Economic Outlook for India FY 2021-22

CARE Ratings' Economic Outlook for 2021-22

With the benefit of hindsight of almost 4 months that have gone past during the financial year FY22 with the second lockdown and subsequent calibrated opening up being witnessed, we have revisited our prognosis made on the economy in March 2021. During this period we have also made revisions to some of the indictors such as GDP growth and fiscal parameters. We present here the outlook for the economy for the year which covers all major macroeconomic indicators.

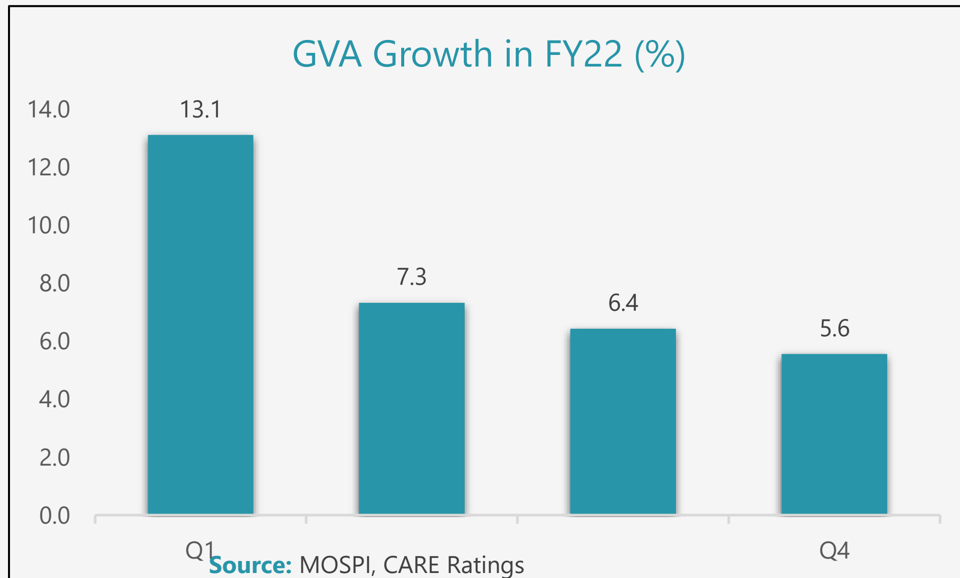
The outlook for the Indian economy on almost all counts would look seemingly better than FY21 on account of a negative base effect. The lockdown induced pandemic had pushed growth down to the negative region of 7.3% in FY21. It was expected that subsequently growth would be rapid in FY22 with both the negative base effect as well as the pent-up demand for consumption and investment helping to accelerate the process. However, the advent of the second wave of the virus in the beginning of the financial year which led to state induced lockdowns has upended this assumption to an extent.

Business, as seen ex post, has been better equipped to face the lockdown and while activity did reduce across the country as well as sectors, the impact was less severe. The reverse migration which took place in large numbers last year was of a lower magnitude this time. SMEs were again under pressure in this phase, but as they were operating at less than normal potential were not pushed back that severely. Therefore, while our projections on growth have come down significantly from March, the drop is less damaging this time.

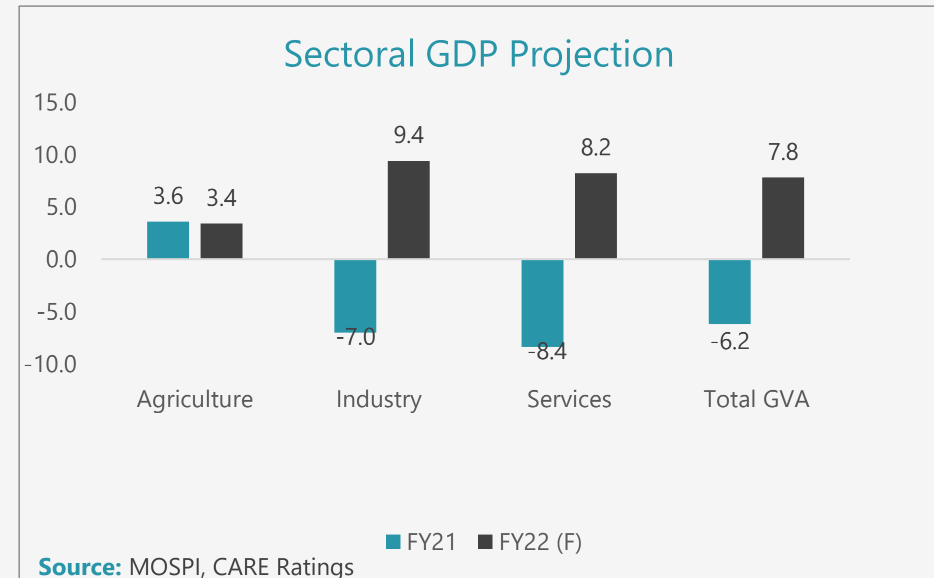
With this preface, we present our outlook for the economy in FY22 with the benefit of witnessing 4 months of the year gone by. April was less disruptive notwithstanding lockdowns in several states, and May witnessed sharp pushback across most sectors. June and July traversed a very gradual opening up of the economy which will hasten along the way. It is assumed however, that the third wave, if it does come, will not lead to similar lockdowns as were witnessed earlier this year.

GDP growth for FY22

GDP growth for the year is expected to be 8.8-9% with GVA growth of 7.8%. The growth rate though impressive should be viewed against a decline of 7.3% in growth in FY21. The main drivers of the economy would be agriculture and industry.



Source: MOSPI, CARE Ratings



Source: MOSPI, CARE Ratings

Services will not be able to reach its potential even at 8.2% growth as the second lockdown has affected sectors like hotels and restaurants, tourism, retail malls and entertainment in particular.

Growth rates to be interpreted with caution

These segments in services were also the ones to be pushed back last year and had started moving towards 50-70% of normal in Q4 of FY21. Also, the entertainment sector (particularly film exhibition, live events, out of home advertising), is expected to take longer to recover. The second lockdown has not only pushed these segments of the service sector back but has also made governments more circumspect when it comes to opening them given that social distancing is hard to maintain. The extent of opening up will depend on a combination of both the pace of vaccination which though increasing has been erratic as well as the caseload coming down.

Alongside is given the matrix of growth forecasts for various sectors based on the current performance as well as the prospects going forward. Some of the numbers will have to be interpreted with caution as the base effect has tended to increase numerically the forecast for growth for FY22. Hence forecast for CVs (commercial vehicles) and hotels has been exaggerated due to the low base effect of FY21. Conversely, the strong growth in tractor sales in FY21 would play down the volumes of tractors to be sold this year, which is expected to be high, albeit lower than year ago.

The growth forecast matrix

	CVs 21-23%	**Hotels & Restaurants 35-40%**
	3wheelers 15-17%	
Pharma 10-12%		Textiles 12-15%
Steel 9-11%		
Cement 4-7%	Machinery 6-7%	Sugar 5-7%
Power 5-7%	Durables 5-8%	Edible oils 5-10%
Fertilizers 3-5%		
Coal 2-3%		
Two wheelers 1-3%	Passenger cars 0-2%	FMCG 3%

Vertical axis: **Growth Forecast %**; horizontal axis: **Sector**

Demand side challenges have to be addressed

We believe that while a lot has been done on the supply side by both the RBI and the government (the June 2021 relief cum stimulus programme), the malaise is on the demand side which has been a problem even before the pandemic. Demand has been set back by both consumption and investment which has to be reversed. Consumption will be driven by employment generation and here we have to see broad-based growth. The services sector has already witnessed loss of jobs last year which has not been restored in 2021 given the second lockdown. Employment generation has been rapid in case of BFSI and IT which is more at the upper income end.

A critical factor this time will be the spending pattern of the rural households. The monsoon forecast is good and ideally a stable kharif harvest should bode well for rural incomes. It is still not certain as to what has been the impact of the pandemic on rural India this time. The emerging picture has been rather mixed. Tractors which is part of agricultural machinery, is witnessing some pick-up, while two wheelers demand is not too robust as SMEs in rural areas have been adversely impacted due these lockdowns. Paint manufacturers are also witnessing good traction, though Q3 will be much better due to rural demand also picking up and supported by wedding season and festivities. The same holds true for automobiles demand. Ability and willingness to spend during the post-harvest festival season will depend on the disposable surplus income that is generated after adjusting for health care expenses in the last few months and this would be a differentiator for overall demand and consumption in the country.

There could be some pent up demand which surfaces this time too from urban India, but it may just about maintain the level of last year and not really breakthrough. It has been noticed that savings have been rising in these uncertain times and while the government has announced higher DA for its employees, it would need to be seen as to how much is spent on consumption this time over.

Higher consumption should stimulate investments. The crux will be investment which has a multiplier effect on demand and investment.

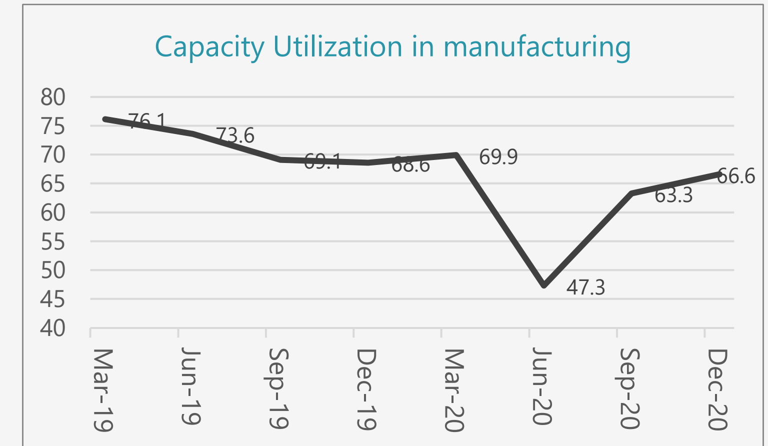
Investment to get limited boost this year, though FY23 can be different

Gross fixed capital formation (at current prices) is the indicator to watch out for when tracking investment trends. This comprise both government and private investment with the share of private sector dominating. The government has a share of around 13-15% in GFCF which is in the minority. The thrust has to come from the private sector, and this has been the main problem in India, due to legacy issues. The NPA issue which surfaced from 2016 onwards has been a signal to banks to be more careful when lending to the infra sector in particular. The central government has been pushing for higher capex and in the FY22 Budget has targeted Rs 5.54 lakh crore (Rs 4.39 lakh crore in FY21(R). Of this Rs 1.40 lakh crore is on defence).

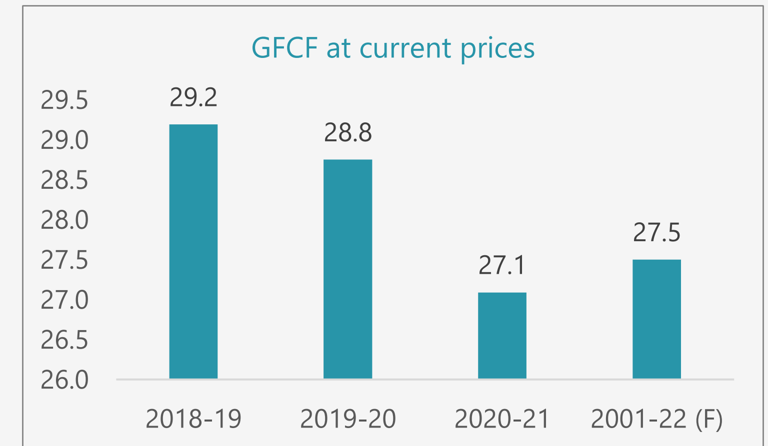
Given the state of the economy and the surplus capacity in industry, we do expect only a marginal increase in the GFCF rate to 27.5% of GDP (from 27.1% in FY21). One of the factors that should be considered is the capacity utilization rate in manufacturing. It had declined to 47.3% in Q1 of FY21. There has been a pick-up subsequently to 66.6% in Q3-FY21. Typically, a level of 78-80% is required to be attained before companies start investing in capital. At the aggregate level this looks some time away. Therefore, capacity expansion is more likely in industries which have reached optimal utilization levels like steel or pharma. But it is unlikely to be generalized which is what is required to push up the gross fixed capital formation rate.

On the positive side we do expect the PLI scheme to help in activating investment though the acceleration would take place form next year onwards. Sectors like sugar, pharma, textiles etc. could see higher investment due to PLI and other incentives provided.

The Q1 investment numbers based on CMIE's new projects announced are not encouraging. At Rs 1.8 lkh crore, it is at the same level as Q4-FY21, but is lower than what was witnessed in any quarter prior to FY21 barring Q1-FY19.



Source: RBI



Source: MOSPI, CARE Ratings

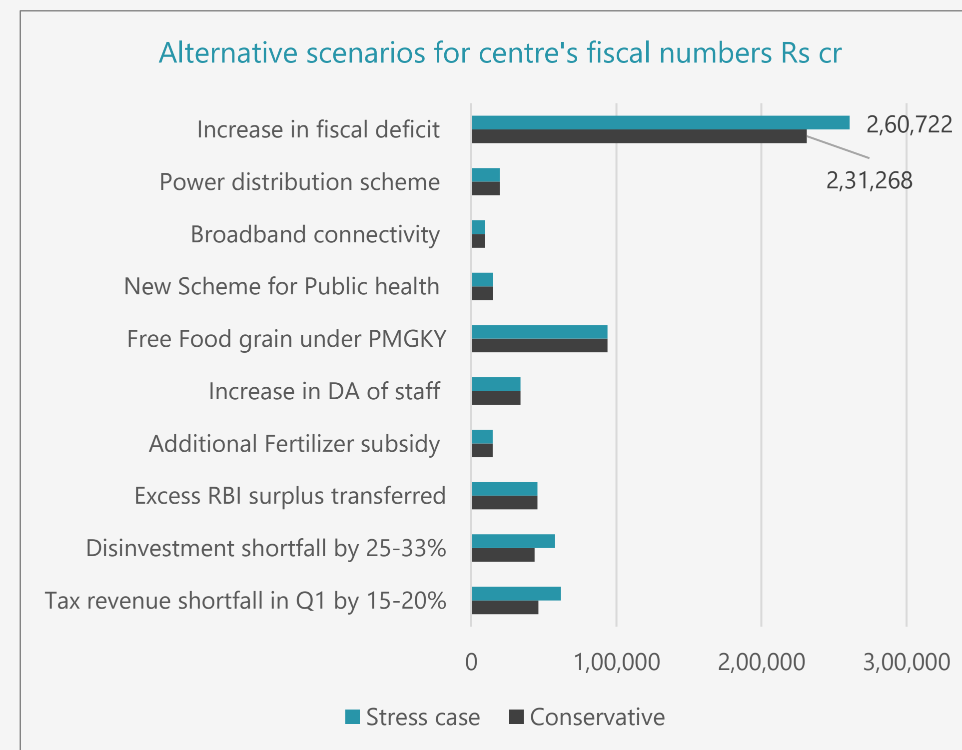
Fiscal conjectures point to slippage of around 1% of GDP

The fiscal deficit for FY22 was projected at Rs 15.07 lakh crore which is 6.8% of GDP. GDP in nominal terms was projected at Rs 222.8 lakh crore which was based on growth of 14.4%. We believe that the growth rate per se will be retained with the composition however changing. Inflation would be higher while real GDP growth would be lower than earlier implies at around 9%.

The funds shortfall (due to additional expenditure and lower income) would push up the fiscal deficit to between Rs. 17.38 lakh crs to Rs. 17.68 lakh crs. For a nominal GDP of Rs.222.9 lakh crore the increase in quantum of fiscal deficit would potentially push up the fiscal deficit ratio to 7.8-7.9% of GDP.

The chart alongside provides the areas of concern here where there would be deviations based on our calculations post the relief programme announced by the government in June that has a bearing on both revenue and expenditure. The government had also announced an increase in the DA of all central government employees which entails an outgo of Rs 34,000 crore.

There would also be additional borrowing by the central government to compensate states for shortfall in GST which has already been announced. Therefore there would be additional pressure on the market. As liquidity is in abundance and the RBI is active in managing the situation, this should not affect availability of funds.



Source: CARE Ratings

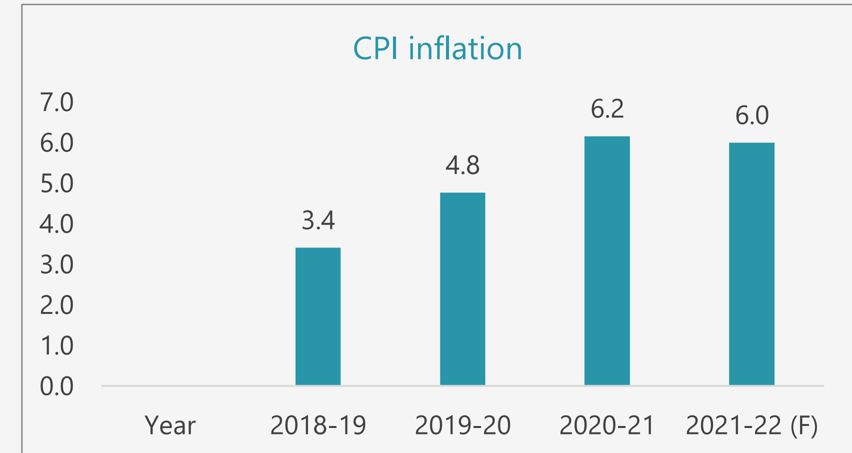
Note: excess RBI surplus transfer provides a limited revenue buffer

Inflation will remain a pain point; but industry will regain some pricing power

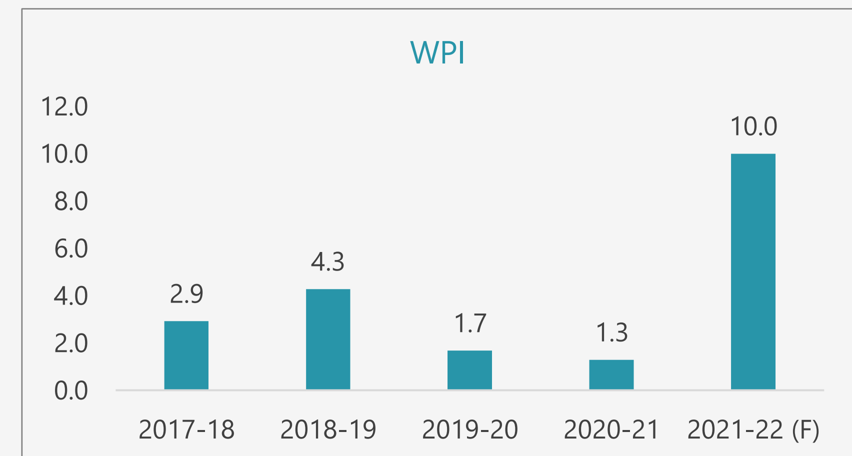
The impact of escalated fuel prices in past few months is factored in the high CPI inflation in India. The Government taxes on fuel (central as well as state) have not witnessed any respite and is affecting the consumer's pockets. Though global prices witnessed some degree of softness after the recent OPEC meeting to further oil supply, the domestic price correction has been limited and is still considerably high as demand for this commodity is only moving upwards.

Inflation, we believe, will continue to exert pressure on the economy. While food prices would be driven by the kharif harvest and the consequent impact on prices, the core segment is a worry which will be elevated at over 6% for the rest of the year. The cost of services has also increased across all components which combined with the fuel-led impact would keep CPI inflation elevated at around 6% by March -end.

WPI inflation will be in double digits mainly due the low base effects as well as rising global commodity prices. The good sign is of manufactured goods prices increasing which reflect the pricing power being restored to an extent. But this will also get reflected in higher prices of final products like automobiles, construction, machinery etc. At this stage of the opening up of the economy producers may not be in a position to pass on the full increase in cost to the final consumer and may have to absorb a part of this amount on their P & L accounts.



Source: MOSPI, CARE Ratings



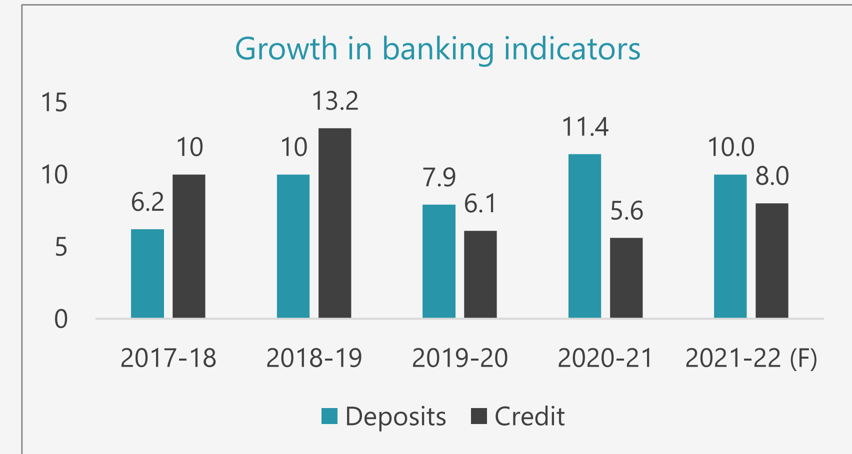
Source: Office of Economic Advisor, CARE Ratings

Banking growth to improve; bankers will be cautious while lending with the NPA issue still clouding their vision

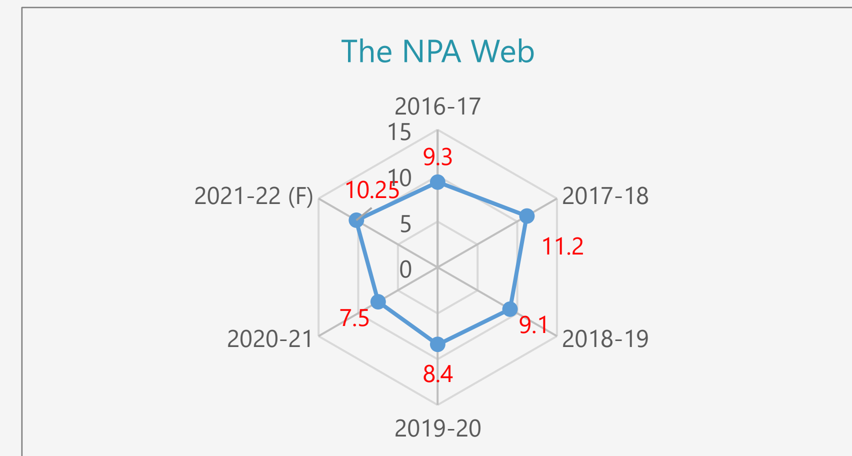
The banking sector has been under considerable strain in the last few years on account of the NPA problem which surfaced when RBI introduced the AQR- asset quality recognition process. Banks suddenly became wary of lending and companies too were less interested in borrowing with the IBC also being active. Hence even while the RBI has been injecting funds into the system there have not been too many takers for the same. This is one of the reasons for surplus liquidity in the banking system for the last two years.

The first 4 months of 2021-22 has played out like the earlier year with demand for credit being low. Growth is more buoyant in retail loans and agriculture while that to industry has been lacklustre. Under these conditions we expect credit growth of 7-9% this year (the mid-point of 8% shown in the graph). Deposits would grow by 9-11% (mid-point of 10% denoted in graph). Deposits have been affected this year too with low interest rates, buoyant stock market and preference for mutual funds, higher expenditure on health, preference for holding on to cash (currency in circulation has increased by Rs 1.27 lakh crore so far since March) etc.

NPAs of the banking system had come down to 7.5% in 2020-21 partly due to the moratorium and restructuring of various loans. RBI has provided three scenarios of gross NPA by March 2022, which is 9.8%, 10.4% and 11.2%. The baseline scenario is predicated by assumptions on GDP Growth (9.5%), combined fiscal deficit of 11.9%, CPI inflation of 5.1%, exports to GDP ratio of 11.5%, average lending rate of 9.2% and CAD of 0.1% of GDP. Our call is different on GDP growth (8.8-9%), CPI inflation (6%) and CAD (0.5-1%). Therefore, our estimate for NPAs is 10-10.5% (represented by mid-point 10.25% in the graph above) for March 2022. The second wave and subsequent lockdowns which are still in force in several locations will affect overall business and while the slippage ratio (NPAs on incremental loans) will remain low, the legacy assets would tend to get a bit strained during the course of the year.



Source: RBI, CARE Ratings



Source: RBI, CARE Ratings

Interest rates will be managed, no repo rate change for sure

Given the high inflation numbers witnessed so far and our expectation of CPI inflation to remain elevated it does not look likely that there can be any rate cut at least in the 2021 calendar year. Therefore, the repo rate will remain at 4% and the reverse repo rate at 3.35%. Even the reverse repo will remain the same as presently the RBI has been incentivizing banks to lend to specific sectors and take benefit of an equivalent amount through the reverse repo window.

Two sets of factors have a bearing on interest rates if one looks beyond the repo rate. The first is inflation trajectory and the other is government borrowing programme. Inflation as per our view is expected to be in the 6% range. The government's fiscal deficit will be higher by 1% of GDP which will necessitate higher borrowings in the market (though a part can be financed from the NSSF). The government will be borrowing an additional Rs 1.5 lakh crore to compensate states for lower revenue on GST. Normally such a scenario will lead to higher GSec yields in the market. However, the RBI has been managing the yield curve by infusing liquidity in the market. This is through the GSAP programme besides the special windows opened for repo-based financing for specific sectors. There is a topping of OMOs to ensure surplus liquidity. This has led to surplus funds being parked in the reverse repo window to the extent of Rs 5-6 lakh crore on a daily basis. This will ensure that yields do not go up sharply, which would have been the case had such infusions not taken place.

Recent developments in the GSec auctions do reveal that the market expects higher yields which has led at times to devolution on the PDs or remaining unsold. The 10-years GSec yields have gone up by 10 bps with the issuance of the new paper a fortnight back which anchored the coupon rate at 6.10%. We believe that this continuous process will make yields inch up to 6.20% in the absence of any change in policy stance. There can be an upward bias along the way.

Source: RBI and CARE Ratings

Foreign trade to grow with global recovery

A positive development this year has been a perceived recovery in global trade with some of the western economies and China poised to grow at high rates this year. This has manifested itself in terms of buoyancy in trade and India has benefited well so far from this upsurge in demand. World trade is projected to grow by 8.5% in 2021 according to the IMF after declining by 8.4% in 2020.

Imports will be largely driven by two factors: oil prices that drive the value of oil imports and the recovery in industry which will lead to an increase in demand for non-oil imports. As we believe that manufacturing will be the engine to growth this year, we may expect the demand for raw materials and intermediate goods to increase. Demand for machinery related goods will remain muted due to the limited investment expected this year. An assumption also made here is that gold demand will remain muted to stable and will not be increasing substantially this year. Our projection for trade is the following: Exports and imports to grow by between 25-30% this year (represented by 27.5% midpoint in the chart).

Consumption of petroleum products like ATF, diesel and motor spirit has risen in June, after prior two months of localized lockdowns. The capacity utilization of refineries has also improved which shows signs of improving demand due to rise in mobility in the country.

Exports growth will be driven by engineering goods, petroleum products, gems and jewelry followed by drugs and pharmaceuticals and chemicals. The movement of the rupee will also hold a clue here as with global demand increasing there will be intense competition from other countries and price advantage will be what most countries will be looking for.

Exports and imports will both grow and be positive

Source: Commerce Ministry, CARE Ratings

Imports growth to be higher due to base effect

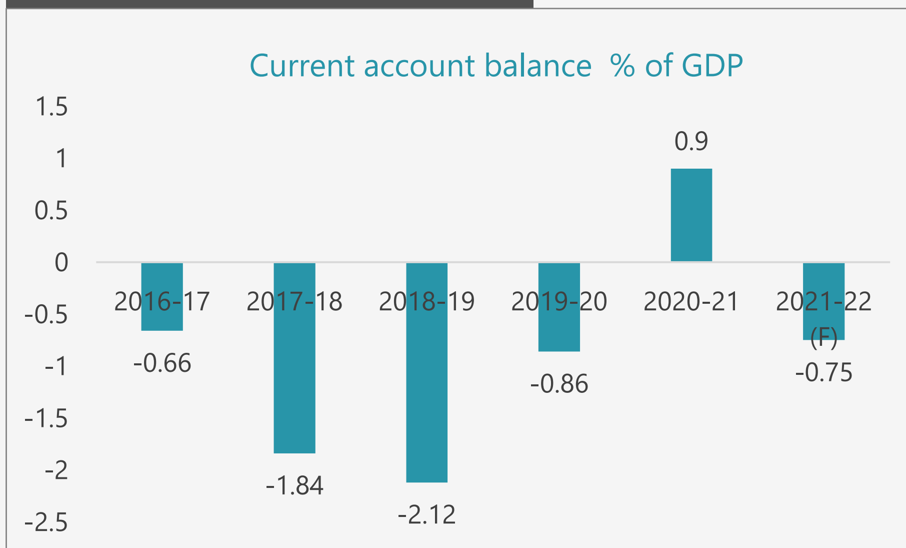
Source: Commerce Ministry, CARE Ratings

Current account will turn to deficit, but capital account support to stay strong

The Indian balance of payments has been sustained by the capital account over the years though in FY21 there was a current account surplus too which helped in increasing the forex reserves when combined with the capital surplus.

The current account will turn into a deficit this year with a higher trade deficit and stable invisible flows. Remittances could yet be lower as the return of migrants to India during the current wave will play a role in this factor. There are still restrictions on movements of people from India to the Gulf countries which will in turn impact this section of population. We do expect a deficit of 0.5-1% of GDP (denoted in graph as -0.75% being the mid-point).

Current account the clue, will turn to deficit



Source: RBI, CARE Ratings

India's balance of payments: FY21

2020-21	$ bn
Current account	23.91
Foreign investment	80.09
Loans	6.90
NRIs	-21.07
Others	-2.20
Capital account	63.72
E & O	-0.35
Overall Balance	87.29

Source: RBI

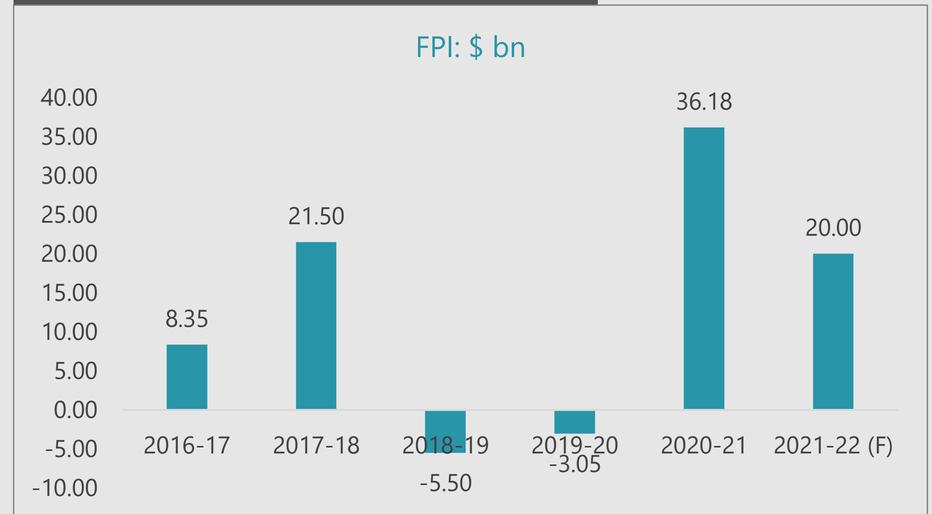
FPIs to be lower while FDI will be maintained

The external account has been steadied a lot by foreign investment as the flows of ECBs and NRI deposits have been largely dependent on the interest rate scenario in the global economy. The rate of interest and the exchange rate risk drive decisions on the ECBs while NRIs weigh the returns on alternatives.

FDI and FPI hold the clue in this context for the external sector. Here too the FPIs are driven by developments in the external markets. While the major central banks have indicated that they will not be raising interest rates or withdrawing liquidity from the system the fact that there is expected growth in these regions would make the foreign investors reconsider their options. The flows to the emerging markets will get impacted this year as the large-scale fiscal spending on infrastructure in the USA would open up several opportunities for investors. Hence the FPI flows to India would be lower than last year and our expectations is that they could be in the region of $ 18-22 bn. Here too the tile will be more to equity than debt.

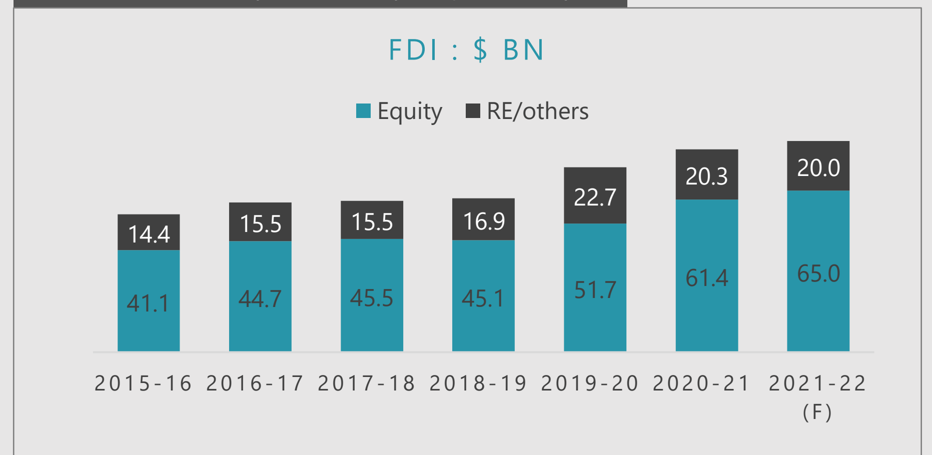
FDI has been a strong pillar for the external sector and the inflows in the last few years have been increasing at a steady pace. This comprises equity flows and reinvested earnings. The equity flows crossed $ 60 bn in FY21 and we expect the level to be maintained at $ 65 bn. Again, the opening up of opportunities in the west including China would be a factor that will come in the way of acceleration of these flows.

FPIs will be whimsical, but can get up to $ 20 bn



Source: CMIE and CARE Ratings

FDI to be stable, may not be major uptick this year



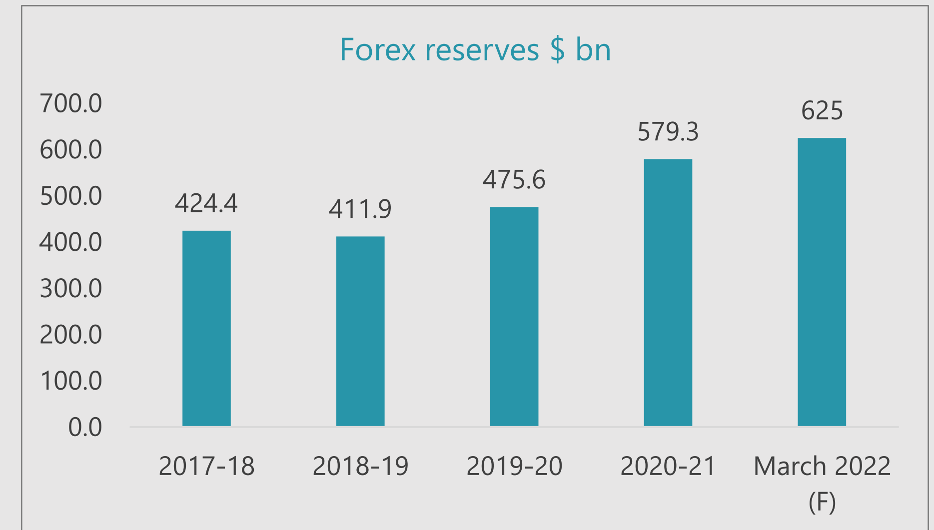
Source: RBI and CARE Ratings

Forex reserves to increase, but currency to weaken

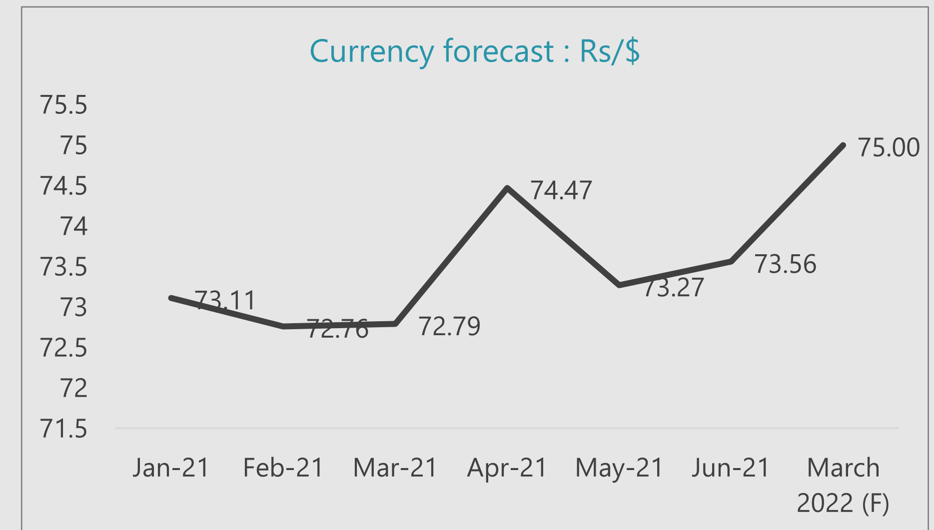
All these transactions would be finally driving the currency. Here the increase in forex reserves is important. We have already seen forex reserves increase to cross $ 600 bn mark, but since then there has been some noise in weekly movements. A lot can be ascribed to the FPI flows on a daily basis. Forex reserves in our estimate would be expected to eb in the region of $ 620-630 bn (denoted by $ 625 bn as mid-point in graph) by March end.

With the current account expected to be in deficit there would be some weakening of otherwise strong fundamentals. Also, it has been seen that the RBI has been active in the market and has bought up dollars to ensure that the rupee tends to depreciate rather than appreciate. In April and May the RBI bought around $ 10 bn in the market The dovish monetary policy stance has also made the rupee weaken and the movement to the Rs 74-76 range can be attributed to this factor. We believe that combined with the fact that the dollar would be a bit volatile which has been revealed in the movements of the dollar index (DXY).

We can expect this range to prevail, and a lot would depend on how the RBI reacts at different points of time.



Source: RBI and CARE Ratings



Source: RBI and CARE Ratings

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