Economics

August 27, 2013

CARE Ratings Economy and Investment Climate Survey – August'13

Message from MD & CEO CARE Ratings

The prevailing economic environment is widely believed to constrain India's economic progress, at least for the near term. The frequent news of adverse economic updates such as low industrial growth, currency depreciation, deterioration in asset quality, reallocation of capital inflows away from the country, to name a few, does not bode well for India's economic progress. The economy has been pressurized by a combination of low economic indicators and weak sentiment, exacerbated by the developments in the global economy.

It is against this backdrop that we decided to undertake a Survey on the economy and investment climate to have an insight, if I may add, into what really are the expectations at the micro level. We tend to read two sets of views on the state of the economy in the media – one from official sources and the other from critics. Our purpose was to actually find out what are the perceptions at the ground level. To get an unbiased view, we have chosen a wide universe of persons across all segments so that the sample that we obtained is truly random. We have in our Survey covered a wide range of sectors and industries, thus making it representative of the overall economy. While a sample of 150 odd companies may not be fully representative of perceptions, it is still very illustrative of how economic agents are reacting to the economic forces.

Our Survey shows that the overall economic situation may not be as grim as feared by various quarters. While expectations are not quite cheerful in terms of growth, at the same time companies are hopeful that things will change and there are also capital plans at hand. Even though contemporary data does reveal that industrial growth is stagnant, companies are hopeful that their sectors could do better and that their own prospects are not that gloomy. This is a positive takeaway.

I would like to thank all those who took part in this survey and for providing us with your valuable insights.

D.R. Dogra

Executive Summary

With the global economy witnessing challenging times, the Indian economy too is expected to follow suit given its strong and wide linkages with the various developed and emerging economies. However, the Indian economy confronts additional challenges in the administrative and economic domains that could derail the growth trajectory though several measures have been announced to provide an impetus to the economy. The impact of these measures is yet to be felt.

Although there are signs of some deterioration across various measurable domestic economic parameters driven in part by fundamental factors, the decline in sentiments has come to play a rather compelling role which is weighing down the country's economic potential.

This Survey attempts to get an insight into the prevailing economy and investment climate and expectations for the same, from the perspective of various companies and businesses operating in the country. The CARE Ratings Survey throws up certain interesting findings, some of which are contrary to the widely held perceptions on the economy's health and progress. The main takeaways based on the majority view are:

- The economy to perform better than that in the fiscal year gone by i.e. by more than 5%.
- Inflation will remain in the same range or increase moderately from the present level of 5%.
- The rupee will be above Rs 60/$.
- Fiscal deficit target is unlikely to be achieved notwithstanding the assurances that have been provided by the government.
- There is an even chance of a further rate cut, which could be between 25-50 bps during the rest of the year.
- Bank NPAs will increase this year too.

The Survey has also shown some encouraging observations, particularly with regard to the performance expectations for the respondents' respective sectors and companies. A large proportion of the respondents expect their respective sectors to perform better or remain the same and not deteriorate this fiscal. In case of their own companies, 93% see status quo or improvement. What is even more noteworthy is that these expectations factor in a weaker currency, lower and limited expectations of interest rate cuts and rising bank NPA's.

The capital investment/ expansion plans and borrowing plans of companies can be viewed as being mixed with nearly half the respondents responding in the affirmative.

Survey approach

CARE Ratings' Survey questionnaire on Economic and Investment Climate was sent to various companies as well as experts and economists to get a diversified sample. The respondents ranged from CEOs and CFOs to Chief Economists and senior heads of business divisions. There are 155 respondents from sectors such as agriculture, automobiles, construction, energy, engineering, finance, infrastructure, jewellery, pharmaceuticals, cement, chemicals, hospitality, real estate, services, steel & textiles among others. All the questions of the survey were answered by over 150 respondents.

<u>Survey Findings</u>

Subdued outlook of economic growth

The responses indicate that the widely anticipated recovery in the country's economy for the current year, projected at the start of the fiscal has been tempered. The Government of India and RBI are talking of lower than initially projected GDP growth of 5.5%. Relative to this revised target of the official sources, 70% of the respondents expect growth to be below 5.5%, with 27% looking at sub-5% growth this year.

Nevertheless, the majority of the respondents (73%) expects the economy to record higher growth than that in 2012-13 i.e. above 5%. 66% of the respondents expect the country to grow between 5-6% in 2013-14.

CARE's own expectation is that GDP growth will be 5.4% this year with a downward bias. A lot will depend on whether industrial growth picks up from September onwards, which is the harvest cum festival season when typically consumption increases. Also the government has cleared projects with investment ranging from Rs 1-1.5 lkh crore, which would hopefully start getting implemented during this time period.

Exhibit 1: Expectations of India's GDP growth in 2013-14

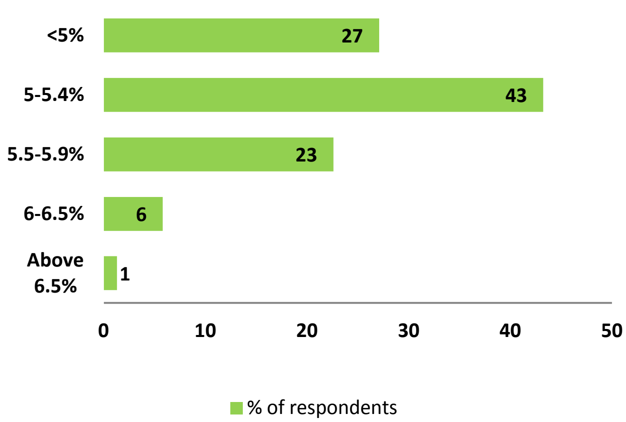
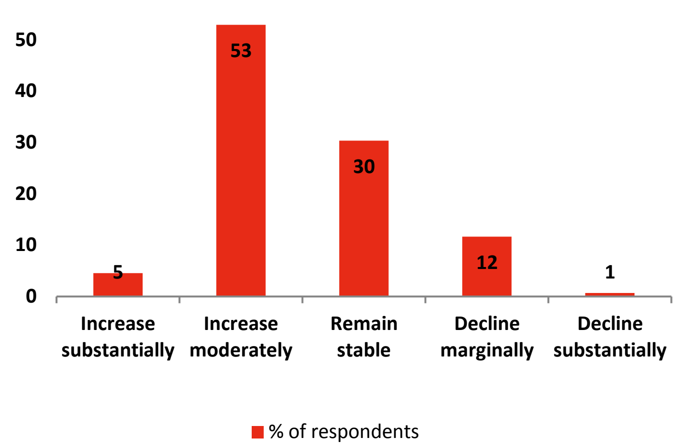


Exhibit 2: Outlook on Inflation (2013-14)



Breather for inflation expectations

The question posed here was given that inflation had moderated to the 5% range, what were the perceptions for the rest of the year in terms of intensity of inflation.

The majority of the respondents do not foresee a sharp rise in price levels this year, providing for the much needed breather to inflation expectations. However, the majority do see inflation rate increasing, albeit moderately (53%), while only 13% are expecting a decline in inflation rate. Around 30% expect inflation to remain in the present range. The significant takeaway is that there is not much optimism for inflation rate coming down even while most do not see a sharp rise in this variable.

The higher inflation expectations will most certainly come in the way of action by RBI. As a corollary, if the RBI were to lower interest rates in future, the trade-off will be at a higher level of benchmark inflation.

Exhibit 3 : View on the Rupee for the remainder of 2013-14

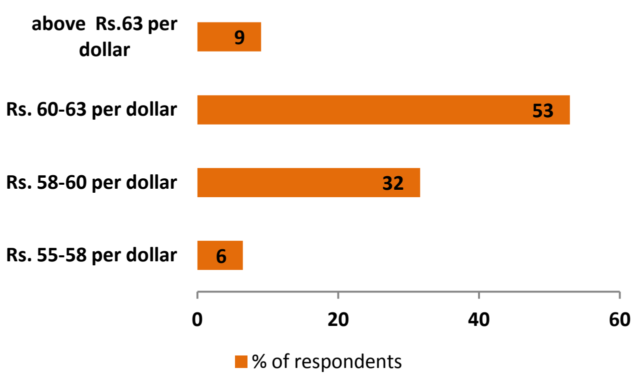
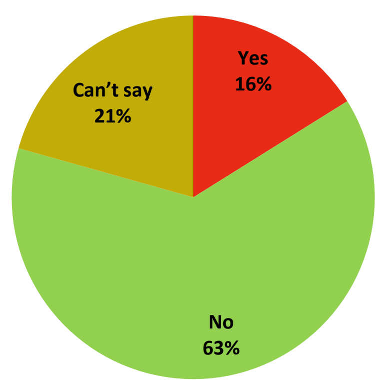


Exhibit 4: Attainability of Fiscal Deficit Target for 2013-14



The Rupee Dilemma

Industry and businesses in the country seems to have factored in the vulnerability of the Rupee. 62% of the respondents expect the rupee now to be above the 60 mark while 38% are looking at a number of less than 60. Nearly 32% of the respondents expect the currency to be in the range of Rs.58-60 per dollar.

(It must be noted here that these responses came before the rupee took on a new benchmark of Rs 64/$. CARE Ratings stance even today is that the exchange rate will settle in range of Rs. 58-60 per dollar once the sentiment on account of the QE becomes normal).

Fiscal slippages to persist

Despite the Finance Minister repeatedly reiterating that the country's fiscal deficit target of 4.8% for the financial year would not be breached, 63% of the respondents do not see the Central Government managing this target. However going by the precedent set last fiscal, of sharp expenditure cuts to maintain the fiscal deficit within target and of achieving a deficit lower than target, 37% of the respondents either expect the government to maintain target or are not sure whether it would cross the target.

CARE Ratings expects that this mark will not be breached. There is a risk here that as the Budget for the ongoing fiscal year was drawn on the assumption of a higher GDP growth rate of around 6.4-6.7%, which will most probably now be less than 5.5%, there would be revenue slippages. To ensure that the target is maintained, the government perforce has to lower its capital expenditure as has been done in the past.

Likely Slippages in fiscal deficit:

- Between 0.1 – 0.5% of GDP as per 23% of respondents
- Between 0.5 -1% of GDP as per 30% of the respondents
- Above 1% of GDP as per 10% of the respondents

Limited expectations of a rate cut

Nearly half the respondents (48%) do not expect any change in interest rates. Of the balance 52%, 25% expect 50 bps reduction in the repo rate while 23% expect 25 bps cut. Therefore, industry appears to be reconciled with limited RBI rate action given the trends in inflation as well as the rupee and the subsequent actions taken by the RBI to arrest the fall of the same.

Combining these expectations with a higher level of inflation is again indicative of the RBI implicitly choosing a higher trade-off on inflation in a bid to revive growth in case it lowers interest rates during the course of the year.

Bank NPAs to increase

An overwhelming 73% of respondents expect the NPAs of the banking system to increase this year, which is significant because even in the last 2 years the quality of assets of banks have been under pressure. 9% think NPAs will come down while 18% are undecided.

The expectation of an increase in NPAs combined with a reduction in interest rates by the RBI does indicate that even in case the repo rate is cut, banks may not lower their lending rates commensurately on account of the increase in risk perception.

Exhibit 6: Expectation of rate cut by RBI

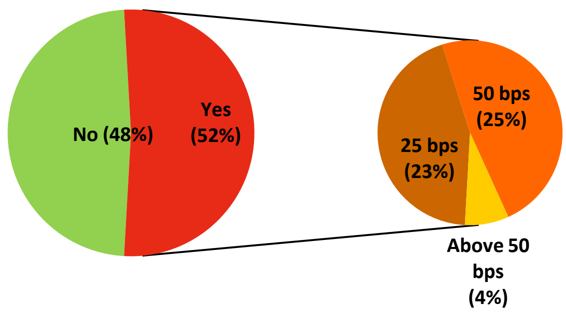
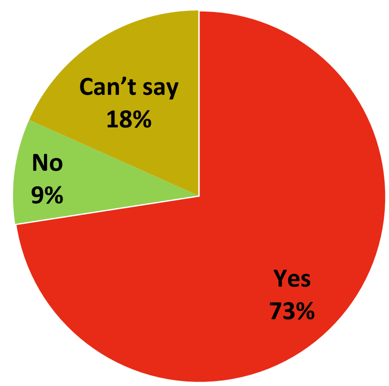


Exhibit 7: Likelihood of rise in bank NPA's in 2013-14



__Improved business performance expectation__

The questionnaire included two questions on how respondents expected their own as well as sector's performance to be in FY14.

Based on their responses, it appears that the business performance expectations (which is largely based on the performance in the current period and recent past) of the respective sectors and companies of the respondents hold promise for improved economic potential and prospects. Only 19% of the respondents expect their sector to be worse off this fiscal and only 5% expect their respective companies to fare worse. 41% expect better performance of their sectors while 38% expect a status quo.

In terms of the 'own company's performance', 65% of the respondents expect their company to do better in 2013-14, of which 41% of the respondent expects their sector to do somewhat better while 24% are even more optimistic of significant improvements. This is fairly encouraging news.

Exhibit 8: Expectation of the respective industry/sector performance in 2013-14

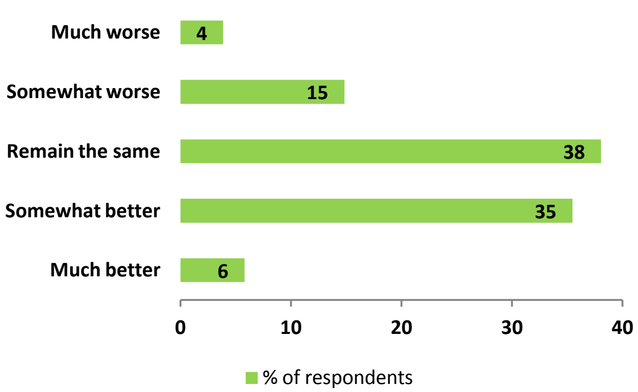
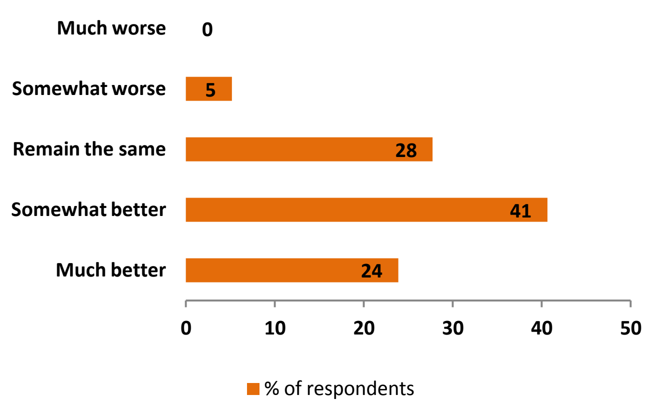


Exhibit 9: Expectation of respective company performance in 2013-14



The sectors that are expected to see stable to better performance in the current fiscal include services, pharmaceuticals, infrastructure, construction, jewellery, textiles, agriculture and engineering.

Although, as per the responses, the finance sector is by and large expected to record a decline in performance in 2013-14, in terms of individual company performance, companies belonging to this sector are expected to see stable to improved performance.

Mixed view on expansions

Nearly half the respondents have plans to increase their capital investments/expenditure, while the other half (77 respondents) do not expect to increase their capital investments/expenditure. For those who do not have investment plans this fiscal, the most cited reason for this is the existence of enough capacity to meet demand. Additionally, high interest rates, demand slowdown and policy constraints too have been inhibiting factors. In many cases combinations of these factors have been stated to be reasons constraining capital investments of these companies. Based on the survey response companies belonging to the pharmaceuticals, infrastructure and finance sector could account for the largest increase in capital expenditure.

Table 1 : Factors stated to be impeding capital investments/expenditure

	Nos of respondents
Demand slowdown	17
Have enough capacity to meet demand	41
Cost of inputs have risen	8
High interest rates	17
Policy constraints/ bottlenecks	12
Other factors	8

The response is quite interesting as often we do put a lot of emphasis on interest rates and policy constraints that are holding back investment. Quite clearly from this sample it appears that demand needs to increase to ensure that capacities are better utilized before fresh investment takes place. RBI's study on capacity utilization shows that based on its sample, as of FY13, capacity utilization rate was around 76%.

Companies to resort to borrowings

65% of the respondents have indicated that they would be resorting to borrowings to meet their business needs. Banks continue to be the most preferred choice for borrowings with practically all these respondents (i.e.101 respondents) indicating it to be the preferred source of funds for them. Equity, FIs and ECBs would be the next important source followed by bonds and debentures.

Table 2: Sources for borrowings	
	No of respondents
Bonds & Debentures	**18**
Equity	**28**
Banks	**101**
Financial institutions	**21**
Unsecured deposits	**5**
ECBs	**21**

In terms of borrowings, the companies belonging to the pharmaceutical, infrastructure, real estate, service and finance sectors are likely to account for higher borrowings in 2013-14.

Conclusion

They Survey findings shows that although the country's economic environment has been subdued with recovery expected to be slow and limited, the fears of a severe slowdown seem to be unfounded. GDP growth, inflation expectations industry and company performance are expected to record improvements this fiscal year. This would be notwithstanding rupee depreciation, increase in bank NPAs and limited monetary easing by the monetary authorities.

Also, the Survey finding have been largely in line with CARE Ratings own projections for the various parameters. CARE's GDP growth projection for 2013-14 stands at 5.4%. We have also projected inflation at 6.5% and the rupee to stabilise around Rs.60 per dollar by the end of year.

Contact:

Madan Sabnavis	***Kavita Chacko***
Chief Economist	***Economist***
madan.sabnavis@careratings.com	*kavita.chacko@careratings.com*
91-022-67543489	*91-022-61443593*