Diwali to Diwali: The economic story

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Diwali and the immediate preceding weeks is traditionally a period of consumption, investment and heightened economic activity in India. Hence, demand and the resultant economic activity are typically at its peak during this period. For India's domestic consumption driven economy (private consumption accounts for 56% of GDP), the demand and sales during this period are vital to and often dictate the performance for the year as a whole. Thus, performance during this period serves as a barometer of the health and strength of businesses and the Indian economy as a whole.

The Diwali festival is based on the Hindu calendar which follows the solar and lunar movements. Although, the festival dates may differ each year, it is always in Q3 (Oct-Nov) of the fiscal year.

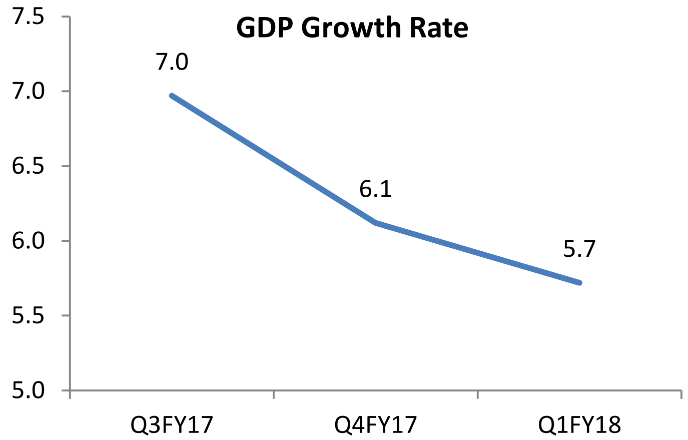
The Indian economy has undergone major structural changes in the last 1 year, starting with demonetization in Nov'16; which was immediately after Diwali (which was in end Oct'16); followed by the implementation of GST in Jul'17, both of which have led to some disruptions on the demand and supply side.

Tracing the movement of the various economic and financial market parameters in the last 12 months i.e. between the 2 festive periods (Diwali'16 and Diwali'17) shows a mixed picture. While there have been improvements in certain parameters, there has been a deterioration in others, suggestive of the underlying weakness in the economy.

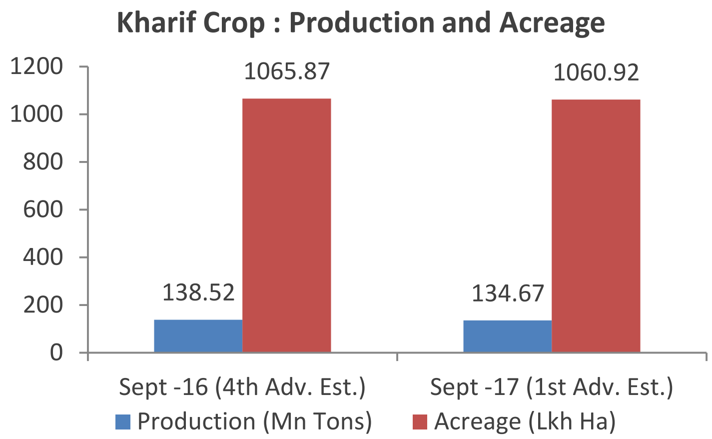
In terms of improvements, in the 12 months gone by there has been an increase in foreign inflows, forex reserves, moderation in inflation, rise in corporate bond issuance, surge in domestic stock indices and appreciation in the domestic currency.

Offsetting the improvements has been the decline in GDP growth, industrial output, bank credit and deposit growth, exports, widening of trade balance and increase in current account deficit.

The movements of the key economic variables since Oct'16 have been illustrated in the charts below.



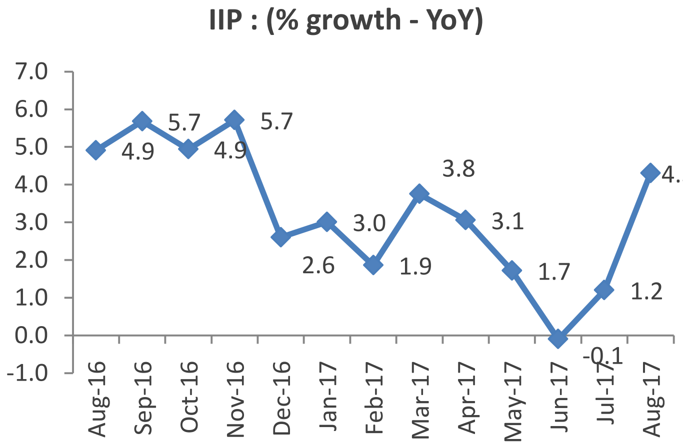
Source: MOSPI



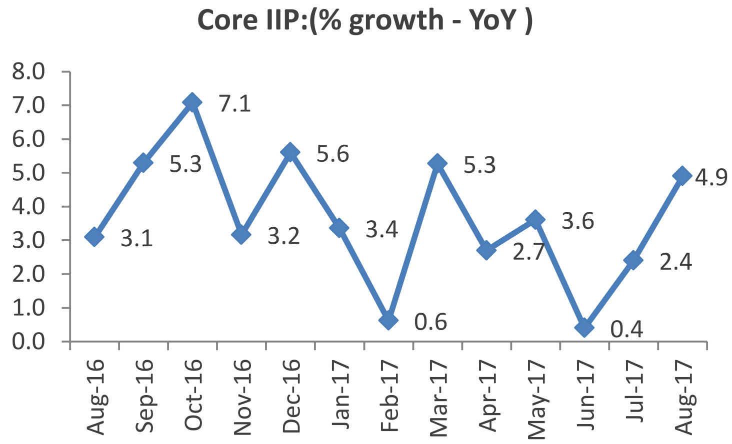
Source: Ministry of Agriculture

Production refers to foodgrains while acreage is for all crops.

- The quarterly GDP growth has seen a sharp deterioration since Q3 FY17. GDP grew at the slowest pace in 3 years in Q1 FY18.
- This decline in GDP in the last 3 quarters can be largely attributed to the demonetization and GST related disruptions. Government has been the leading sector in Q1-FY18.
- The performance across sectors has moderated in recent quarters.
- The agricultural output in FY18 could be lower than that last year. The kharif output for FY18 as per the 1st advance estimate is 3% lower than that in FY17.

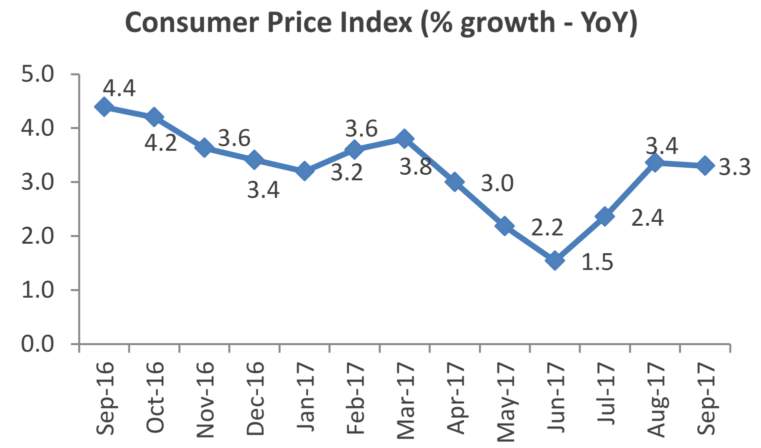


Source: MOSPI

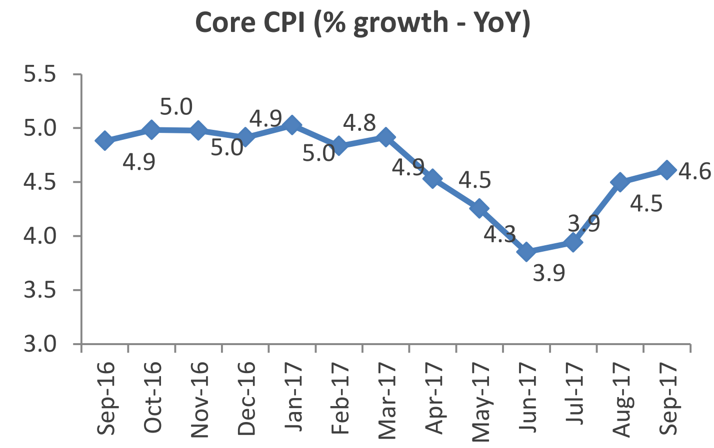


Source: Office of Economic Advisor

- Industrial output growth has fallen since Nov'16 (following demonetization) and has been prone to fluctuations.
- The decline and contraction in IIP in May'17 and Jun'17 can be ascribed to the GST related de-stocking.
- There has been an improvement in IIP in Jul'17 and Aug'17 and could be attributed to the post GST restocking.

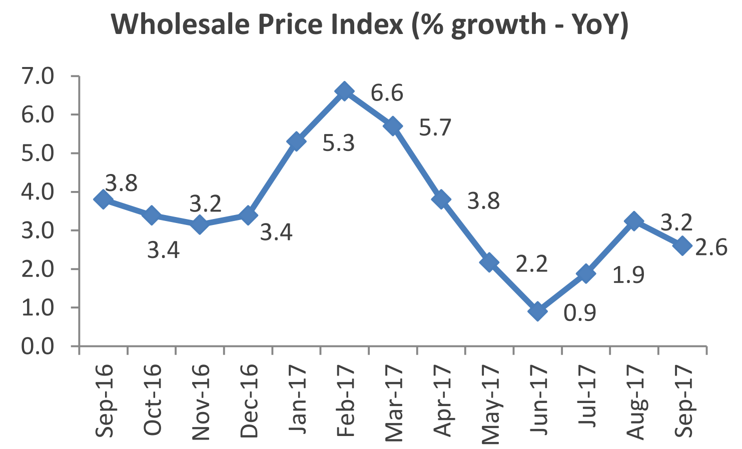


Source: MOSPI

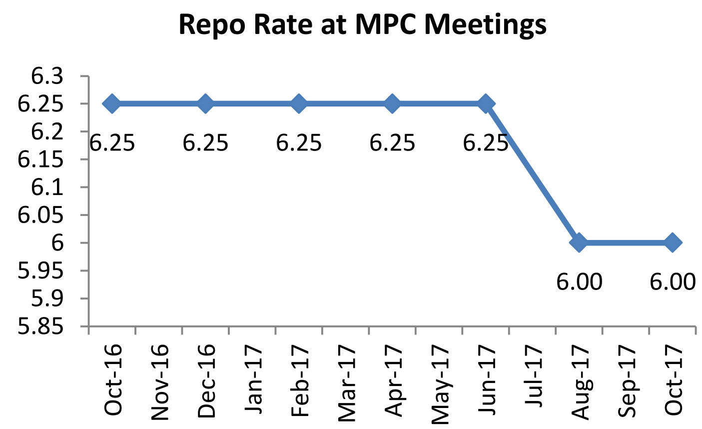


Source: MOSPI

- Retail inflation has moderated since Oct'16 with a slide in food prices. However, inflation has firmed by over 2% since Jun'17, driven by the increases in non-food items viz. housing, transport, clothing etc. The core inflation (that excludes food and fuel components) has been rising and draws attention to the price pressures in the economy. CPI inflation however continues to be lower than the RBI's target rate of 4%.
- The RBIs monetary policy has been tracking the retail inflation trajectory and the moderation in inflation led to the RBI lowering policy rates by 25 bps at its Aug'17 policy meet. The building risks to inflation in the last 2 months lower the possibility of immediate future rate cuts.

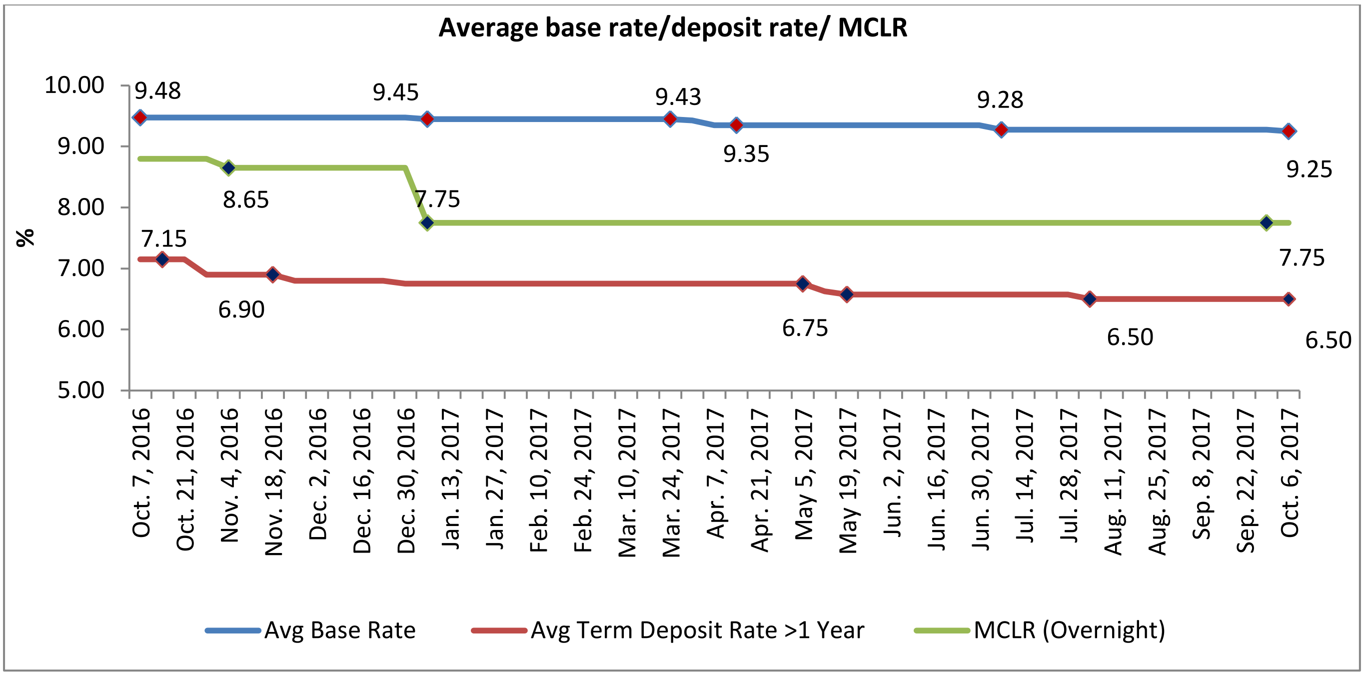


Source: Office of Economic Advisor

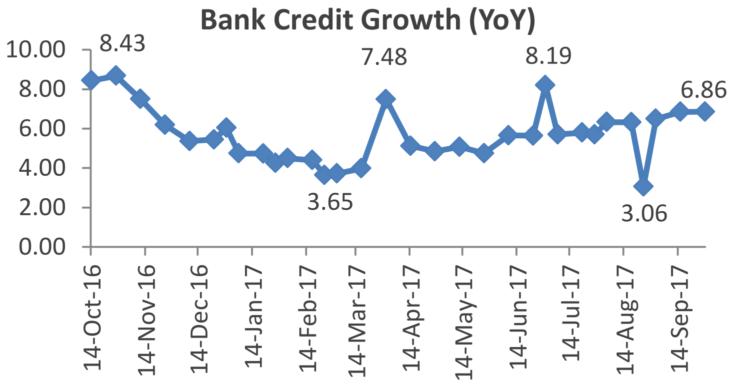


Source: RBI

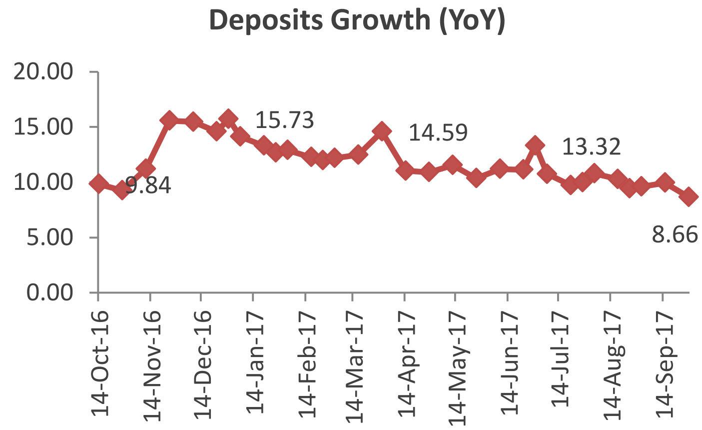
- Although the RBI has cut policy rates, banks have been slow in transmitting the rate cuts to their borrowers.



- Bank credit growth saw a sharp decline immediately after demonetization. It has been lackluster since the beginning of the fiscal with credit offtake across sectors being low/weak. The growth in bank credit continues to be led by retail loans.
- Bank deposit growth surged following demonetization. Deposit growth has moderated/normalized since then. The recent moderation can in part be attributed to the growing investor preference for other financial instruments/markets that offer higher returns viz. mutual funds.



Source: RBI

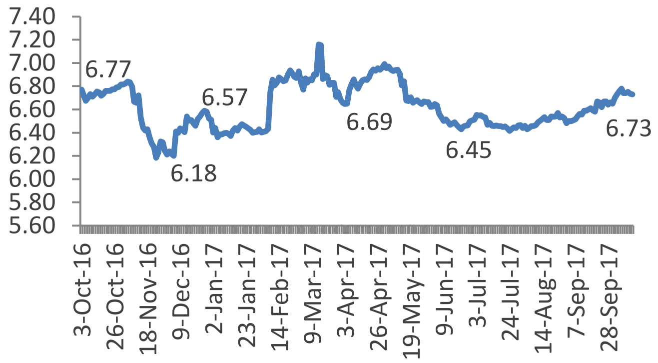


Source: RBI

- The surplus liquidity in the banking system following demonetization and higher foreign inflows has lowered the yields of GSecs. Yields have risen since Sept'16 with firming inflation that lowers the chances of further rate cuts by the RBI.
- US Treasuries yields have risen in the last 12 months with the US Federal Reserve raising interest rates (Mar'17 and Jun'17) and moving toward unwinding/unloading its portfolio of bonds that it has accumulated since the

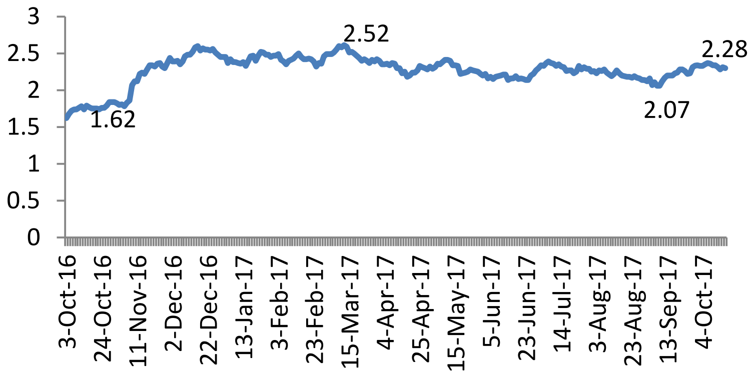
financial crisis of 2008. The Federal Reserve has indicated that it will raise rates further this year as well as next year.

10 Year Gsec Yields



Source: FIMMDA

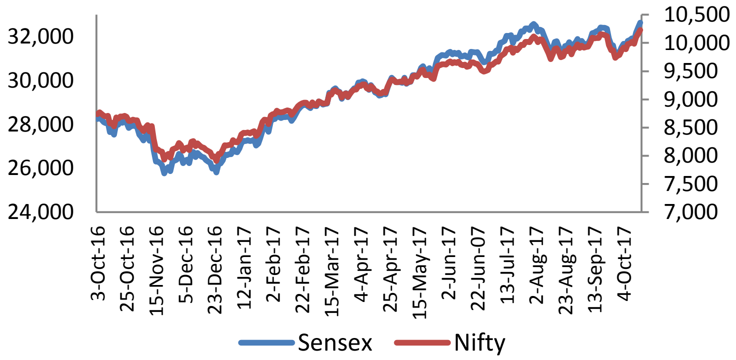
US 10-yr Treasurie Yield (%)



Source: CNN

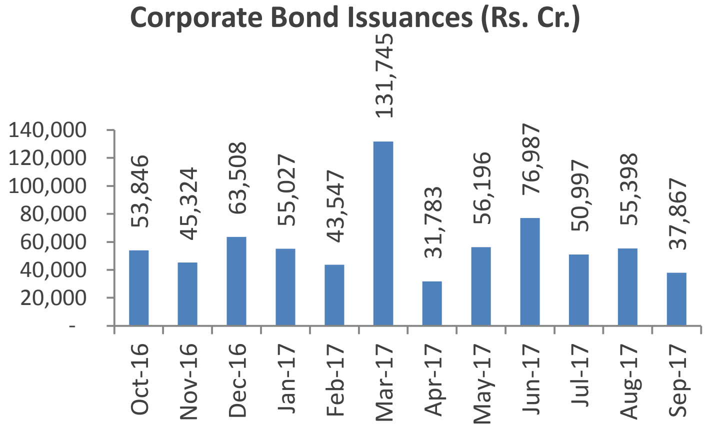
- The benchmark equity indices have seen a sharp rise since Nov’16 and have touched record highs, driven mainly by higher domestic investments chiefly by DIIs (domestic institutional investors) in the stock markets.

Domestic Stock Indices



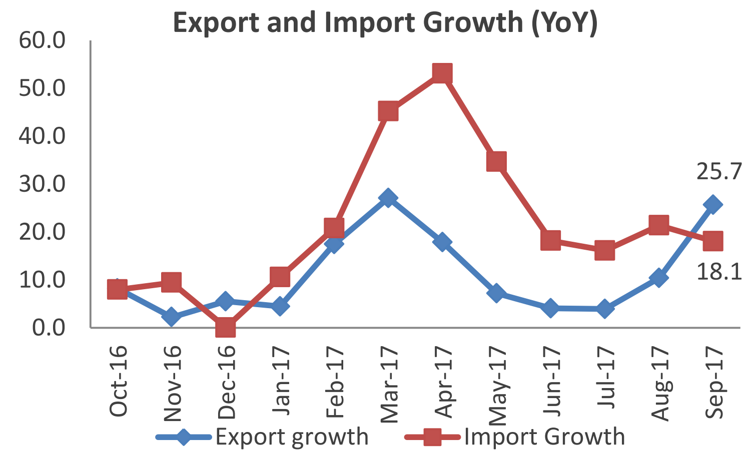
Source: NSE, BSE

Corporate Bond Issuances (Rs. Cr.)

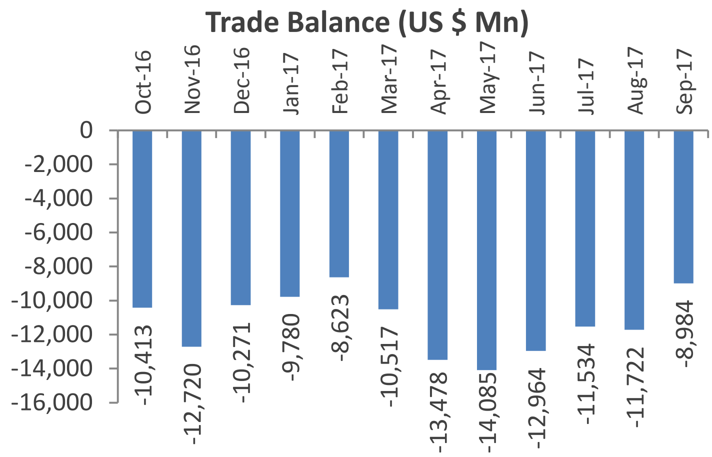


Source: Prime Database

- Corporates have been increasingly tapping bond markets for their funding needs given the stress in the banking system that has been curtailing bank lending.

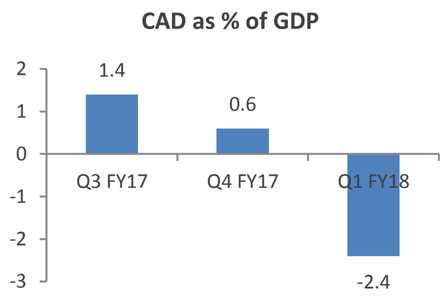


Source: Ministry of Trade and Commerce

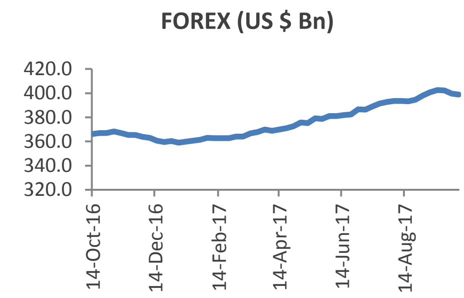


Source: Ministry of Trade and Commerce

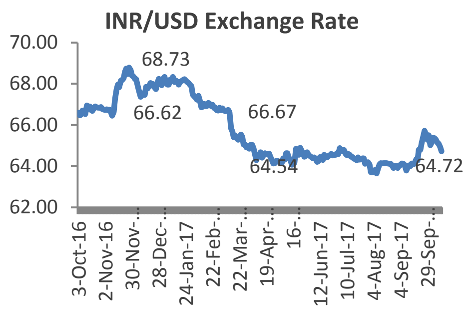
- Imports have been growing at a higher rate than exports in recent months, widening the trade balance. Imports grew by 28% in H1 FY18 and exports by 8% in H1 FY18.
- Trade deficit has narrowed to its lowest in last 7 months in Sept'17.
- The widening trade balance has been pressuring the current account deficit which has risen in FY18.



Source: Ministry of Trade and Commerce

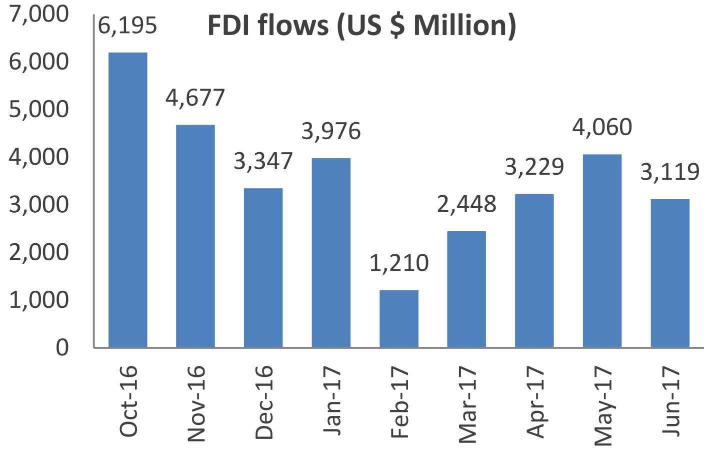


Source: RBI

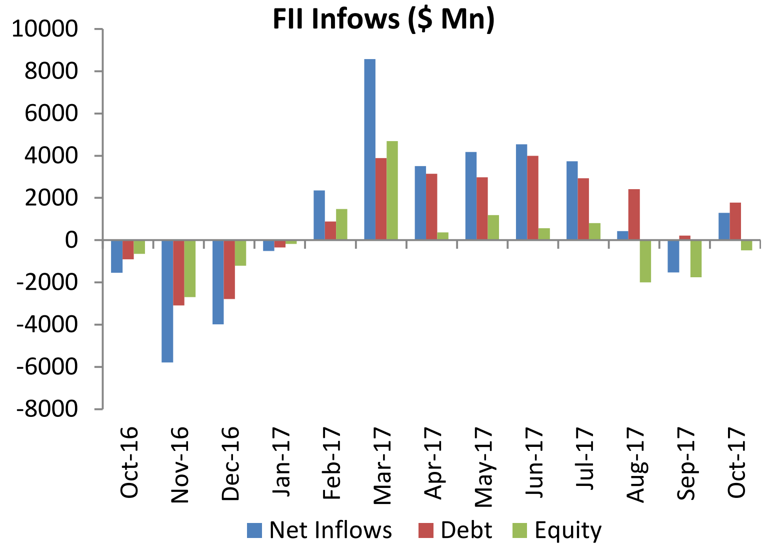


Source: RBI

- The forex reserves have risen to record levels (over $ 400 bn) driven by the rise in foreign inflows. This has led to the appreciation in the rupee.
- The present level is almost Rs 4 lower than the peak witnessed in Nov-Dec.

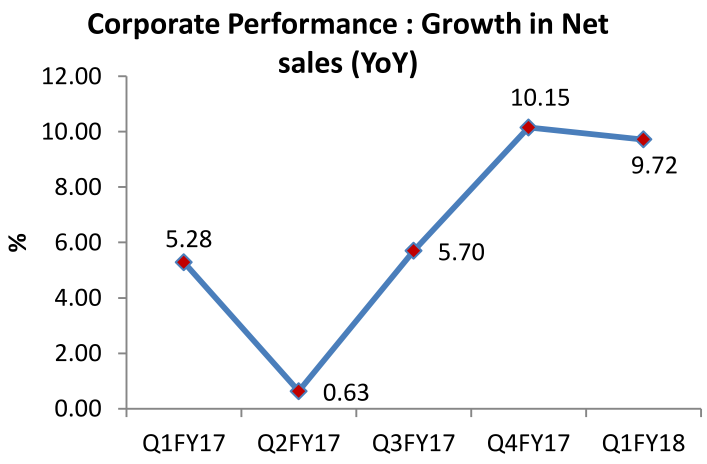


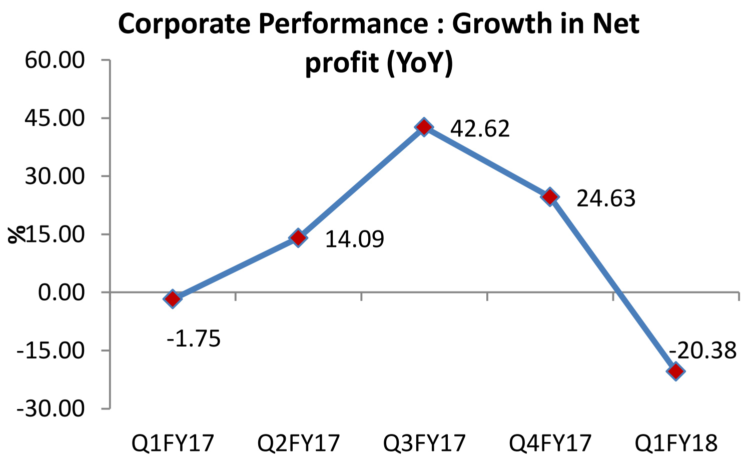
Source: DIPP



Source: NSDL

- FII inflows witnessed a sharp increase since Mar'17 following the key state elections and growing optimism about the prospects for the domestic economy. The various reforms undertaken by the government (GST, Demonetization, RERA, bankruptcy code) are being increasingly viewed as being supportive of the long term growth prospects of the Indian economy.
- FII inflows have predominantly been in the debt segment and have been driven by the yield differentials between domestic debt securities and those of other global markets coupled with the fairy stable currency. Since Mar'17, debt inflows have totaled $21.3 bn, compared with the net outflows of $ 6 bn during Oct'16-Feb'17.
- There has been a rise in FII outflows since Aug'17 mainly from the equity segment. The outflows are being attributed to high valuations, delay in earning revival, concerns pertaining to the overall strength of the domestic economy and anticipation of US rate increases that has increased outflows from emerging markets.
- FDI inflows have been lower since Nov'16. The inflows aggregated $28 bn during the 7 month period Apr-Oct'16. FDI inflows were $22 bn for the subsequent 7 months i.e. Nov- May'17.





Source: ACE Equity

- Corporate performance based on the sample of 3,102 companies (including banks and oil companies) indicated a growth of 10% in net sales in Q1FY18, 5% higher than the growth registered in the corresponding period last year while the growth in Q1FY18 remained largely stable compared with the previous quarter (Q4 FY17).
- There has however been a contraction of (-) 20% in net profits during Q1FY18 (highest in the last 5 quarters) compared with the growth of 25% witnessed in the preceding quarter (Q4 FY17).
    - The decline in profits can be attributed to the increase in input costs and the inability of producers to pass on the increases to consumers.
    - Also, the higher provisioning by banks for their stressed assets have been pulling down the overall profits while higher earning by oil companies has been pushing up the overall corporate performance.

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