Fears of Economic Slowdown Intensified
December 2019

RBI takes a pause, government needs to explore more options to bring the slowing economy on track

The release of the second quarter GDP estimate has confirmed the fears of continuing slowing down of the Indian economy. The economic performance has slid further in the second quarter despite the policy initiatives taken by the government during the past few months and RBI’s continued accommodative stance. The GDP grew at a much lower rate of 4.55% in the second quarter, the lowest in last 26 quarters, despite favourable base effect. With this, the first half of 2019-20 GDP stands at 4.8%, plunging to the levels seen in March 2013.

The major contributor to this slowdown is the slowdown in the manufacturing sector. On the back of slowdown in automobile sector, most of the manufacturing companies continued to cut down productions like auto parts, which is adversely impacting services like logistics as well. The IIP data for September 2019 which contracted by -4.3% also portrays the stagnant industrial activity. This is the lowest production performance of IIP in the 2011-12 series. Eight core sector’s performance in the last two months also deteriorated further.

Government as well as RBI already taken several measures to improve the economic conditions. However, in a surprise move the Monetary Policy Committee in its December 2019 meeting, took a pause and kept the policy repo rate unchanged at 5.15%, while maintaining accommodative stance. Rising inflationary expectations and concerns on fiscal situation contributed to this pause rather than making it the sixth consecutive rate cut of the year. Despite growth concerns, ensuring adequate real rate of return on the savings could be an objective of keeping the repo rate constant. Because, the transmission of the reduction in the policy (repo rate), requires the lending rates to fall. That would also require the deposit rates to fall which could result in reduced saving by the households. When the inflation rate is perking up, if the banks also reduce the deposit rates, the rate of return on savings will decline which could not only reduce the incentive to save but also can hurt the elderly who maintain themselves from the interest income.

The RBI has also revised downwards the real GDP growth for 2019-20 to 5% from 6.1% earlier. The monetary stance and GDP projections both are in line with BWR expectations.

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MACRO-ECONOMIC INDICATORS

Economy Trends

The continuous fall in economic performance since June 2018 quarter and further fall in the second quarter GDP confirms the fears of slowing down of Indian economy. Despite the policy initiatives taken by the government during the past few months and RBI’s continued accommodative stance, the second quarter GDP grew at a much lower rate of 4.55%, the lowest in last 26 quarters. Similarly, the first half of 2019-20 GDP growth stands at 4.8%, plunging to the levels seen in March 2013.

Negative production growth in eight core sector and IIP suggests deterioration in domestic demand. Government’s efforts failed to boost sentiments so far, as the second quarter did not provide any signs of revival in economic activity. Most of the economic indicators do not fetch any optimism, hence BWR revised downwards its GDP growth estimates to 5% for FY 20.

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

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

The Consumer Prices Index (CPI) increased by 4.62%, touching 16-month high in October 2019, on account of sharp uptick in food price inflation. Easing Core Inflation (excluding food and fuel) to 3.5%, lowest in the current series, and sustained fall in crude oil prices provides some respite. Although the flexible inflation targeting framework has some more scope for rate cuts, the MPC took a cautious stance and decided to take a pause in the December MPC review.

Source: MOSPI, RBI, BWR Research

Crude oil Prices and INR/USD rates

Crude oil prices moved upwards after remaining relatively stable in the last few months, whereas rupee-dollar exchange rate depreciated amid rising domestic growth concerns and strengthening US dollar.

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

BWR Views

Recent spikes in vegetable prices created upside pressure on inflation, hence RBI in its December MPC took a cautious approach and increased the inflation outlook to 5.1-5.7% for H2:2019-20. We expect the inflation to remain within the MPC’s target in the rest of the current fiscal and inch up further in November and December 2019.

Indian rupee is vulnerable to both domestic and global factors. Stable oil prices, FPI flows, helped the rupee to remain steady against US dollar recently, however, underlying economic concerns and rising dollar demand exerted pressure on the rupee in November.
Merchandise Trade

Both exports and imports fell during October 2019 compared to a year ago period, while the trade deficit narrowed down sharply by 39% (y-o-y) to USD 10.96 billion. Imports fell by 16% (in value terms) on account of contraction in crude oil imports (-32%). Merchandise exports also decreased by 0.9% compared to last year due to reduction in re-exports of 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.

![India's Trade Balance](image)

Source: Ministry of Commerce, BWR Research

Forex Reserves and Import Cover

Amidst all the gloomy economic scenario, Foreign exchange reserves reached $443 billion at the end of November 2019, reporting $50 billion increase in a year. The current level of forex reserves is adequate to cover 11.8 months of imports, which is comfortable and helps to absorb external shocks like exchange rate volatility.

![Forex Reserves and Import Cover](image)

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

The fiscal deficit crossed the full year target of Rs 7037.60 billion to Rs 7204.45 billion during April to October 2019-20. Total expenditure increased by 13.6% whereas, total receipts rose by 15% during the same review period. Through disinvestments, government has collected Rs 1736.5 billion so far and expected to generate more to bridge the fiscal gap. The net tax revenue increased only by 3.4%, whereas total revenue receipts increased by 15% during the review period.

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

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-November 2019 vis-à-vis 2018, the gross GST revenue collection has grown by 3.7% and the November 2019 GST collection is the third highest monthly collection since introduction of GST.

Source: Ministry of Finance, BWR Research
SECTORAL INDICATORS

Automobiles

Domestic automobile sales fell by 13% y-o-y in the month of October 2019 driven by weak sales of commercial vehicles. Revised axle norms 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 9% largely driven by recovery in passenger vehicle sales reflecting festive buying.

Source: CMIE, BWR Research

Automobile production and sales

Domestic automobiles production declined by 26% y-o-y in October 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.

The cabinet in the past month cleared the proposal to postpone the spectrum dues of telecom operators for FY21 and FY22. Though, this is a positive step for the sector, there is still no clarity whether there will be any relief on the adjusted gross revenue (AGR) front as the review petition is still pending with the Supreme Court. This ruling resulted in an additional liability of more than Rs. 1.30 Lakh Crore for a sector already saddled with a debt of above Rs. 4 Lakh Crore.

Meanwhile, all the telcos have hiked their prepaid tariffs in the range of 39%-42% which will surely boost up their revenue generation and profitability. However, even with a 39% hike in its tariffs Jio’s plans are still 25% cheaper than the incumbents. Retention of their customers is critical for the incumbents in order to reap the benefits of tariff hike and the numbers for Q4 FY20 will bring more clarity on that front.

Source: TRAI, BWR Research

BWR Views

The proposed tariff hikes by all the players is a credit positive for the sector especially for Bharti Airtel and Vodafone Idea.

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Power generation fell by 13% y-o-y in October 2019 reflecting a slump in industrial activity in the country. The decline was largely due to lower generation from thermal sources. Thermal power units continue to struggle on account of falling demand due to reduction in manufacturing and industry output. The sector also faces other challenges such as non-availability of adequate bank credit, absence of long term PPAs and issues related to coal tie-ups.

The standoff between the renewable energy power producers and the Andhra Pradesh Government has finally come to an end with the Government of Andhra Pradesh (GoAP) finally concurring with the Ministry of New and Renewable Energy (MNRE) that Power Purchase Agreements (PPA) are inviolable and no renegotiation will happen on the terms stipulated in the agreements unless the agreement specifically provides for the same. This move is estimated to help 5.2 GW of power projects with a cumulative debt of more than Rs. 21000 Crores.

Further the centre has also approved granting of loans to GoAP by central institutions such as PFC, REC and IREDA at concessional rates so that it is able to meet its obligations and GoI has declared that inter-state transmission charges will be waived off for all states who have procured renewable power in excess of their purchase obligation (as in the case of GoAP).

Another major decision taken by GoI in favour of the industry is that if the Discoms curtail renewable power for a reason other than grid safety, they will still have to pay for it on account of ‘Must Run’ status assigned to renewable energy. While, investors in the sector will definitely be relieved now, it will still take time for the sentiment to improve and the sector to be back on track.

BWR Views

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

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Source: Central Electricity Authority, BWR Research
India's power supply position improved in October 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

The steel sector continues to operate in fits and starts, reflecting the difficult times the country is passing through, in economic terms. On the one hand, producers in the Eastern region are expanding capacities, helped by an improvement in demand as well as in prices. While on the other hand, producers in other parts are finding it tough to sustain present levels.

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.

Steel Production & Prices

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.

Source: CMIE, BWR Research

BWR Views

With the continuous focus of the Government on infrastructure and affordable housing, the cement demand is expected to increase going forward. 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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Banking

Overall bank credit during the period April-October 2019, increased by only 0.7% as compared with a growth of 4.2% during the same period previous year. The slowdown 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.

Source: RBI, BWR Research

Legend:
- Production (000 tonnes)
- Consumption (000 tonnes)
- Average retail price (Rs per 50 kg) (RHS)

Source: CMIE, 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.

Source: FIMMDA, SBI, HDFC, BWR Research

Yields of shorter tenor corporate bonds have eased on anticipations of RBI cutting the key policy rate again in December. However, going forward, we expect the yields to continue to remain volatile on account of current bearish sentiment due to no rate action by RBI in its December Bi-monthly policy.

Source: FIMMDA, SBI, HDFC, BWR Research
The yields of AAA rated corporate bonds maturing in 5-year, 3-year and 1-year have eased in November compared to October on strong hopes of further repo rate cuts by RBI amid slowdown in growth.

**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

Indian companies continue to prefer overseas borrowings on account of easy availability of longer tenure loans from overseas. However in October due to some volatility in rupee, ECBs reported slight fall.

BWR Views

Companies borrowing through External Commercial Borrowing (ECB) may increase due to favourable cost factors and anticipation of stable currency.

Source: RBI, BWR Research
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