharp rally of late assisted by a steady rupee followed by fall in crude prices and RBI led MPC's recent rate cut with accommodative stance. This comes on the back of the favourable election outcome and a sharp drop in US treasury yields which have further buoyed gilts. The 10-year benchmark yield traded between 6.98-7.22% during the month of June as against 7.20-7.60% during the May 2019. Looking ahead, bond markets will continue to mirror the rupee and oil trajectory, the fiscal target & borrowing plan and the US Federal Reserve's policy regime.

Union Budget which adhered to fiscal consolidation roadmap buoyed the bond market sentiments. The bond yields fell around 18 basis points in a single day following the FM Sitharaman's Budget speech. Also, the market cheered the government's decision to raise part of its gross borrowing from the overseas market, which could reduce supply-side pressures in the domestic market. The yield on the benchmark 10-year bond fell to as low as 6.56% during the day before ending at 6.69%.

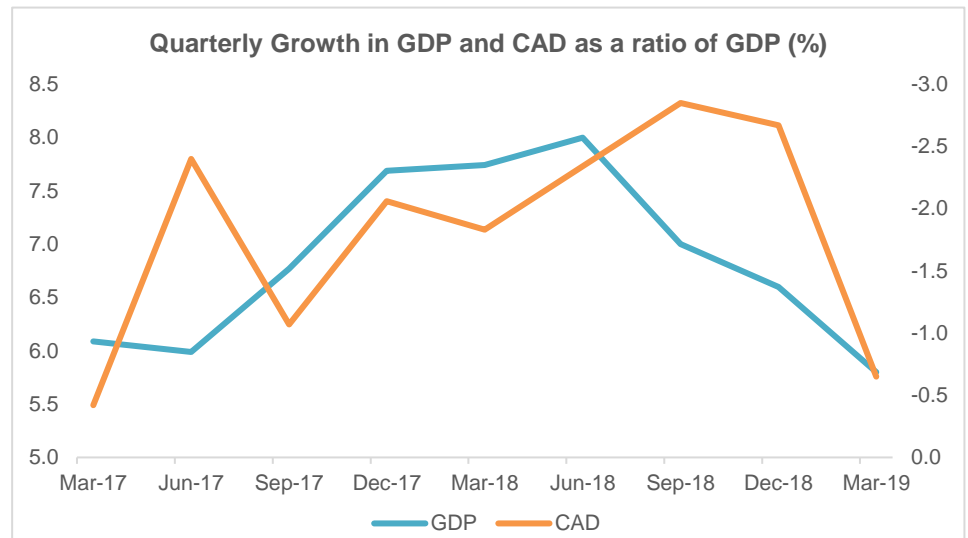
## MACRO-ECONOMIC INDICATORS

### Domestic GDP Growth and Current Account Deficit

#### View

After a deceleration in the growth momentum in 2018-19 India's (GDP) growth is expected to improve in 2019-20 reflecting a recovery in investment and consumption. Huge political mandate for the government and accommodative stance of monetary policy both augur well for the initiation of structural reforms.

The slowdown in the domestic economy on account of lower farm output witnessed in the fourth quarter (Q4) of 2018-19, the full year GDP growth rate revised downwards to 6.8% compared to 7.2% reported in the previous year. On the other hand, the current account deficit (CAD) as a percentage to GDP narrowed down to 0.7% in Q4, while for the full fiscal 2018-19, CAD increased 2.1% from 1.8% reported in the previous year.



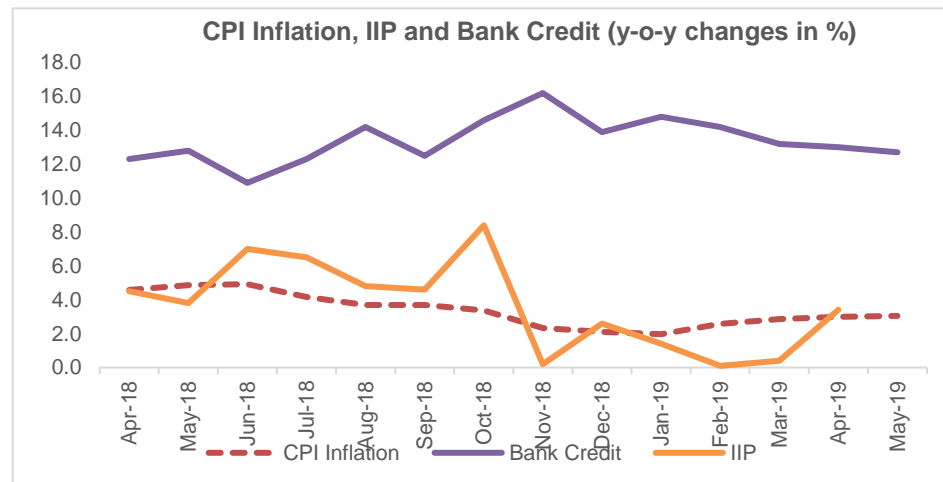
Source: MOSPI, IMF, RBI, BWR Research

### Inflation, IIP and Bank Credit

#### View

Significant moderation in CPI inflation during 2018-19 which remained within the targeted level of RBI at 4%, helped the MPC to change its stance. The decline in crude oil prices expected to keep the inflation benign in 2019-20 as well. The credit growth is expected to pick-up on the back of monetary easing by MPC.

CPI inflation moderated in May and remained within the targeted level of RBI at 4% (+/-2%). The reduction in repo rate thrice in 2019 did not revive the credit growth much due to poor transition of rate cut. In the meantime, IIP picked up in April and recorded 3.4% growth in output, suggesting revival in production largely due to improving investment scenario.



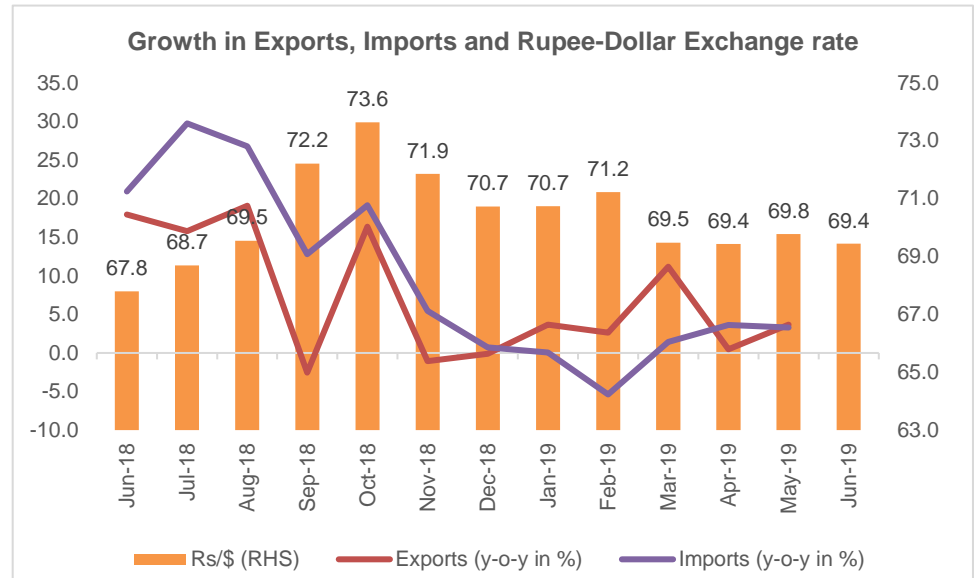
Source: MOSPI, RBI, BWR Research

### Trade and INR USD Exchange Rate

**View**

After crossing Rs 71 per USD, responding to both global and domestic factors the rupee remained stable since March 2019. A lower trade deficit at US\$ 35.2 billion as compared with US\$ 41.6 billion a year ago helped the CAD to narrow down.

After showing significant volatility, rupee appreciated marginally since March 2019. Exports showed improvement in March 2019, but dropped in the previous month. Imports grew by 3.3% in May whereas, exports increased by 3.7%, thus helping the trade balance to narrow.



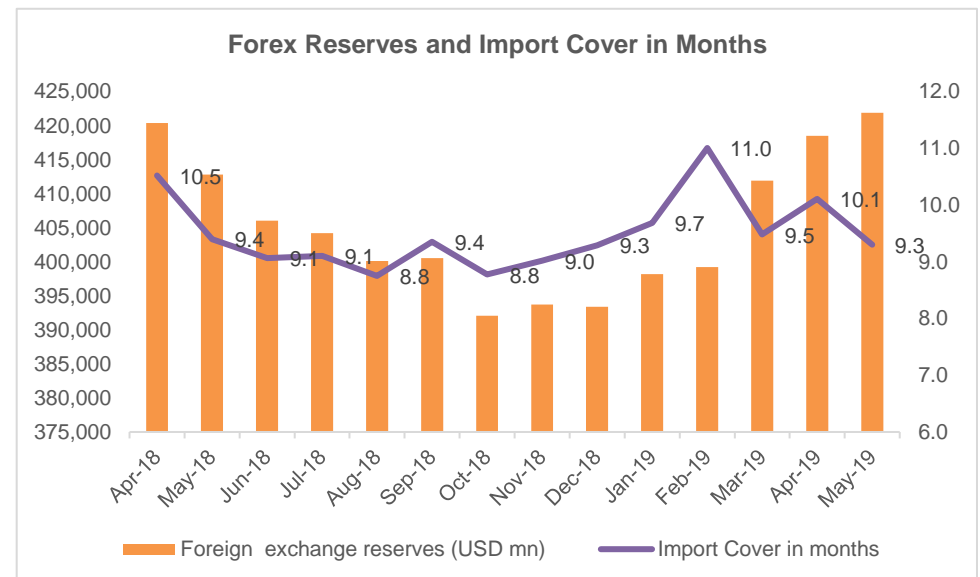
Source: Ministry of Commerce, RBI, BWR Research

### Forex Reserves and Import Cover

**View**

With a stable rupee, RBI has reduced its interventions in the forex market. This would support foreign currency assets to remain at higher levels.

India's foreign exchange reserve cover for imports has fallen to 9.3 months in May from 10.1 months in April. Rising imports are the major reason, however accumulation of enough forex reserves helped to arrest this reduction.



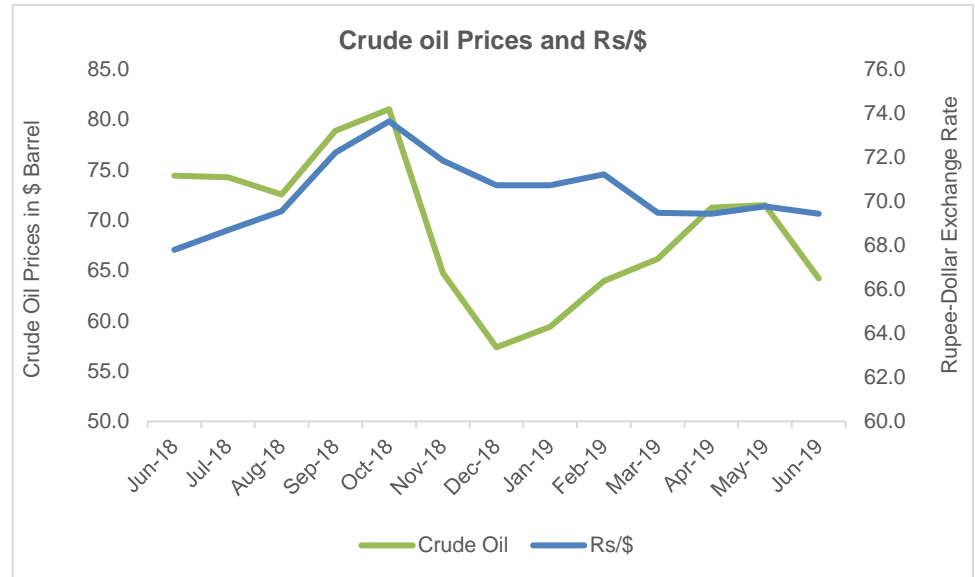
Source: Ministry of Commerce, MOSPI, BWR Research

### Fluctuation in Crude oil Prices and its Impact on INR/USD

**View**

Easing crude oil prices helped the rupee to appreciate against US dollar. If the trend continues this would help the economy to manage fiscal situation well.

Rupee remained stable supported by falling crude oil prices. Slowing signs of US demand kept the oil prices under check with signs of a recovery in oil exports from Venezuela in June and growth in Argentinian output in May.



Source: RBI, U.S Energy Information Administration, BWR Research

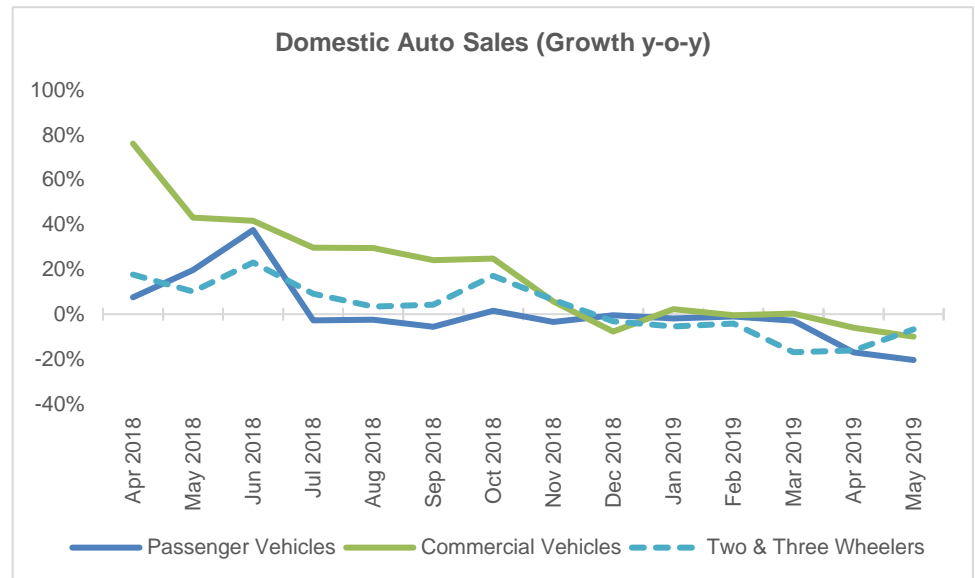
## SECTORAL INDICATORS

### Automobiles

Overall automobile sales fell by 8.6% in May 2019 driven by weak sales in passenger vehicles segment. High cost of ownership due to increased insurance cost has hampered the passenger vehicles and two-wheeler sales. Revised axle norms and financing issues due to NBFC crisis have hit the commercial vehicle sales.

#### BWR Views

Vehicle sales are expected to remain under pressure till H1 FY20, post which commercial vehicles might see an uptick in purchases by fleet owners before the BS-VI norms kick in from FY21.



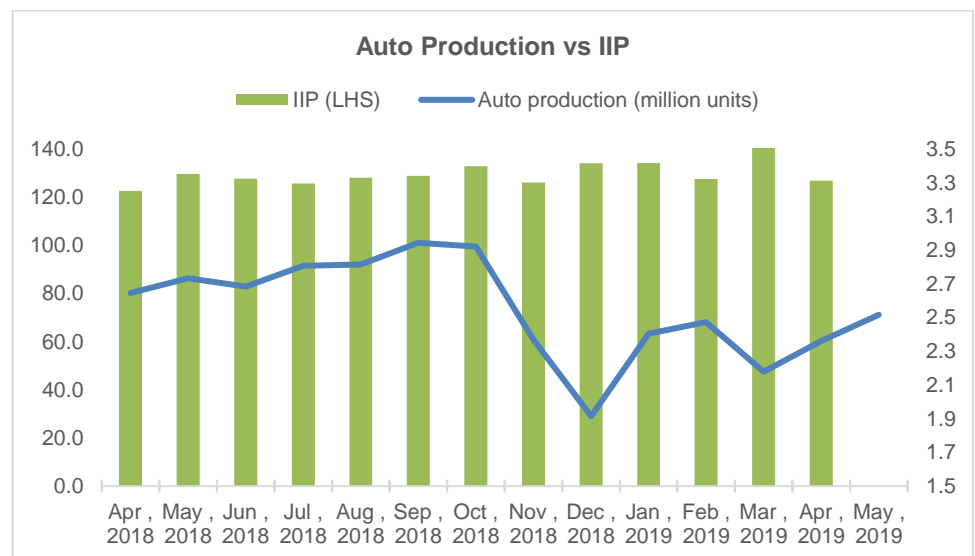
Source: CMIE, BWR Research

### IIP and Automobiles

Slowdown in auto production is in line with overall decline in IIP growth. Slowdown in manufacturing activity is a proxy for falling consumer demand which is evident in the flat growth in IIP.

#### BWR Views

Slowdown in vehicle sales has resulted in huge inventory build-up. Therefore, production cut down is expected in the coming months to clear the inventory as and when the demand picks up.



Source: MOSPI, CMIE, BWR Research

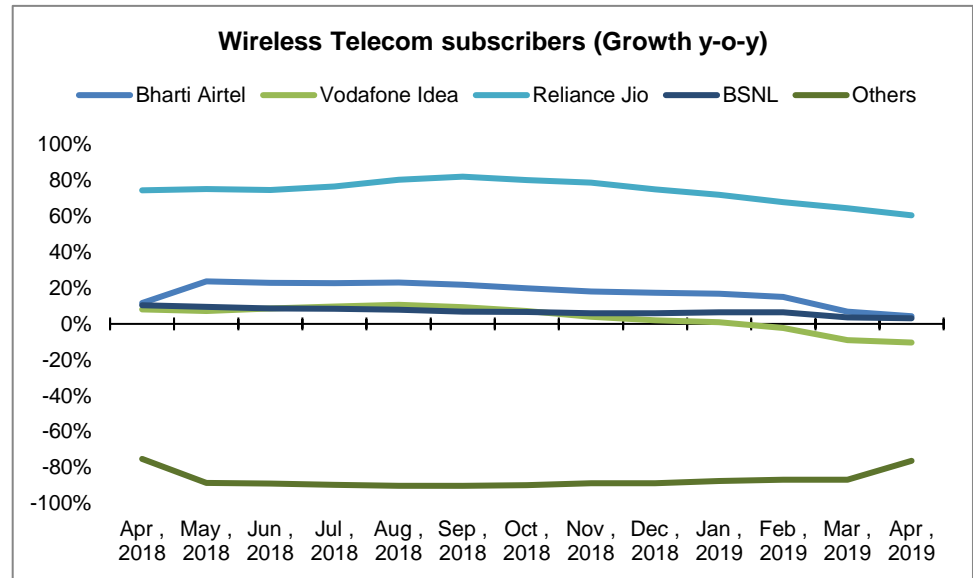
## Telecom

Consolidation of the market continues with Jio increasing its market share and driving the overall subscriber additions in the sector. As on April 2019, the market share of Vodafone-Idea was 33.8% followed by Bharti Airtel at 27.7% and Reliance Jio at 27.1%.

However, Reliance Jio has been substantially adding new subscribers, while subscriber additions for Airtel has been very slow and in contrast Vodafone-Idea has been losing subscribers. Players other than the top 4 are now completely out of the market.

### BWR Views

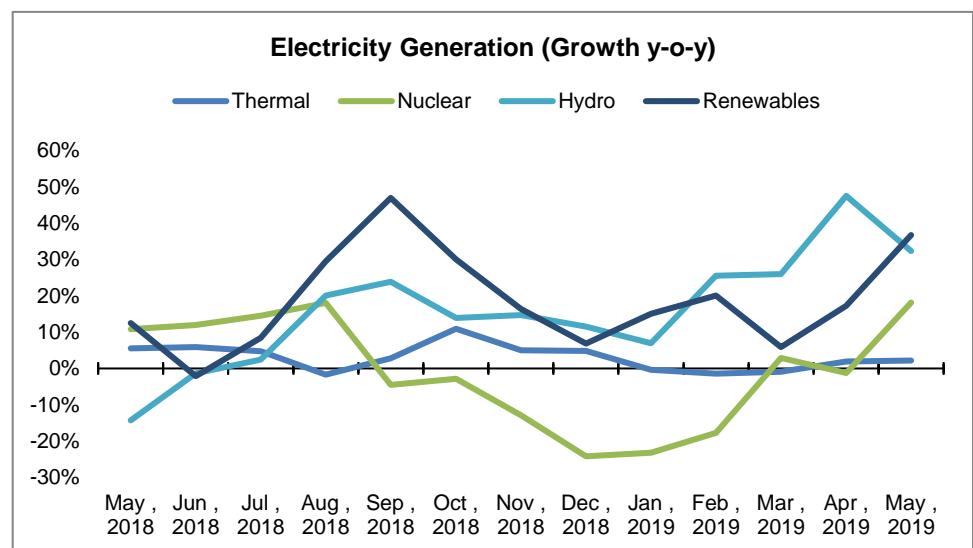
Competitive intensity is expected to ease as pricing by players are now on the same lines. Reliance Jio is expected to increase its market share going forward.



Source: TRAI, BWR Research

## Power

Power generation in hydro show a healthy growth this year compared to thermal in terms of conventional energy sources. Thermal power producers has been facing challenges in terms of coal availability. On the other hand, renewable sources continue to show strong growth.

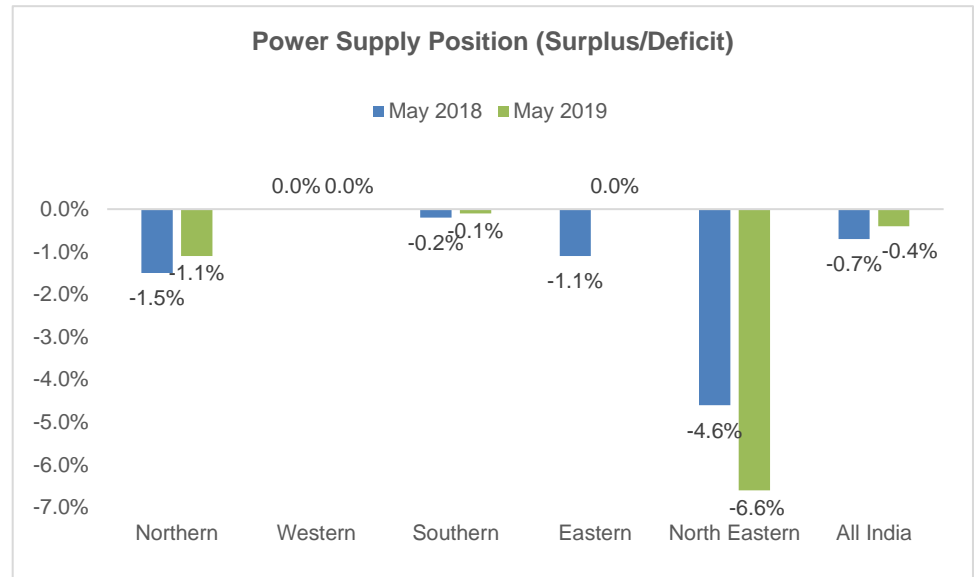


Source: Central Electricity Authority, BWR Research

**BWR Views**

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

India's power supply position improved in May 2019, but country is still not a power-surplus nation. The deficit is primarily due to discoms not being able to buy power on account of its mounting losses and huge debt burden.



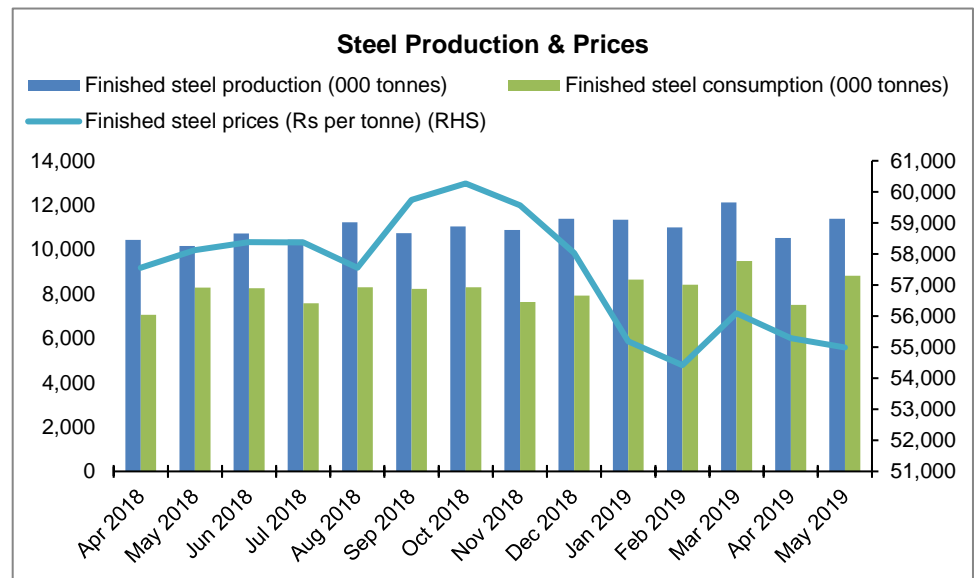
Source: CEA, BWR Research

**BWR Views**

Steel prices are expected to remain firm in the next 1-2 months as demand revival will be slow owing to overall economic slowdown and lack of liquidity in the market.

**Steel**

Steel prices witnessed a decline after October 2018, owing to subdued industrial activity in the country visible in declining infrastructure & construction activity and lower automobile sales. However, from March 2019, domestic steel prices started to rise owing to increased raw material prices, particularly iron ore.



Source: CMIE, BWR Research

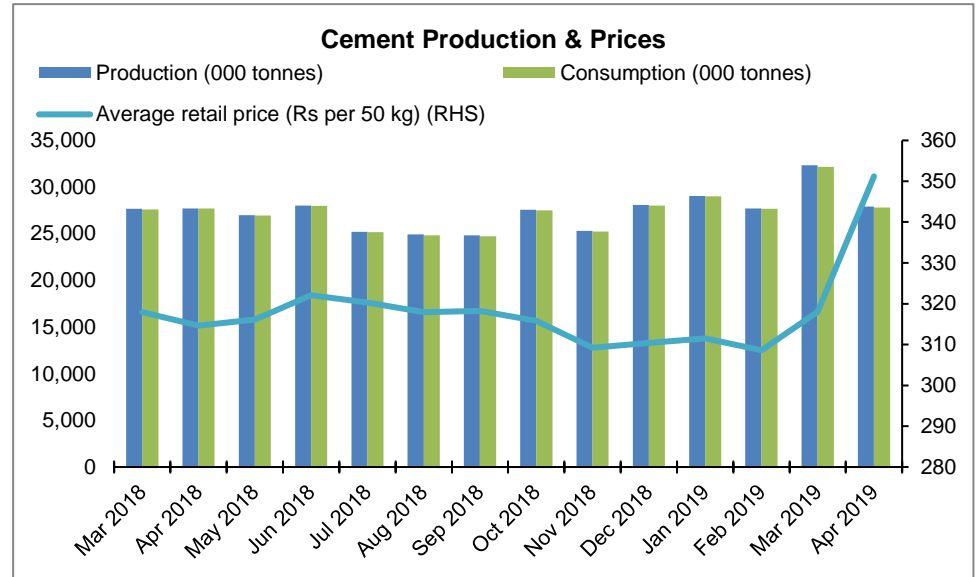


## Cement

Cement prices have remained range bound in 2018-19. Despite demand remaining low and input cost remaining stable, players increased the prices in March 2019.

### BWR Views

Cement prices are expected to firm up in expectations of government projects picking pace. The growth will be driven by Pradhan Mantri Awas Yojana and multiple infrastructure projects such as metros, highways and irrigation projects.



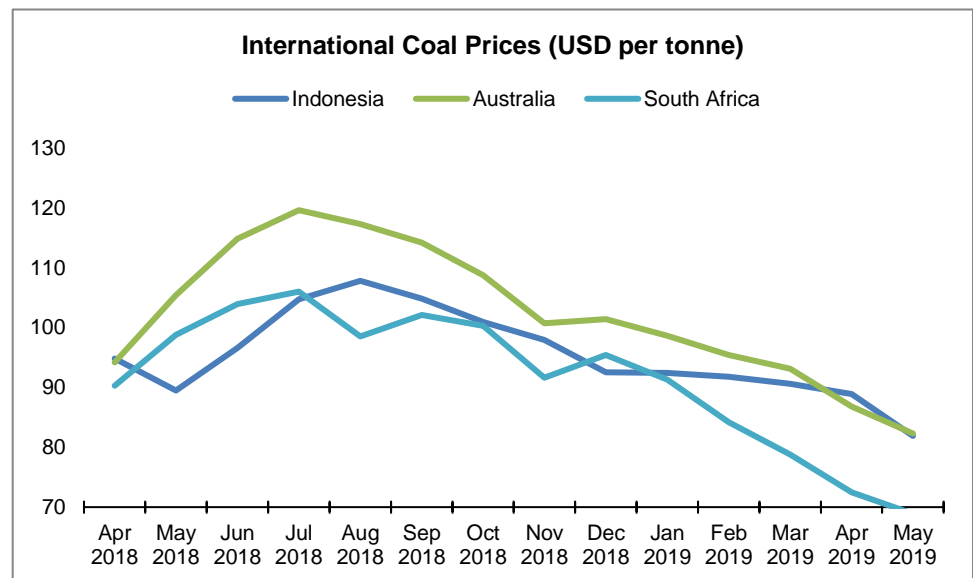
Source: CMIE, BWR Research

## Coal

Coal prices have been declining since July 2018, due to weak global growth and lower demand. Also, record increase in coal production in China and its plans to open new mines put further pressure on the price.

### BWR Views

International coal prices may continue to soften on the back of expected lower demand from markets like China and India.



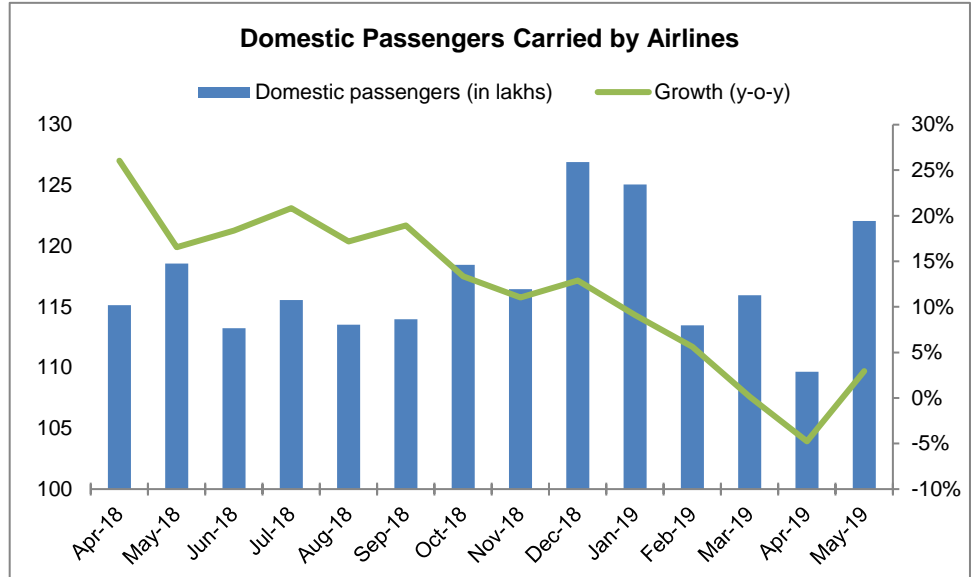
Source: CMIE, BWR Research

## Airlines

Domestic air passengers grew by 3% y-o-y in May 2019. This is a revival in growth after a decline in April 2019 and a slowdown since the start of the year. The growth in May 2019 was aided by capacity additions and also due to other airlines redeploying grounded aircraft of Jet Airways.

### BWR Views

Domestic passenger growth is expected to grow at a faster rate going forward aided by induction of new aircrafts and discounts offered by airlines in the off-peak period.



Source: DGCA, BWR Research

## DEBT MARKET INDICATORS

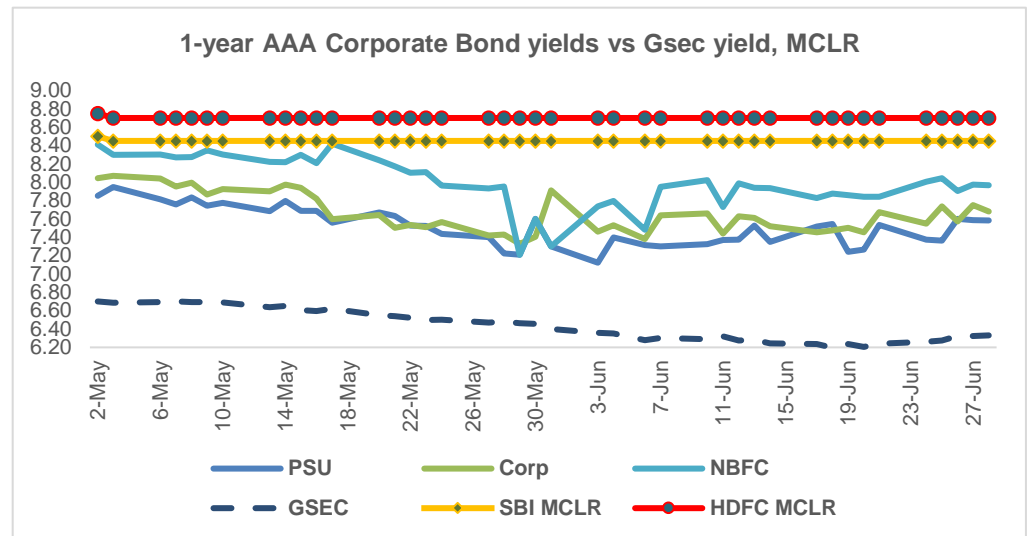
### Movements in Bond Yields

#### View

Yields of shorter tenor corporate bond has eased due to moderation in crude oil prices amid further expectation of RBI's easing monetary stimulus.

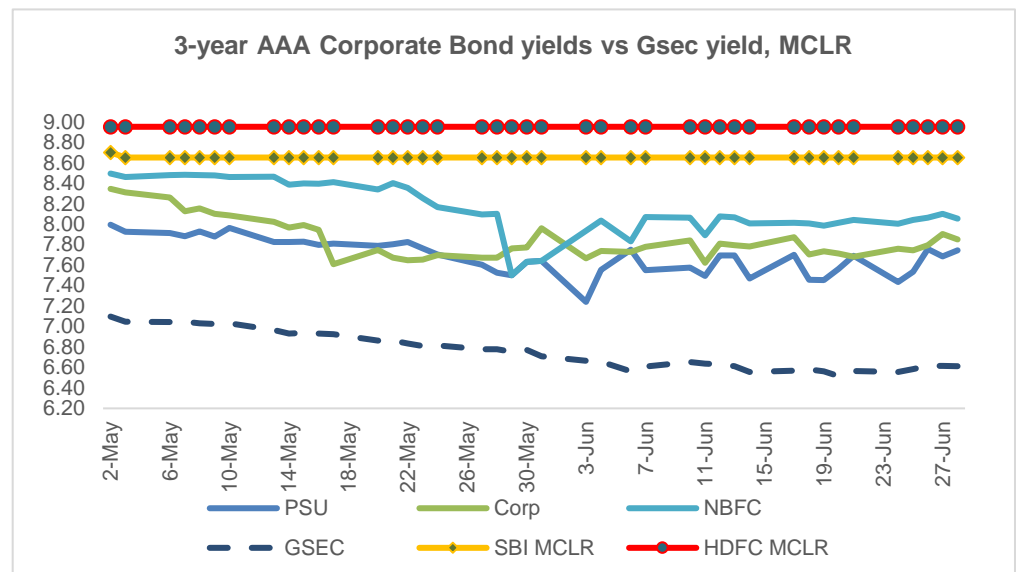
Bond yields (annualised) of Public Sector Units (PSUs), Corporates and Non-Banking Finance Companies (NBFCs) maturing in 1-year, 3-year and 5-year with corresponding Government Securities and Bank MCLR are provided below.

The yields of AAA rated corporate bonds maturing in 1-year have eased by 56-83 basis points in the month of June compared to May due to better liquidity in the bond market amid infusions by Reserve Bank of India on daily basis.



Source: FIMMDA, BWR Research

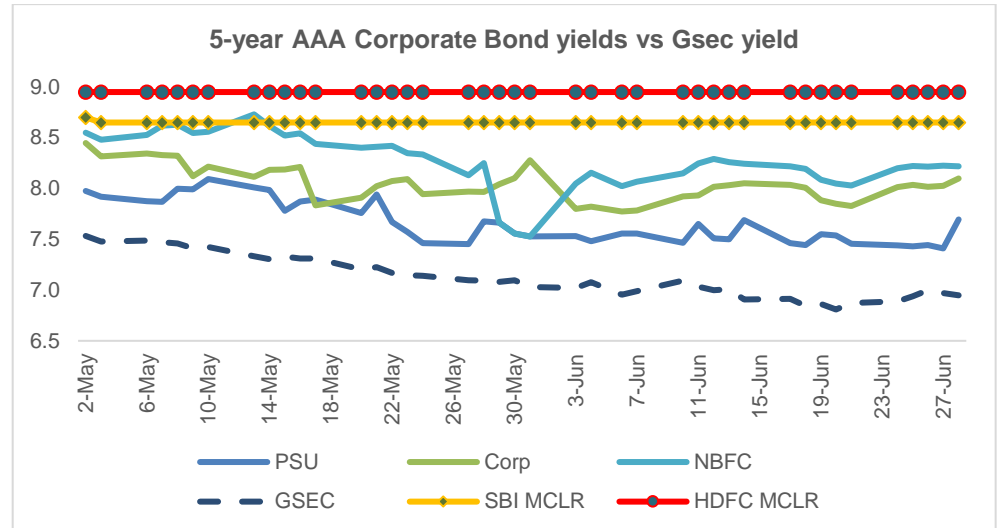
Similarly, the yields of AAA rated corporate bonds maturing in 3-year have eased by 56-75 basis points in the month of June compared to previous month.



Source: FIMMDA, BWR Research

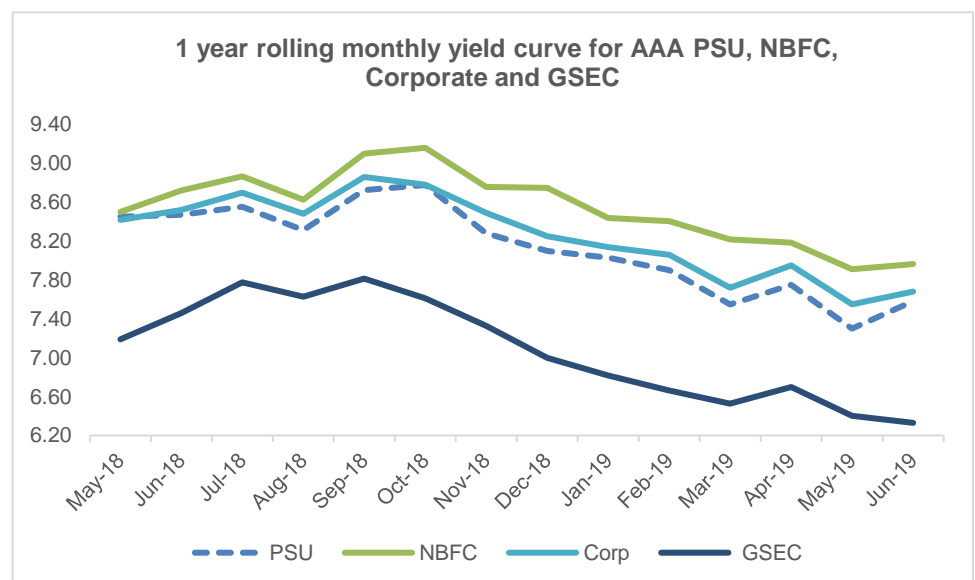
### Monthly yield curve of AAA PSUs, NBFCs, Corporates and Gsec

The bonds across sectors also shows improving investor sentiments owing to anticipation of RBI's further easing key policy rates amid sharp fall in crude oil prices.



Source: FIMMDA, Brickwork Research

Rolling maturity of Government Security maturing in 1 year along with similar trend reflected by Corporate bonds of PSUs, NBFCs and Corporates has witnessed easing trend due to softening of interest rates (RBI-MPC repo rate cuts) amid infusion of huge liquidity by Central Bank through Open Market Operations (OMOs) and daily injections.



Source: FIMMDA, BWR Research

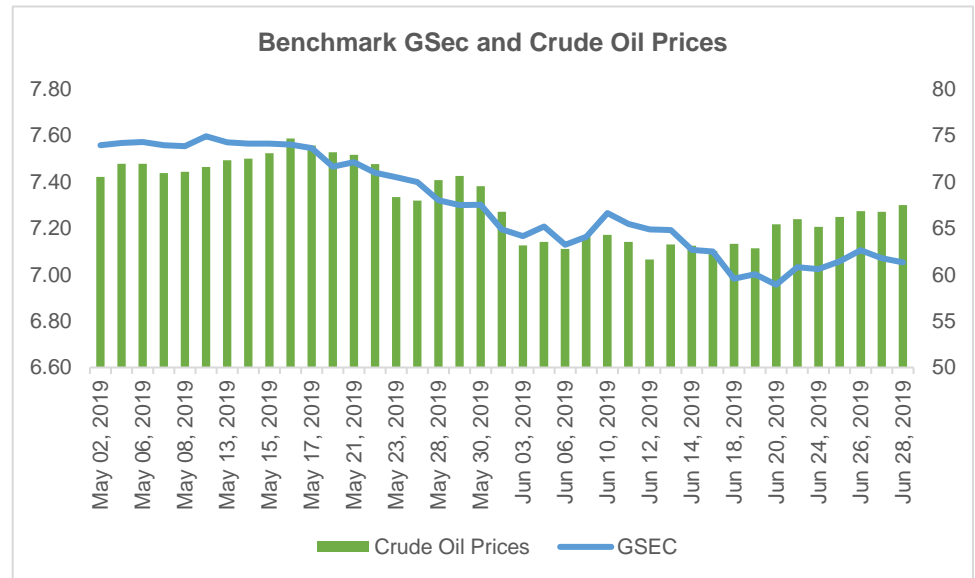
## Lower Brent Crude Oil directs the Indian Government Securities

The recent fall in Brent Crude oil prices has reflected in the easing of yields, thereby, boosting positivity in the bond market.

The average crude oil prices saw a sharp fall in the month of June to USD 64.33/ barrel as against previous month's average of USD 71.32/barrel.

### View

Recent sharp fall in the crude oil prices amid drop in US treasury yields helped easing domestic yields. Global cues may continue to influence the Indian bond market.



Source: U.S Energy Information Administration, BWR Research

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