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Economic and Sectoral Outlook

Quarterly Report

August 2022

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Outlook Guide

Positive (+)   Negative (-)   Stable (=)

FY23: The Year of Cautious Optimism

Mehul Pandya,
MD & CEO

It would not be a stretch to say that the past two years have been turbulent for global economies in ways many would not have imagined. From the pandemic to the Russia-Ukraine war, these unforeseen and unpleasant events have had to far-reaching consequences in the form of slowing growth, high commodity prices, rising interest rates a n d volatile financial markets. T h o u g h the Indian economy has waded through these challenges rather well with policy support from the government and the Central Bank, there is no denying that the uncertain global environment is posing a strong headwind to domestic growth through various channels.

The silver lining is that there is a gradual improvement in domestic demand indicators and some easing of inflation is showing. It is only pertinent though that the consumer sentiment recovers going forward to ensure a sustained rise in consumption demand. In FY22, despite the global and domestic turbulence, India Inc managed to record healthy growth in sales and profits, but FY23 has further challenges in store. A jump in total expenditure due to high raw material and employee costs is a pain point already, and the slowing global growth, a depreciating rupee and rising interest rates could create further roadblocks.

If we look at sector-wise performance, infrastructure divisions such as roads and construction will benefit from the continued high government spending, while the renewable power sector continues to have a favourable outlook supported by consistent private investments and government push. The manufacturers of key metals such as steel and aluminium will benefit from the increased demand, even after considering the recent price fall in metal prices. Notwithstanding the global slowdown, Indian exporters in pharmaceuticals, textiles, and chemicals are expected to continue to benefit from the increased demand backed by China plus one strategy. Consumption demand and discretionary spending are making a gradual recovery, which augurs well for the consumption-oriented sectors.

The central government has taken consistent efforts to control inflation and support domestic fundamentals through an export tax on steel, excise duty cut on petrol and diesel, a windfall tax on oil and gas exports and other measures. While part of these measures will support demand, they will also have an impact on the profitability of these key sectors.

With deleveraging by corporates in the last few years and improving capacity utilisation levels, the backdrop is set for the private investment cycle to pick up. However, the current economic uncertainties, high commodity prices and rising interest rates are a dampener for investor sentiments. Overall bank credit is recording a strong recovery, mainly led by the retail and services sector. For large enterprises, the bank credit demand is still muted. The debt issuances in the Corporate Debt market have also been muted in the last few months.

CARE Ratings clocked a decadal high Credit Ratio (ratio of upgrades to downgrades) of 2.64 in H2FY22, after facing pandemic-led disruptions in the earlier two years. The uptrend was contributed by upgrades in both, the Infrastructure and Manufacturing/Services sectors. The Credit Ratio for the BFSI segment moved above unity for the first time since the NBFC crisis. The credit quality of CARE Ratings' rated portfolio witnessed a marked improvement in H2FY22 on the back of deleveraging efforts by corporates, better operational performance indicators, government push by way of schemes like Atmanirbhar Bharat and Emergency Credit lines, impact of China + 1 strategy, pentup demand, lower cost of capital and better realisations. The leverage indicators for India Inc. are currently at comfortable levels and we expect this to be maintained going forward. However, the credit ratio is expected to moderate in FY23 from the highs witnessed earlier due to moderation in the performance of rated entities.

Overall, we are going through an uncertain and turbulent phase given the challenges emanating from the global front. However, with relatively healthy domestic fundamentals, we remain cautiously optimistic about the Indian economy and the performance of India Inc.

Rajani Sinha,
Chief Economist

Navigating through Myriad Challenges

Still reeling under the pandemic's stress, the global supply chain has suffered another jolt in the form of the Russia-Ukraine crisis, thereby resulting in an environment of high inflation and slowing growth. And even as economic recovery falters, Central Banks are left with no choice but to hike the policy interest rate to counter the spike in inflation.

This tightening of liquidity globally and heightened risk aversion have resulted in volatility in financial markets across the globe and most asset classes. The US dollar has continued to strengthen in response to aggressive rate hike expectations from the US Federal Reserve. The consequent weakening of other currencies has severe repercussions, specifically for economies with high external debt. Given the rise in commodity prices and strengthening of the US dollar, the net importing countries are feeling the pinch of imported inflation and widening of their current account deficit. Emerging economies are also seeing strong FPI outflows as investor sentiment turns risk averse. Global commodity prices have eased in the last couple of months, providing some reprieve. However, it is difficult to say if this trend reversal will be sustained.

Indian economy, however, is relatively better placed, with the economic indicators showing an improvement, albeit at a slow pace. This is not to deny that consumption growth in the economy is still weak, and the manufacturing sector is still recording a slow improvement. On the investment front, the government's strong capital expenditure plan as budgeted will provide a boost to growth. The private sector is showing some increase in the intent of investment, with increasing capacity utilisation levels. However, slowing global growth, high commodity prices and rising interest rates are a dampener for investor sentiments.

Inflation is a cause of concern for the Indian economy too, though the spike in inflation in India is not as sharp as being witnessed in many of the developed economies. Supported by the recent easing of global commodity prices and with all the measures taken by the government and Central Bank in the last few months, CPI inflation in India appears to have broadly peaked. In its fight against inflation, RBI has already hiked the policy interest rate by 90 bps and the hiking cycle is likely to continue given the aggressive rate hikes expected from the Federal Reserve. We expect another 100 bps rate hike taking the terminal repo rate to 5.90% by the end of the fiscal year.

With global growth slowing, the Indian economy will feel the pinch in terms of slowing merchandise and service sector exports and lower investment. With a weak external environment, our current account deficit is expected to widen to around 3.1% of GDP and the Balance of Payment is likely to slip into the negative territory. While we have enough forex reserves (around 10 months of import cover), the Central Bank would be cautious given the risk of sharp depletion in forex reserves going forward. On the fiscal deficit front, the situation does not look too bad, as the additional expenditure in the form of subsidies, will be countered by additional tax revenue collections. This should help in keeping the fiscal deficit broadly around the budgeted target.

Overall, the Indian economy is going through a precarious phase. Just when the economy was getting back to its feet from the Covid pandemic, it has been hit by the global turmoil. Given the strong linkages with the global economy, the Indian economy cannot remain unscathed from global developments. However, the positive aspect is that the macro fundamentals of the domestic economy are relatively better. The corporate sector balance sheet is healthy, and the banking sector is also on a better footing. Hence, a sustained improvement in household demand should support the Indian economy in wading through the current challenges.

Global Economic Scenario

Global Economy in a Turbulence

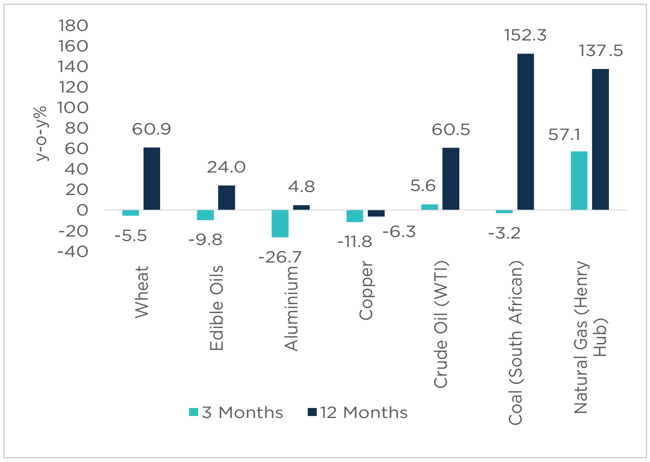
The global economy is going through a turmoil. Slowing growth, high inflation, tightening of global liquidity and financial market volatility have cast a dark shadow on global economic recovery. The Russia-Ukraine war has severely disrupted the global supply channels, resulting in a shooting up of commodity prices. While many commodity prices have eased in the last two months, inflation is still soaring in developed and emerging economies. In the US and EU, the CPI inflation has been hovering at 8-9%, while for many emerging economies inflation is in double digits.

Global growth is slowing down, with increased fear of recession. IMF in its July 2022 outlook had revised the global GDP growth projection lower by 0.4 percentage points to 3.2% for 2022. Despite growth slowing, most Central Banks globally are in a monetary tightening phase to control the inflationary risk. As anticipated, there is heightened volatility in the financial markets as the US Federal Reserve continues with its aggressive rate hiking cycle. Emerging economies are feeling the pinch in the form of strong capital outflows. The dollar index has strengthened to a 20-year high, resulting in a strong weakening of other currencies. Rising US dollar and commodity prices are an anomaly and are causing extreme pain to net importing countries, in the form of widening trade deficit and high inflation.

High inflation, low growth, sharp currency weakening, and high external debt have resulted in Sri Lanka defaulting on its external debt. The big risk is that some other economies could meet a similar fate as the global macro-environment remains unfavourable.

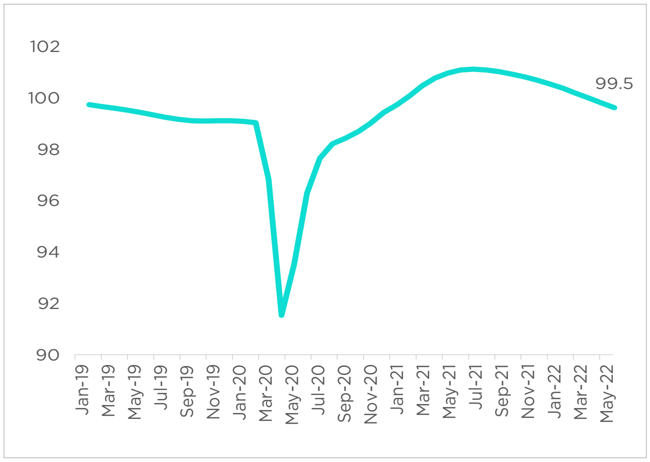
In this turbulent and uncertain global economic environment, the joker in the pack is Crude oil prices. With the supply bottlenecks continuing and global growth slowing, it is difficult to predict the trajectory of global crude oil prices. However, in the current volatile environment, Brent Crude oil is likely to hover in the range of USD 100-110/bbl. Going forward, the global economy needs to brace up for a phase of low growth, high inflation, monetary tightening and financial market volatility in the near term. The recent slowdown in some of the commodity prices will provide a big reprieve if sustained.

Movement in Select Commodity Prices



Source: CEIC; Note: Data as on June 2022

OECD CLI - Signalling Economic Slowdown



Source: OECD; CLI: Composite Leading Indicator

GDP

Government Investments to Stimulate India's GDP Growth

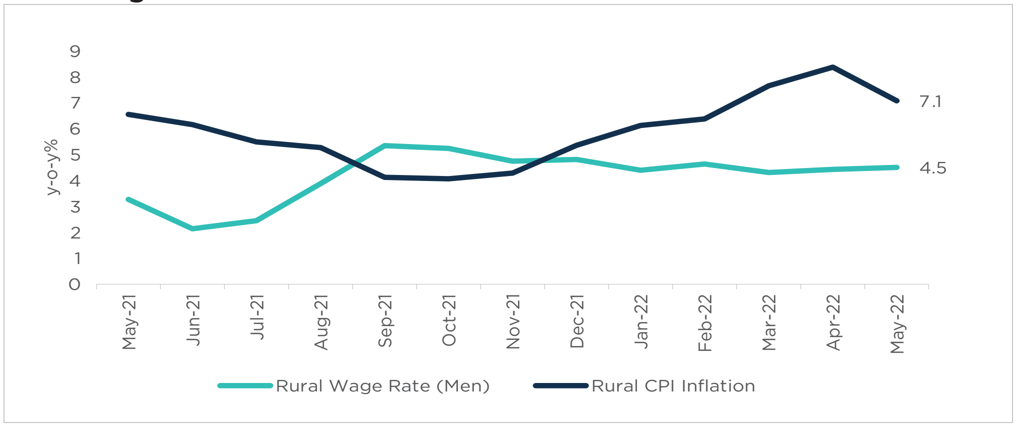
Indian economy rebounded from the pandemic-led contraction of FY21 and witnessed a 22-year high GDP growth of 8.7% in FY22. The growth was exaggerated by a low base as a pre-pandemic comparison showed that the economy grew only marginally (1.5%) in FY22. Though fresh challenges emerged in the last quarter of FY22 due to heightened geopolitical tensions in the form of the Russia-Ukraine war, FY23 started on a good note on account of improved levels of economic activity. Various high-frequency economic indicators such as GST collections, E-way bill registrations, credit growth and power consumption have performed well during the first three months of FY23.

Economic growth in FY23 is likely to be steered by improved investment prospects. All-time high budget allocation of Rs 7.5 lakh crore to capital expenditure is expected to drive economic revival by crowding-in private sector investments. The private investment cycle is likely to gain momentum with improvement in capacity utilisation levels. RBI survey showed that the capacity utilisation level rose 74.5% in Q4 FY22, the highest in the last 12 quarters. Some of the other indicators like imports of capital goods and credit to the industry have also been growing persistently. Some of the credit growth to industries could be because of the higher working capital requirement, but it is also a reflection of improved investment demand. In a positive development, the share of the private sector's proposal for new investments jumped to nearly 91% in Q1 FY23, up from 78% during the previous quarter (CMIE data). Policy thrust from the government in the form of investment-oriented schemes (PLI, PM Gati Shakti, NIP etc.) will provide much-needed impetus to growth with a multiplier effect across the sectors. However, the current uncertain economic and financial environment could weigh on private investors' sentiment.

Consumption demand, which has the largest share in Gross Domestic Product, has shown muted improvement. The output of consumer durables, as well as non-durable, continue to remain weak as inflationary pressures have dampened demand. However, all is not bad. Indicators such as vehicle registrations, reflective of discretionary consumption, for both passenger vehicles and two-wheelers, have witnessed a robust growth (more than 60%) in Q1 FY23 compared with the first quarter of last fiscal.

While urban demand has been recovering gradually on account of pent-up demand, rural demand is yet to pick up the pace. Although the rural wage growth has been steady in the past few months, CPI-based rural inflation has accelerated, resulting in an erosion of household purchasing power. Hopefully, robust Kharif output coupled with higher MSPs for Kharif crops will support the rural demand in the coming months. The recent easing of global commodity prices (including fuel and fertiliser) will also help lower input prices for the agriculture sector.

Rural Wage vs. Rural Inflation



Source: CEIC

Fears of global growth slowdown and easing commodity prices could hamper India's export outlook. Many international agencies have revised the global GDP growth for FY23 downwards amid aggressive monetary tightening by major central banks. Apart from Merchandise exports, services sector export, specifically IT services export, will also feel the pinch of slowing global growth.

Services Sector to Drive Growth

The agriculture sector is expected to exhibit steady growth in FY23 on the assumption of a normal monsoon. Rainfall has gathered pace in July supporting the sowing of crops like pulses, oilseeds and cotton. However, the sowing of crops like rice and sugarcane is still lagging compared with last year's level due to a shortfall of rains so far in major producing states. As of July 15, overall Kharif sowing is marginally higher (0.1%) compared with the previous year's level and is expected to gain momentum in the coming weeks with the progress of the monsoon.

Heatwaves-led disruptions have impacted crop harvest, especially of wheat, cotton and vegetables. However, a robust Kharif output and higher prices for farm products are expected to make up for the loss. We expect the sector to grow at a steady pace of 3.0% in FY23.

India's manufacturing sector has been reeling under pressure due to high input costs due to which the sector witnessed a contraction in Q4 FY22. If sustained, the recent easing of metals and fuel prices along with improved economic activities could aid the sector's growth in the coming months. However, the revival of consumption demand would remain a crucial factor. Core sector data for industries such as cement and electricity has shown positive trends during the first three months of FY23 supported by improving industrial and commercial activities. Expecting the momentum to continue, we project industrial sector GDP to grow at a pace of 5.4% in FY23.

With relaxation in Covid-19-related restrictions, the services sector bounced back strongly. PMI-Services has been expanding since February and scaled to a record high in June. With improved mobility, passenger and freight traffic (both air and railways) have grown significantly. Foreign tourist arrivals have jumped more than 21 times in May 2022 (compared with year ago level) with receding fears of Covid-19. However, the slowdown in the US economy poses risk for India's IT sector. Against this background, we expect the services sector to register a growth of 8.7% in FY23.

Based on the performance of these three sectors while accounting for the potential domestic and external headwinds, we expect the economy to grow at 7.1% in FY23. The main challenge to India's GDP growth projection would be any further deterioration of the global environment, which will impact India through exports and investment routes.

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Growth Projections

Growth (y-o-y%)	FY19	FY20	FY21	FY22	FY23(F)
Agriculture	2.1	5.5	3.3	3.0	3.0
Industry	5.3	-1.4	-3.3	10.3	5.4
Services	7.2	6.3	-7.8	8.4	8.7
GVA	5.8	3.8	-4.8	8.1	6.8
GDP	6.5	3.7	-6.6	8.7	7.1

Source: MOSPI and CareEdge; F=Forecast

Performance of Select Economic Indicators During Past Six Months (2022)

	Unit	Jan	Feb	Mar	Apr	May	Jun
GST Collections	Rs lakh crore	1.4	1.3	1.4	1.7	1.4	1.4
E - Way Bill	Crore	6.9	6.9	7.8	7.5	7.4	7.4
PMI - M	Unit	54.0	54.9	54.0	54.7	54.6	53.9
PMI - S	Unit	51.5	51.8	53.6	57.9	58.9	59.2
PV Registrations*	Lakh	3.6	3.4	3.9	3.7	3.6	3.7
Two - Wheeler Registration	Lakh	10.2	9.8	11.6	11.9	12.2	11.2
Tractor Sales	Lakh	0.6	0.6	0.8	1.0	0.9	1.1
Air Passenger Traffic	Crore	1.5	1.8	2.4	2.4	2.7	2.5
Railways Passenger Traffic	Crore	34.5	41.4	48.4	45.6	50.1	50.1
Rail Freight Traffic	Ton million	129.0	119.7	139.2	122.2	131.7	125.5
Air Freight Traffic	Ton million	0.2	0.2	0.3	0.3	0.3	0.3
Rail Freight Revenue	y-o-y%	12.5	11.7	11.3	17.6	23.2	21.5
Outstanding Credit - Total	y-o-y%	8.2	7.9	9.6	11.1	12.1	
Power Consumption	y-o-y%	1.1	4.5	5.9	11.5	23.2	16.2
Petroleum Consumption	y-o-y%	2.3	5.4	6.5	9.6	23.7	17.9
Capital Goods Import	y-o-y%	24.6	14.5	18.8	17.1	17.2	18.6
IIP - Manufacturing	Index	139.2	129.9	145.3	131.8	134.5	
IIP - Mining	Index	158.9	152.0	169.5	149.8	153.1	
IIP - Construction	Index	124.9	123.3	144.4	116.2	120.1	
IIP - Consumer Durables	Index	118.5	112.9	129.5	110.9	113.5	
IIP - Consumer Non-Durables	Index	154.4	137.6	149.9	139.2	136.8	
IIP - Capital Goods	Index	94.9	94.5	111.4	89.5	95.3	

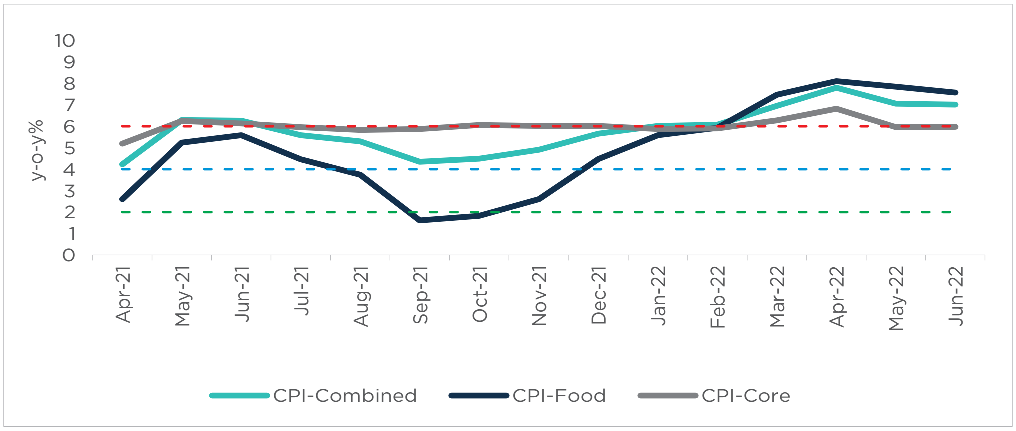
Source: CEIC; *Light and Medium Vehicles

Inflation

Domestic and External Shocks Could Weigh on Inflation Outlook

Inflationary pressures have been hardening since the second half of last fiscal. The heightened geopolitical rift in February and the consequent supply-side bottlenecks further aggravated the inflationary concerns. There has been an unprecedented rise in food and fuel prices due to the Russia-Ukraine conflict since February. As a result, CPI inflation breached RBI's target range for the sixth month in a row in June. High input prices fed into other categories causing the inflation to become broad-based which is visible in hardening core price pressures.

Inflation Trajectory



Source: MOSPI and CareEdge

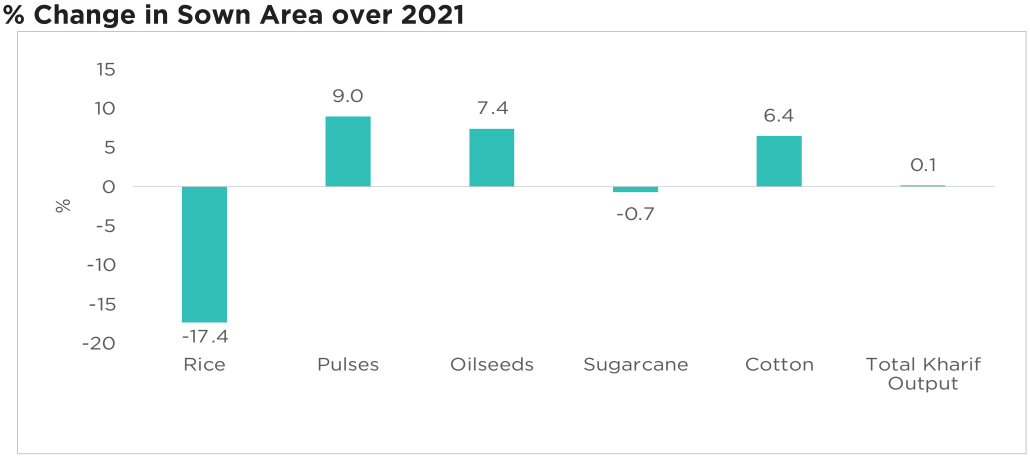
In a bid to cool down inflation, both RBI and the government have been acting proactively and in a coordinated manner. Since May 2022, RBI has increased the policy rate by 90 bps and is expected to remain hawkish in the near term. The Government has also announced multiple measures aimed at easing price pressures for necessity items such as wheat, sugar, cotton, edible oils and fuel.

Government's supply-side measures have helped in slowing the momentum of the price rise. Consequently, some moderation in retail inflation has been witnessed since May 2022. Additionally, global commodity prices have been showing signs of easing on global slowdown fear. However, it remains to be seen if this trend will continue in the coming months amid a volatile economic environment. Therefore, the domestic inflation trajectory remains uncertain as it is contingent on various domestic and external factors.

Domestic Factors: Climate-Related Challenges Pose Upside Risk to Food Inflation
On the domestic front, the heatwave-led disruptions have worsened the outlook for food inflation. Extremely high temperatures during March and April impacted the production of wheat, cotton and vegetables. As a result, the third advance estimate of foodgrains production revised down the wheat output by 4.4%. The combined impact of supply shortages and rising transportation costs have kept vegetable inflation elevated in double-digits. Tomato prices (retail) have also skyrocketed growing by nearly 145% in June on a y-o-y basis while potato prices have also hardened.

The second important factor is the progress of monsoon and Kharif sowing. After a dull start in June, the progress of the monsoon improved in July. As of July 29, rainfall (cumulative) was 9% above normal. Despite the improvement at all India levels, major food-producing states such as Uttar Pradesh and West Bengal have received deficient rains so far. As a result, acreage under rice and sugarcane is lower compared with year-ago period. The progress and distribution of rainfall in the next few weeks will be crucial for the Kharif sowing which has been slow to gather pace.

% Change in Sown Area over 2021



Source: CEIC; Note: Data as on July 15, 2022

We expect food inflation to remain elevated at 7.9% in H1 FY23. Towards the second half of the fiscal, the food price pressures could witness some easing in expectation of a healthy Kharif harvest. Also, easing global agricultural commodity prices, like edible oils, wheat and fertilisers etc. will provide comfort to India's food inflation.

External Factors: Volatile Energy Market and Falling Domestic Currency could Hurt
While the recent easing of commodity prices in international markets is a positive development, with no relief on the war front, the global economic environment remains quite uncertain.

Global crude oil prices softened in July on growth slowdown concerns. However, the oil markets remain highly volatile in the present geopolitical scenario. Further, there is a risk that the depreciating rupee can offset the decline in global oil prices. Additionally, coal prices have been on the rise in international markets raising the input cost for power-producing companies. As a result, many Indian states have raised power tariffs to maintain the margins. High fuel and electricity prices have cascading impact on other categories of inflation as well and could lead to the firming of core price pressures.

Factoring for the domestic and external risks to the inflation outlook, we expect CPI inflation to stay elevated near 7% till September. Consequently, the CPI inflation will remain above RBI's tolerance level for the first three quarters and could ease below the 6% mark only in the fourth quarter of the fiscal. For the full FY23, we expect CPI inflation to average at 6.5%.

Wholesale inflation which has remained in double digits throughout FY22 and has exceeded 15% in the first three months of this fiscal, poses a further upside risk to consumer inflation.

Going ahead, the global commodity prices trend will be the most crucial factor for the projected inflation trajectory. It will be interesting to see if the recent fall in commodity prices will be sustained. With global growth concerns aggravating, the sustained fall in global commodity prices could provide big comfort even on the domestic inflation front.

Inflation Projections

	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23 (F)	Q3 FY23 (F)	Q4 FY23 (F)	FY21	FY22	FY23 (F)
CPI	5.6	5.1	5.0	6.3	7.3	7.1	6.1	5.8	6.2	5.5	6.5

Source: MOSPI and CareEdge; F=Forecast

Central Government Finances

Tax Revenues and Capex Upbeat in Q1 FY23

The central government's fiscal deficit climbed to 21.2% of the Budget estimate during the April- June period of FY23 as against 18.2% in the corresponding period of the previous year. The widening of fiscal deficit is primarily on account of increased expenditure, with revenue expenditure up by 8.8% and capital expenditure notably higher by 57% in April-June compared with the corresponding period of FY22. The government's focus on capital expenditure is encouraging as it is expected to have a multiplier effect on the economy and consequently drive the growth momentum.

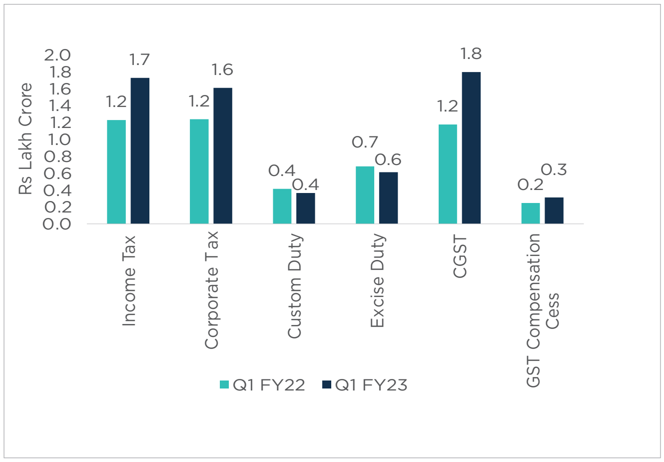
On the revenue front, the net tax collections have increased by 22.6% in the first quarter of the current fiscal, while non-tax revenues have fallen by 51.2% compared to the corresponding period of the previous year. Of the major tax heads, collections have declined for custom and excise duties by 11.8% and 9.8%, respectively, while income tax and central GST collections have logged a growth of 40.7% and 52.7%, respectively. The decline in the non-tax revenue can be ascribed to lower dividend transfer from the RBI to the government, which is at a decadal low of Rs 30,307 crore. Capital receipts recorded a notable jump to Rs 27,982 crore in the April-June period of FY23 compared with Rs 7,402 crore in the comparable period of the previous year. Disinvestment proceeds at Rs 24,559 crore comprised of around 88% share of the total capital receipts during this period.

Central Government Finances Snapshot (Rs Lakh Crore)

	Q1 FY22	Q1 FY23	% Change
Total Receipts	5.5	6.0	8.9
Revenue Receipts	5.4	5.7	5.2
Net Tax Revenue	4.1	5.1	22.6
Non-Tax Revenue	1.3	0.6	-51.2
Capital Receipts	0.1	0.3	278.0
Total Expenditure	8.2	9.5	15.4
Revenue Expenditure	7.1	7.7	8.8
Capital Expenditure	1.1	1.8	57.0
Fiscal Deficit	2.7	3.5	28.3
Revenue Deficit	1.7	2.0	20.4

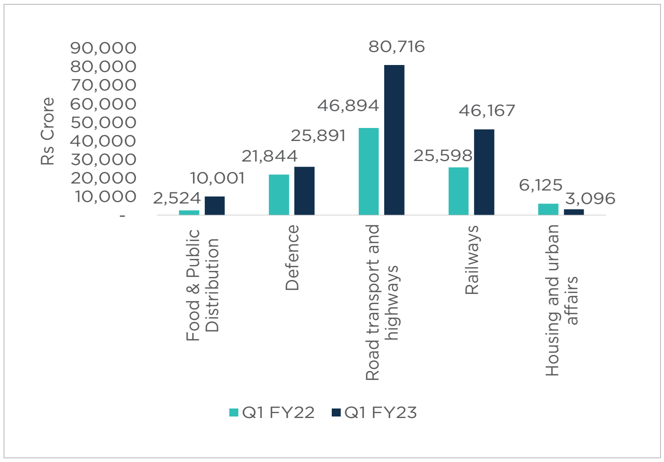
Source: CGA

Major Heads of Tax Revenue



Source: CGA

Major Heads of Capex



Source: CGA

Healthy Revenue Growth to Support Government Finances

Russia's invasion of Ukraine in late February this year worsened the already existing supply-chain disruptions, pushing up global as well as domestic inflation. Against this backdrop, the government announced a slew of measures to restrict the amplifying price pressures in the economy. These measures included a cut in fuel excise duty and waiver of customs duty on raw materials and intermediaries for plastic products and iron and steel with a revenue loss of around Rs 1.15 lakh crore for the current fiscal. However, the continued strong trend in GST collections amid improved levels of economic activity and high inflation has raised expectations of better tax collections in the current fiscal. We expect tax buoyancy in FY23 to be at 1.1 and even after accounting for the revenue loss due to tax cuts announced, we expect the gross tax revenue collections to exceed the budgeted target by Rs 2.4 lakh crore. After accounting for lower transfer from the RBI of Rs 30,307 crore, we estimate net revenue receipts of the Centre to overshoot the budget estimates by around Rs 1.3 lakh crore. Three months into the current fiscal, the government has already garnered disinvestment proceeds of Rs 24,559 crore which is 38% of the total budgeted amount for FY23. The government has also announced a stake sale in Hindustan Zinc Limited, which will enable further disinvestment receipt of Rs 38,000 crore, bringing the total disinvestment very close to the budgeted target of Rs 65,000 crore. Hence, we believe there are chances of the government exceeding the budgeted target of disinvestment in FY23. On the expenditure front, we expect the government to overshoot its budgeted expenditure amount by around Rs 2.4 lakh crore on account of the extension of the food subsidy program up to September 2022, the announcement of the LPG subsidy and increased allocation towards the fertiliser subsidy.

The fiscal deficit in FY23 has been pegged at 6.4% of the GDP on the assumption of an 11.1% growth in the nominal GDP. We expect the nominal GDP growth to be higher at 13.5%. Factoring in the possibility of additional expenditure being partially compensated by better revenue realisations the fiscal deficit would have still slipped to 6.5-6.6% of the GDP. However, the additional revenue from the recent announcements of a windfall tax on domestic crude, tax on the export of diesel, aviation turbine fuel (ATF) and a hike in gold import duty is likely to help contain the fiscal deficit at the budgeted 6.4% of GDP.

Balance of Payments

Current Account Deficit at a 3-Year High in FY22

In FY22, the current account deficit (CAD) widened to 1.2% of GDP as against a surplus of 0.9% in the previous year. The widening of CAD was driven by an expansion in the merchandise trade deficit which jumped by 85% to USD 189.5 billion, the highest since FY14. This rise in the trade deficit was partially offset by a higher surplus on the invisible account, restricting the rise in the CAD. The capital account was supported by healthy FDI inflows and strong loans growth, even while there were high FII outflows. Overall, the economy recorded a BoP surplus of USD 48 billion in FY22.

Balance of Payments (USD Billion)

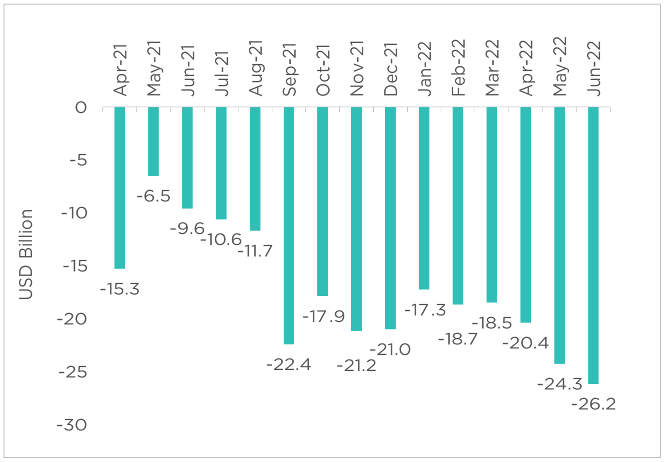
	FY19	FY20	FY21	FY22	FY23 (F)
Current Account	**-57.3**	**-24.7**	**23.9**	**-38.8**	**-113**
CAD as % of GDP	**-2.1**	**-0.9**	**0.9**	**-1.2**	**-3.1**
Trade Balance	-180.3	-157.5	-102.2	-189.5	-270
Trade Balance as % of GDP	-6.7	-5.6	-3.8	-6.0	-7.4
Invisibles	123.0	132.8	126.1	150.7	157
Capital Account	**54.4**	**83.2**	**63.7**	**85.8**	**45**
Foreign Investment	30.1	44.4	80.1	21.8	23
-FDI	30.7	43.0	44.0	38.6	41
-FII	-0.6	1.4	36.1	-16.8	-18
Loans	15.9	25.7	6.9	33.6	10
Banking Capital	7.4	-5.3	-21.1	6.7	8
Others	1.0	18.4	-2.2	23.7	5
Overall Balance (BoP)	**-3.3**	**59.5**	**87.3**	**47.5**	**-68**

Source: CMIE & CareEdge; Note: (-) Deficit / (+) Surplus; F=Forecast

Weakening Exports And Strong Imports To Widen CAD

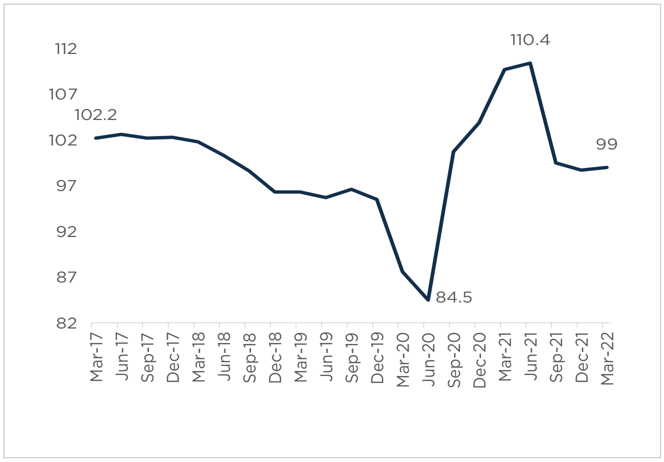
India's merchandise trade deficit has been widening in recent months as growth in imports has outpaced the momentum in exports. Global inflationary pressures, monetary tightening by central banks and heightened concerns around recession in major economies are expected to darken the global trade outlook. The WTO World Goods Trade barometer, a reflector of global trade, has slowed to 99 in March 2022 from a high of 110.4 touched in June 2021. India's merchandise exports will feel the pinch of slowing global growth in FY23. The services sector export, including the IT sector, will also feel the pinch of likely slowdown in the US and other major economies. The import momentum is expected to continue fuelled by a rebound in domestic economic activity and high commodity prices. While there has been a fall in commodity prices in the last month or so, many of the commodity prices are still high. The Bloomberg Commodity Price Index had climbed to an eight-year high in early June of 2022. Despite a moderation of around 11% from this year's peak, the index continues to remain higher by around 22% on a year-to-date basis. We expect the trade deficit to rise to USD 270 billion (7.4% of GDP) in FY23 and the current account deficit to widen to USD 113 billion (3.1% of the GDP) in FY23.

Trend in Merchandise Trade Deficit



Source: CEIC

WTO World Goods Trade Barometer

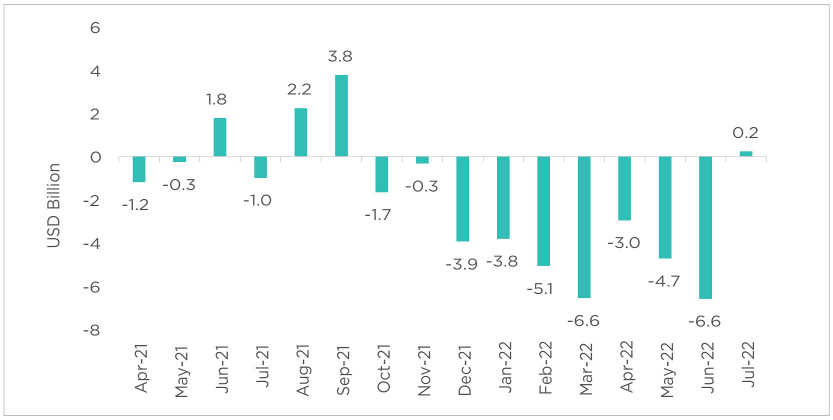


Source: CEIC

Capital Outflows Expected

In FY22, net FPI outflows from India totalled USD 16 billion. The global risk-off sentiment has accelerated the pace of FPI outflows from India as investors have turned cautious on emerging markets including India. Four months into the current financial year, portfolio investors have pulled out USD 14 billion. As far as the more durable FDI is concerned, we expect the trend of healthy inflows to continue in FY23. Capital inflows through the ECB route are expected to reduce given the rising global interest rates, depreciating bias on the rupee and heightened economic uncertainty. We expect net capital inflows to moderate to USD 45 billion in FY23.

Trends in Foreign Portfolio Investments



Source: CEIC; Note: Data up to July 29, 2022

Balance of Payment Expected to Turn Negative in FY23

The sharp rise in the current account deficit coupled with a moderation in the capital inflows would translate into the BoP moving into negative territory in FY23. We estimate, the BoP at a deficit of USD 68 billion in FY23. The worsening BoP scenario would result in a drawdown in the forex reserves currently at a comfortable level of USD 573 billion and add to the woes of the rupee which is already facing a weakening bias.

Exchange Rate

Rupee Weakens

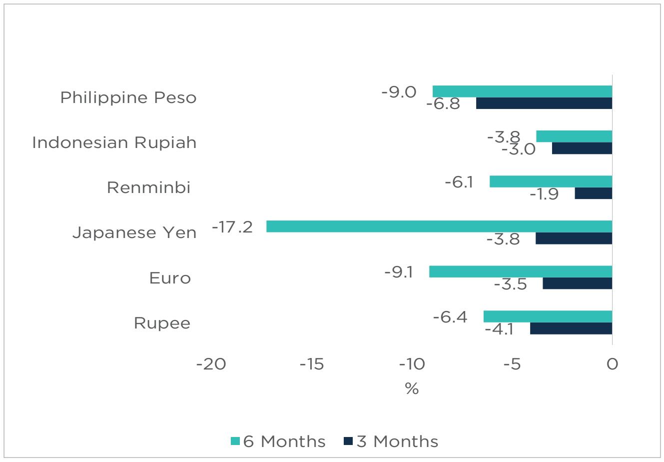
The US Federal Reserve's rate-hiking spree has bolstered the dollar index by 11.2% this year, taking it to a 20-year high. This has resulted in weakness in other currencies including the Indian rupee. In the last six months, the Indian currency has weakened by around 6.4% in line with weakness in other emerging market currencies. In the same period, other currencies like the Indonesian Rupiah (IDR) weakened by 3.8%, Philippine Peso (PHP) by 9%, and the Chinese Renminbi (RMB) by 6.1%. Other major currencies such as Euro have weakened by 9.1%, while Yen has weakened by a sharp 17.2%. As per the latest Fed's dot plot, the Fed fund rate is likely to rise to 3.4% by the end of 2022. While the US economy is showing signs of weakness, the Fed so far has maintained its hawkish stance, in a bid to control inflation. In such a scenario, the dollar index is likely to remain strong, implying that there will continue to be weakening pressure on other emerging market currencies including the Indian rupee.

The domestic parameters have also turned unfavourable for the Indian rupee, with the widening of trade deficit and FII outflows. The Indian economy has seen FII outflows of USD 29 billion since January this year. With crude oil prices remaining high, we expect India's Current Account Deficit to widen to 3.1% of GDP and expect the Balance of Payments to move to negative territory in FY23. India's forex reserves have fallen by USD 61 billion since January. But at the current level of forex reserves of USD 573 billion, we have an import cover of around 10 months. RBI has been intervening in the spot and forward market to contain a sharp weakening of INR.

RBI has also announced an easing of norms for FPI investment in the debt market, ECB borrowings and NRE deposits in a bid to improve capital flows into the economy. RBI's move of facilitating international trade in the rupee is also a bid to support INR at the current juncture while moving towards the internationalisation of the rupee.

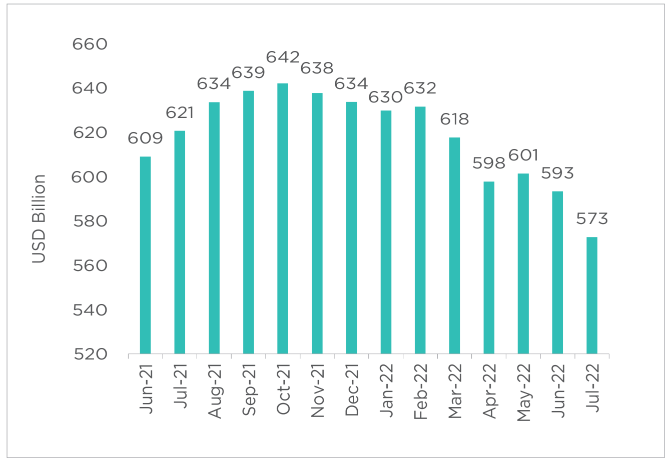
We feel that the weakening pressure on INR will continue as the dollar index continues to strengthen. With all other emerging market currencies weakening, RBI will allow the Indian currency to weaken gradually. However, with RBI also likely to continue with its rate hiking cycle, INR is unlikely to weaken sharply from the current levels. We expect USD/ INR to move in the range of 79-82 levels in the next three months.

Weakness of Other Currencies vis-à-vis USD



Source: CEIC

Falling Forex Reserves



Source: CEIC; Note: Data up to July 15, 2022

Interest Rates

Expectation of Further Rate Hikes

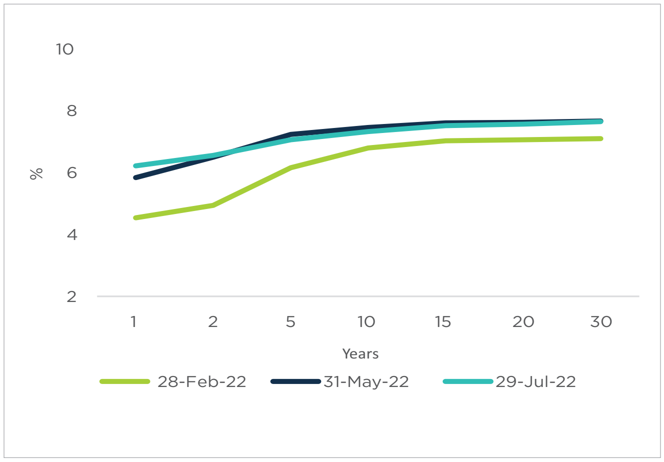
With CPI inflation above RBI's comfort zone, the Central Bank has hiked the repo rate by 90 bps in the last two months. While CPI inflation is still around 7%, the easing of many of the global commodity prices has come as a big relief. The government has also announced several measures in the form of a cut in excise duty on petrol/ diesel and other import duty cuts and export duty hikes to contain the inflationary pressure on the economy. While inflation appears to have broadly peaked at the current levels, we expect it to fall below 6% only by the fourth quarter of FY23.

With US Federal Reserve expected to continue hiking interest rates, we feel that the RBI will also continue with its rate hiking cycle. The hike in the repo rate is warranted not just for controlling inflation but also to contain further sharp weakening of the Indian currency. With growth recovering, the Central Bank would like to move towards a positive real rate of interest by the end of the fiscal year. We expect the Central Bank to hike the policy interest rate by another 100 bps taking the terminal repo rate to 5.90% in the current fiscal year. CPI inflation seems to have peaked at the current levels and the easing of global commodity prices is providing further comfort. Hence, the Central Bank is unlikely to go for steeper rate hikes.

Liquidity in the system has reduced with the outstanding liquidity surplus in the banking system reducing to Rs 0.8 lakh crore by July from a high of Rs 6.2 lakh crore in end-January. This has resulted in steepening of the yield curve, with the 10-1 year G-Sec spread reducing to 1.10 percentage points (pp) in end-July 2022 from 2.18 pp at end-January. With forex inflows reducing and with credit offtake picking up, the liquidity in the system is likely to reduce further, which will keep the yield curve steep. This will also enable better transmission of the policy rate hikes by the Central Bank. While further rate hikes by RBI, will put upward pressure on G-Sec yields the impact will be to some extent mitigated by any further lowering of global commodity prices. We expect 10-year G-Sec yield to rise to 7.50-7.75% by the end of the current fiscal year.

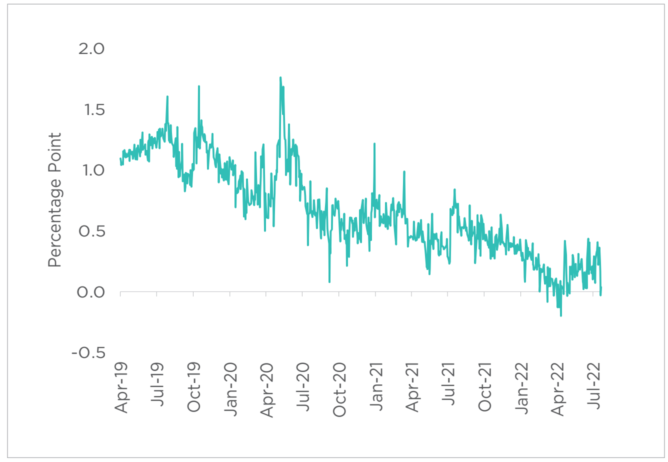
In the last year, we saw the corporate bond spread reducing on low corporate bond issuances. In FY22, corporate bond issuances fell by 24% compared to the previous year. However, we feel the corporate bond issuances are likely to improve in FY23 on the back of some pick-up in investment demand. The rise in bank lending rates should also result in some credit demand moving to the corporate bond market, going forward. This should result in higher corporate bond yields and widening of corporate to G-Sec bond spread.

G-Sec Yield Curve



Source: FBIL

Corporate Bond Spread: 10 Year AAA Rated



Source: FIMMDA

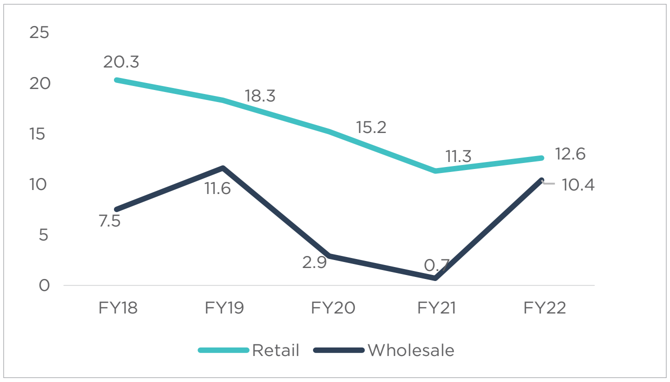
Banking

Outlook - Stable

Credit Growth Momentum to Sustain

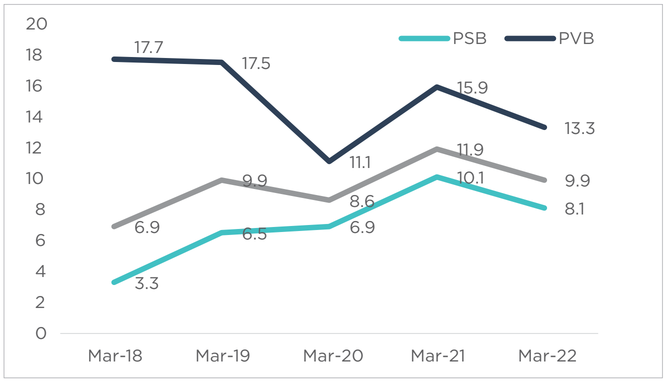
India has a relatively lower level of credit to GDP ratio when compared to other countries and to improve the same, access to credit and the cost of credit need to be addressed. In India, the credit market is dominated by the banking sector with the bond market still in a developing phase. Consequently, the banking sector's health is a priority area as it plays a key role in financial intermediation in the economy. Bank credit growth has generally been closely linked to the pace of economic growth. Credit growth was muted pre-Covid, reflective of macro adjustments such as NPA clean up, and risk aversion in lending, while Covid-19-led lockdowns impacted credit growth during FY21.

Movement in Bank Credit Growth (%)



Source: RBI; CMIE; CareEdge Calculations

Deposit Growth (%)



Source: RBI

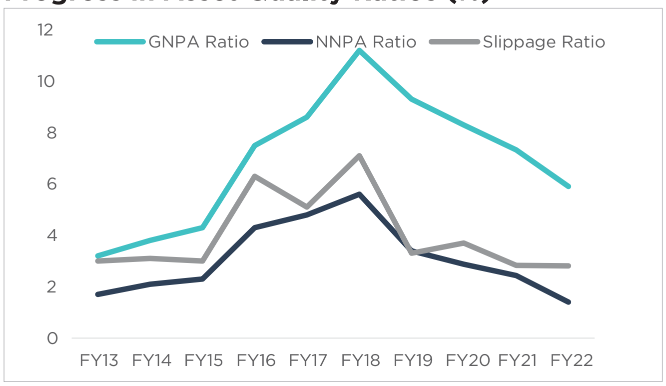
In FY22, the gross banking credit growth registered a y-o-y increase to reach 9.6% in March 2022 due to a pick-up in business activities, comparatively lower interest rates, credit push by the banks at the close of the fiscal year and the low-base effect. Apart from retail, the major driver of this growth has been the MSME segment (which resulted in wholesale credit reporting double-digit growth after witnessing a significant slowdown last year).

SCB deposit growth slowed to 9.9% in March 2022 compared with 11.9% in March 2021. Deposit growth in PSBs and PVBs was outpaced by their credit growth as credit grew by 9.2% for PSBs and 15% for PVBs. PVBs generally outpaced their public counterparts. Incremental credit growth is likely to outpace incremental deposit growth.

After a modest credit growth in recent years, outlook for bank credit offtake is positive due to economic expansion tracking nominal GDP growth, rise in government & private capital expenditure, commodity prices, implementation of PLI scheme, extension of ECLGS for MSME and retail credit push. The retail segment is expected to do well as compared with industry and service segments. The medium-term prospects look promising with diminished corporate stress and a substantial buffer for provisions. CareEdge estimates the credit growth to be in the range of 12% - 13% during FY23, however, high inflation and rate hikes could adversely impact credit growth.

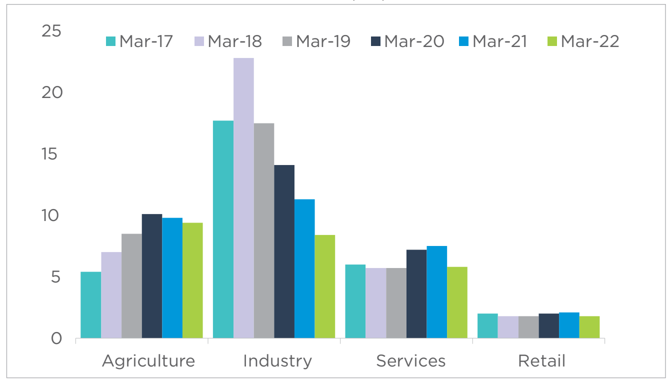
Asset Quality to Continue Witnessing Improving Trend

Progress in Asset Quality Ratios (%)



Source: RBI, CMIE; CareEdge Calculations

Sector-wise GNPA Ratio (%)



Source: RBI

Post the asset quality review (AQR) in 2015-2016, banks saw a spike in GNPAs from 3.8% in FY14 to 11.2% in FY18 (and NNPAs from 2.1% in FY14 to 5.6% in FY18) due to weakness in wholesale advances which required banks to make a significant amount of provisioning and write-offs over the next four to five years. The GNPA ratio had been on a downward trajectory since Mar-19, which continued even during the pandemic period, led by increasing deleveraging and regulatory intervention. Asset quality has also seen some improvement (GNPA reduction) due to recoveries and write-offs, OTR schemes, etc. In FY22, the GNPA ratio fell to 5.9%, a six-year low, however, continued to remain above the pre-AQR levels. The slippage ratio and write-offs declined across bank groups in FY22 indicating older NPAs had already been written off and lower accretion of fresh NPAs.

Driven by moderation in slippages, healthy PCR resulting in lower credit costs, higher bank credit growth, and a declining trend in the stock of GNPAs and the proposed transfer of larger accounts are to NARCL and other ARCs in this financial year, the SCB GNPA ratio could improve from 5.9% in FY22 to 5.0%-5.2% by FY23 end. The possibility of increased slippages arising from sectors that were relatively more exposed to the pandemic continues as support measures are unwound along with rising interest rates. The performance of restructured accounts continues to be monitorable in the current fiscal.

Profitability to Remain Robust

Net Interest Margin (NIM) of SCBs increased marginally in FY22 and stood at 3.4%. PVBs recorded higher NIMs compared to PSBs due to relatively higher growth in retail loans, improvement in asset quality, and a low base. Earnings are expected to remain robust as most banks have maintained a positive outlook on margins for FY23. The Return on Assets (RoA) further improved during FY22, especially in the second half of the year. The RoA of PSBs stood at 0.5%, roughly one-third of the RoA reported by PVBs at 1.4% for FY22. The RoA of SCBs overall stood at 0.9% for the same period.

Adequately Capitalised

The capital to risk-weighted assets ratio (CRAR) of SCBs edged up to 16.7% in March 2022 from 16.0% in March 2021; PVBs recorded a 40bps rise, while PSBs recorded an 80bps increase due to capital raising and earnings retention by banks. GoI has been infusing capital into public sector banks to shore up their net worth. Further, at the beginning of the pandemic, most banks had raised significant amount of capital to deal with any unforeseen shocks, hence, the system remains adequately capitalised.

Outlook

After a modest credit growth in recent years, the outlook for bank credit offtake is positive due to the economic expansion tracking nominal GDP growth, rise in government & private capital expenditure, rising commodity prices, implementation of the PLI scheme, the extension of ECLGS for MSME and retail credit push. The medium-term prospects look promising with diminished corporate stress and a substantial buffer for provisions. Hence, CareEdge estimates the credit growth to be in the range of 12%-13% during FY23, however, high inflation and rate hikes could adversely impact credit growth. Lower treasury income and higher operating expenses could impact the PPOP margins. Further, driven by moderation in slippages, healthy PCR resulting in lower credit costs, higher bank credit growth, a declining trend in the stock of GNPAs and the proposed transfer of larger accounts to NARCL and other ARCs in this financial year, the SCB GNPA ratio could improve from 5.9% in FY22 to 5.0%-5.2% by the end of FY23. At these levels, GNPA figures would be closer to pre-asset quality review levels of around 4%. On the other hand, the possibility of increased slippages arising from sectors that were relatively more exposed to the pandemic continues as support measures are unwound along with rising interest rates. The performance of restructured accounts continues to be monitorable in the current fiscal.

Automobiles

Outlook - Stable =

Gradual Recovery in Progress

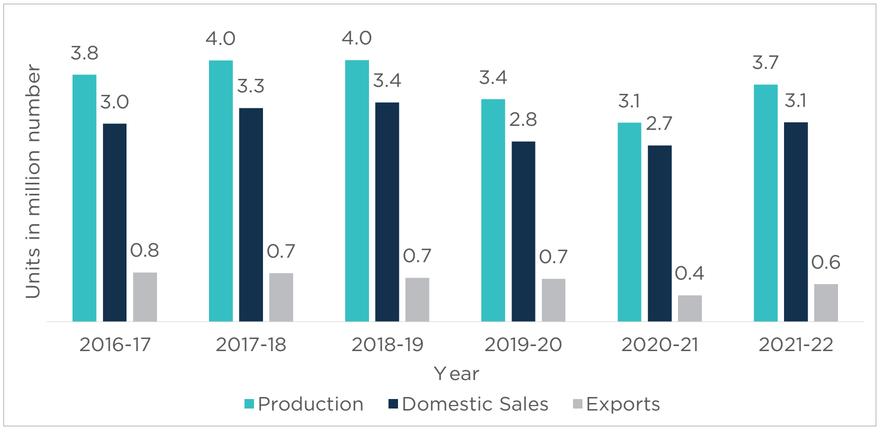
Accounting for nearly 15% of the Indian automobile industry sales, the passenger vehicle segment is grouped into three categories – passenger cars, vans, and utility vehicles, while two-wheelers, comprising motorcycles, scooters, and mopeds, constitute 81% of total domestic automobile sales. The three-wheelers industry comprises two segments – goods carriers and passenger carriers. The growth of the tractors industry hinges upon the growth of the rural economy and farming given its linkages with the agrarian economy.

Passenger Vehicles

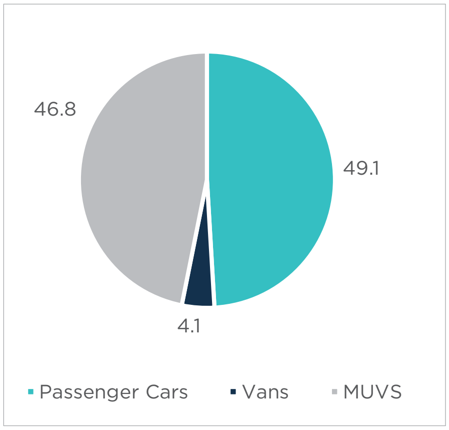
Passenger vehicles (PVs) as a segment showed improvement in domestic sales with a growth of 13.2% on a y-o-y basis for FY22. This post-pandemic demand was driven by a low base of FY21, the year that witnessed disruption amid the global Covid-19 pandemic, which led to a strong preference towards personal mobility and hence, passenger vehicles. In addition to that, new launches by various OEMs aided the growth in this segment. The utility vehicle (UV) subsegment (within the PV segment) witnessed significant growth reflecting the changing preference toward UVs which now constitute almost half of the total PV domestic sales. The UV preference has been supported by technological advancements, the inclusion of safety features, innovative designs and higher flexibility offered in this sub-segment by OEMs. Further, this changing consumer preference has also led to long waiting periods for most models in the UV sub-segment across OEMs - leading to the creation of a strong demand pipeline for PVs overall and UVs in particular.

Exports in FY22 grew 43% compared to FY21 on the back of strong demand from Latin American countries. Additionally, the demand from the US and other countries such as Chile & Peru also remained steady. The passenger cars segment contributed the highest to the domestic PV sales at 49.1% in FY22, followed by Utility Vehicles (UVs) at 46.8% and vans at 4.1%. The increasing consumer preference for the premium car segment primarily led to the growth in the utility vehicle segment.

Production, Sales & Exports of PV Industry



FY22 Market Share (%)



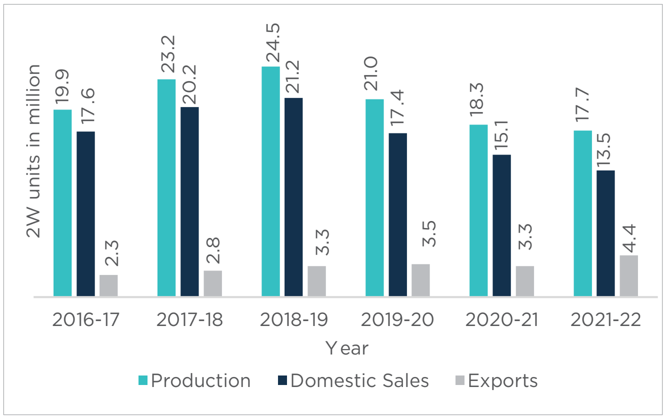
Source: SIAM; CMIE

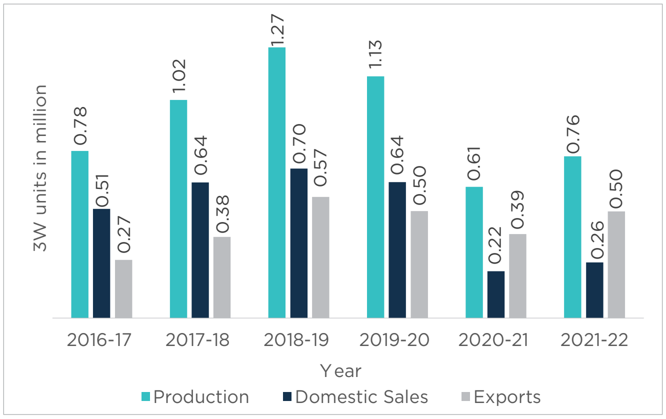
Two-Wheelers & Three-Wheelers

With the largest chunk of the automobile pie, the two-wheeler industry witnessed a decline of 10.9% in domestic sales in FY22. Subdued domestic demand, both in rural as well as in urban markets amidst higher fuel prices, a steep increase in vehicle rates, and low commuting as corporates continued to allow work from home to employees impacted the sales during the year. However, exports saved the day with 35.3% growth in FY22. This can be attributed to the steady demand from the African nations. The constant demand from international markets could be a major factor for growth in the two- wheeler industry. The contribution of motorcycles stood at 67% followed by scooters and mopeds with 30% and 4%, respectively in FY22.

The three-wheelers segment domestic sales grew by 19% in FY22. Improved intra-city commute as educational institutions and offices opened up led to the overall growth of 19% in three-wheeler domestic sales. An increase in the transportation of goods to rural and semi-urban areas also helped. Improved demand from new international markets ensured the export growth of 27% in FY22 over FY21. The contribution of goods carriers and passenger carrier stood at 70% and 30%, respectively, in FY22.

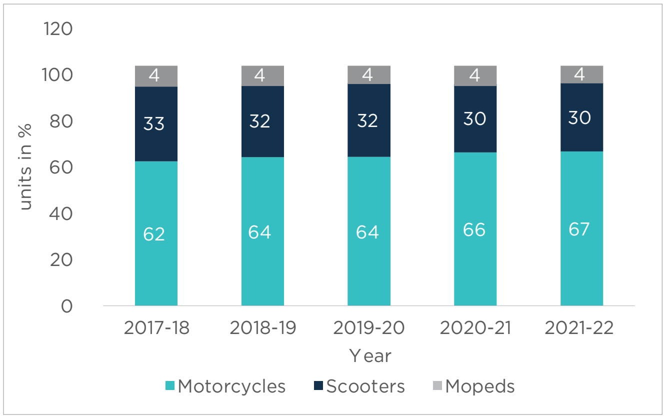
Production, Sales & Exports of Two-wheeler and Three-wheeler Industry

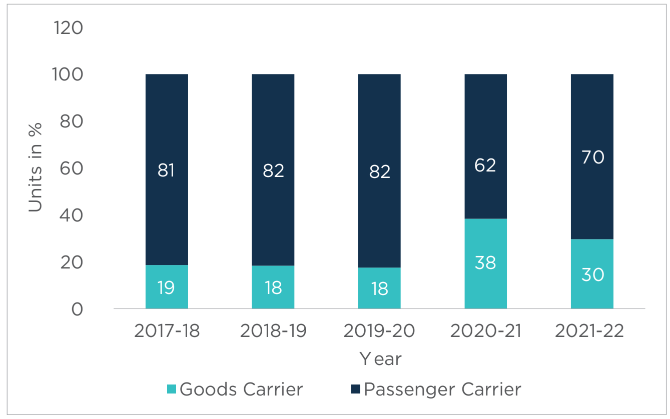




Source: SIAM; CMIE

Segment-wise Market Share of 2W and 3W Industry





Source: SIAM; CMIE

Tractors

The domestic tractor sales in India declined by 6.3% during FY22 due to a high base effect and increased inflation. However, the exports market showed strong momentum in sales with a growth of 45.1%, led by increasing demand for tractors in the international markets during FY22.

Production, Domestic Sales and Exports of Tractors

Year	Production (in units)	Domestic Sales (in units)	Domestic Sales YoY Growth (%)	Exports (in units)	Exports YoY Growth (%)
FY17	691,361	661,195	15.7	78,351	1.1
FY18	790,673	796,873	20.5	85,395	8.9
FY19	898,052	780,032	-2.1	92,233	8.0
FY20	777,752	705,011	-9.6	76,054	-17.5
FY21	965,231	899,407	27.5	88,621	16.5
FY22	961,100	842,266	-6.3	128,636	45.1

Source: Tractors Manufactures Association (TMA), CMIE

Outlook

Passenger Vehicles: As geopolitical tension hampers the supply chain and semiconductor shortages persist, the passenger vehicle industry is likely to encounter tough situations in the near term. From steep rate hikes of vehicles due to increasing raw material costs to rising fuel prices, consumer sentiment is seen taking a hit. However, as problems around chip shortages ease and OEMs collaborate with semiconductor suppliers to streamline production to cut the waiting period, the production in FY23 is expected to be higher than in FY22.

This, in addition to a low base effect, growing preference for personal mobility, and new launches, could improve demand sentiment. Easy availability of finance, lower interest rates on vehicle loans, an increase in export demand and new launches in the electric mobility space might further help support the passenger vehicle industry demand over the medium term.

Two-Wheelers & Three-Wheelers: With the timely arrival of monsoon, new product launches, ease in the supply of chips and semiconductors and a hike in minimum support prices of Kharif crops, the sales of the two-wheeler and three-wheeler industries are expected to recover in the near term. Rural sales account for a significant proportion of total entry-level motorcycle sales in India. However, the elevated fuel and input costs might dampen the customer sentiment. The urban demand is likely to improve going ahead as some corporates continue to work from the office, resulting in more people commuting to work, for both 2W and 3W industries. The three-wheeler passenger carrier segment is seen benefitting from product up-gradations from 2-stroke to 4-stroke and petrol or diesel to CNG as well as from the fresh permit opening by different state governments. A shift in consumer preference from “shared mobility” to “personal mobility” induced by the pandemic, will benefit the two-wheeler industry. Overseas demand for both two-wheeler and three-wheeler is likely to revive going forward following an improvement in the pandemic situation across various international markets.

The slowdown in the demand for internal combustion engine-based two-wheelers will be partially negated by the rising demand for E2Ws and E3Ws. Additionally, OEMs and the government are also working on setting up charging infrastructure for EVs. The Union Budget FY23 proposed the Battery Swapping Policy considering the constraint in space in urban areas for setting up charging stations at scale. The NITI Aayog will come up with battery swapping standards. The adoption of electric vehicles is on the rise due to government support in the form of subsidies and rising fuel prices. OEMs expect the demand for EVs to continue to grow in the near term.

Tractors: Tractors are an integral part of mechanisation and have a crucial role to play in increasing agricultural productivity. The demand outlook for the tractor industry remains stable with the government’s continued focus in rural and agriculture sectors along with favourable crop prices, normal monsoon forecast and good water reservoirs levels. The tractor OEMs may take price hikes going ahead to cover increasing raw material prices and maintain margins which might hurt the demand.

In the FY23 Budget, the government has made a conscious effort for revolutionising Indian agriculture. To finance start-ups for agriculture & rural enterprise, a fund with blended capital raised under the co- investment model will be facilitated through NABARD. The activities for these start-ups may include support for Farmer-Producer Organisations (FPOs), machinery for farmers on a rental basis at farm level, and technology including IT-based support. The budget has also provided significant impetus on sunrise sectors in order to encourage sectors such as agri-tech through setting up thematic funds for blended finance. The share of the Government will be limited to 20% and the fund will be managed by private fund managers.

Going forward, OEMs are continuing to focus on developing and launching products complying with new emission norms and application based oriented products. The industry is likely to adopt TREM- IV emission norms from April 2022 in higher HP (more than 50) tractors. Increased usage in non- agricultural segments such as haulage in construction and infrastructure projects will further increase demand of tractors. Increased procurement in acreage of Kharif crop will further boost farm income. In the long term, positive forecast for monsoon, Government support through subsidies, loan waivers, MSPs on crops, supporting rural customer sentiments along with the technology upgradation like hybridization, electrification, autonomous connectivity might lead to volume growth in the tractor segment. Substantial increase in exports of agricultural products like cotton, sugar, wheat will further improve the cash flows of farmers which will further boost tractor demand.

Commercial Vehicles

Outlook - Stable =

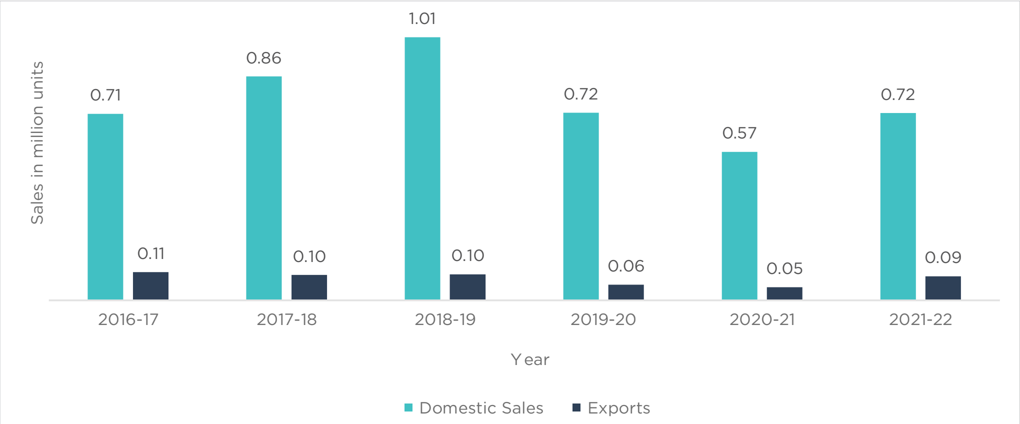
Lifeline of the Economy

With nearly two-thirds of goods and 87% of passenger traffic moving via roads, the commercial vehicle industry is the lifeline of the Indian economy. Any movement in the sector is considered a crucial indicator of the mood of the economy. As the initial period of the pandemic brought industrial activity to a halt, the sales in the commercial vehicle segment fell by 20% y-o-y in FY21. But with the government's continued focus on infrastructure development and easing of Covid-19 induced restrictions, sales improved by 26% in FY22. The Medium & Heavy Commercial Vehicles (M&HCV) segment is seeing a demand recovery because of improvement in fleet utilisation levels, extensive road construction projects and improved cement consumption while the demand in the Light Commercial Vehicles (LCV) segment is gaining some momentum with the increase in the transportation of essential goods and FMCG goods.

Exports Stay Strong in FY22

There has an been a decline in the exports of CVs in the last two years FY20 and FY21 but it grew significantly in FY22. Exports declined in FY21 primarily because of economic slowdown and liquidity crunch in major export markets including SAARC, Middle East and Africa. However, both MHCV and LCV segment grew by 83% y-o-y in FY22 due to low base effect of last year. The domestic sales and exports trends along with the commercial vehicle segment wise contribution has been depicted below: -

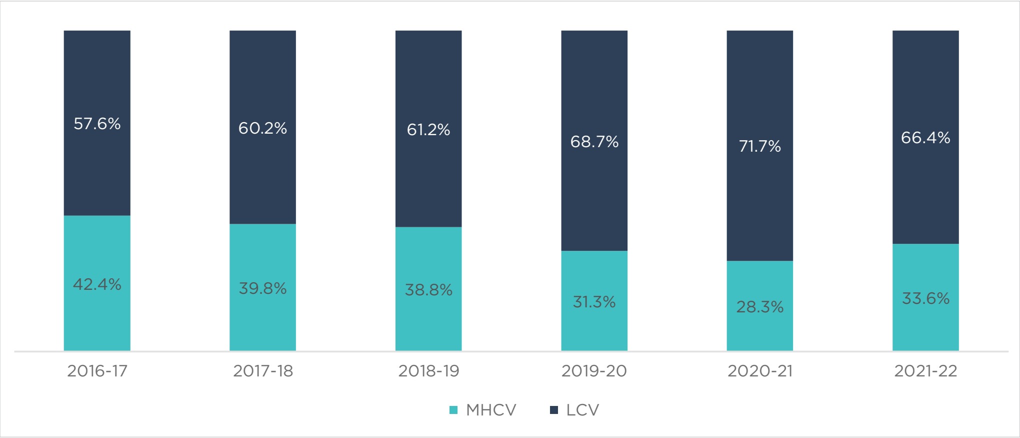
Domestic Sales and Exports of Commercial Vehicles



Source: SIAM; CMIE

The MHCV segment contributes to around 34% of total CV sales in India while the LCV segment contributes to around 66% share in FY22.

Market Share of M&HCV and LCV Segment



Source: SIAM; CMIE

Outlook

The commercial vehicles segment is expected to benefit from the structural upcycle over the near to medium term. The industry draws its demand from the economy and hence recovery in economy is expected to drive the demand for CVs. The government's focus on improving infrastructure and growth in real estate and mining activities is expected to boost M&HCV sales. The MHCV truck segment sales is expected to increase supported by replacement demand and the bus segment sales is likely to grow backed by reopening of schools and offices. Some government initiatives such as Vehicle Scrappage Policy, Production Linked Incentives (PLI) and greater spending on infrastructure projects may further help in reviving the sector.

In addition, most corporates, schools & colleges have opened as the Covid-19 situation is improving. This will improve the demand for passenger carriers. Moreover, the LCV segment is expected to improve with the increasing need to transport essential goods such as groceries within the cities and the rising e-commerce sector.

However, the upwards trajectory of crude oil price due to the ongoing geopolitical conditions may restrict growth for CVs in the near term. The ongoing war may further escalate the semiconductor shortage as some of the major components used in semiconductor chip manufacturing are majorly supplied by Russia and Ukraine. Going forward, push toward public transportation in urban areas contemplated by clean technology and governance solutions, special mobility zones with zero fossil- fuel policy will further lead to increased adoption of Electric Vehicles (EVs) passenger carriers and buses in CV space.

Auto Ancillaries

Outlook - Stable =

On the Move

An integral part of the automobile value chain, the auto component industry includes OEMs that are engaged in the manufacturing of high-value precision instruments and the unorganised segment that comprises low-valued products for after-market services. The industry, despite the disruptions caused by the second wave of the Covid-19 pandemic, witnessed strong growth in H1 FY22 due to a surge in international demand, growth in sales to Original Equipment Manufacturers (OEMs) and a low base effect. Accounting for 63% of the total exports, Europe and North America showed the highest exports.

Exports in the tyre industry, too, remained strong as India gained from the US' anti-dumping duty on China and increased acceptance of Indian types globally. In 9MFY22, the industry witnessed growth driven by demand from OEMs as well as replacement segments along with higher price realisation and low base effect. However, the cost of synthetic rubber had increased owing to the rise in crude oil prices that tyre manufacturers were unable to pass on completely to OEMs. This led to a decline in the profit margins of the industry.

Auto Components Industry (in Rs Lakh crore)

Particulars	FY21	FY20	Growth in FY21 vs FY20 (%)	H1 FY22	H1 FY21	Growth in H1 FY22 vs H1 FY21 (%)
Turnover	3.41	3.50	-3	1.96	1.20	65
Sales to OEMs	2.79	2.87	-3	1.53	0.87	76
After Market	0.65	0.69	-7	0.39	0.31	25
Exports	0.98	1.02	-4	0.69	0.39	77
Imports	1.02	1.09	-6	0.64	0.38	68

Source: ACMA

Note: Turnover is calculated as Sales to OEMs + after-market sales + exports – Import

Tyre Industry (in 000' nos.)

Particulars	FY21	FY20	Growth in FY21 vs FY20 (%)	9M FY22	9M FY21	Growth in 9M FY22 vs 9M FY21 (%)
Production	1,69,071	1,76,795	-4	1,44,240	1,17,590	23
Sales	1,68,981	1,83,896	-8	NA	NA	NA
Exports	28,596	26,702	7	33,726	19,481	73
Imports	2,088	9,489	-78	1,971	1,623	21

Source: CMIE

Outlook

Auto Ancillary: The auto components industry strives to overcome the challenges of semiconductor shortages, increase in raw material prices and escalating freight costs. The demand from the aftermarket segment, however, is expected to be good in the short term as individuals may defer buying new vehicles given the high prices, low-consumer sentiments, long waiting periods and high fuel prices. The need for repairs on existing and second-hand vehicles provides ample opportunity for the short-term growth of the sales of auto components in the aftermarket segment. In the OEM segment, the recovery in demand for commercial vehicles owing to traction in infrastructure, mining, real estate & industrial activity is expected to drive demand for auto components. Several global firms are looking to invest in the Indian auto components industry, with a focus on companies that make parts for internal combustion engine vehicles and electric vehicles. Currently, the country contributes only a small proportion to the total imports of its biggest buyers -- the US, Europe and China. As supply chains shift, India could expand its share in the global auto components trade.

The government's supply-side interventions and change in the definition of the MSME sector with doubling of the budget for MSMEs are also expected to benefit the auto components industry. The focus on enhancing deep localisation in the auto components sector should also improve price competitiveness in the global market. The auto components industry finds huge scope to localise and substitute imports of high-value parts such as engine/engine components, engine electrical, fuel systems and exhaust parts, as well as gearbox parts. In addition to enhancing exports, the auto components industry is also targeting to curb the import of spurious and sub-standard components that are purchased due to lower pricing which augurs well for the industry.

Tyre: Led by the low base effect and expected improvement in automobile sales in domestic as well as export markets going forward, CareEdge expects production and sales of tyres to recover. Vehicles aged more than three-four years, which require tyre replacement due to wear and tear, positively influence the sales too. The Ministry of Road Transport and Highways has issued a notification that new tyres for passenger cars, trucks and buses will have to meet the defined standards for rolling resistance, wet grip and rolling sound emissions from October 2022. All existing tyre designs will have to comply with wet grip and rolling resistance standards from next April and fewer rolling noise standards from next June.

Exports are expected to grow for the tyre industry. Steady demand from major export destinations such as the US, the UK, and the European nations including Germany, France and Italy supported exports in the previous year. In the coming years, exports are expected to increase and exceed pre-Covid-19 levels.

The increasing consumer preference towards the premium car segment, which is primarily led by growth in the SUV segment along with the increasing trend in personal mobility due to the Covid-19 pandemic is also expected to drive car sales in future and thus tyre consumption. The replacement demand is also expected to show high potential growth going forward. Further, government policy and interventions toward import restrictions will help the domestic tyre industry to grow over the long term.

Cement

Outlook - Stable =

On Solid Footing

After suffering a decline of 11.4% in FY21, India's cement sector bounced back with an all-time growth of 20.3% in FY22, backed by the government's infrastructure push through various schemes and allocations towards the creation of hard assets and a low base effect.

Though Q3 was hurt by sudden rains, a ban on construction activities in the National Capital Region, a shortage of labour and a restricted supply of sand in Eastern India, a strong recovery of 36% in H1 and a 13% jump to over 100 MT mark in Q4 ensured the year ended with a 20.3% growth.

Domestic Production (in million tonnes)

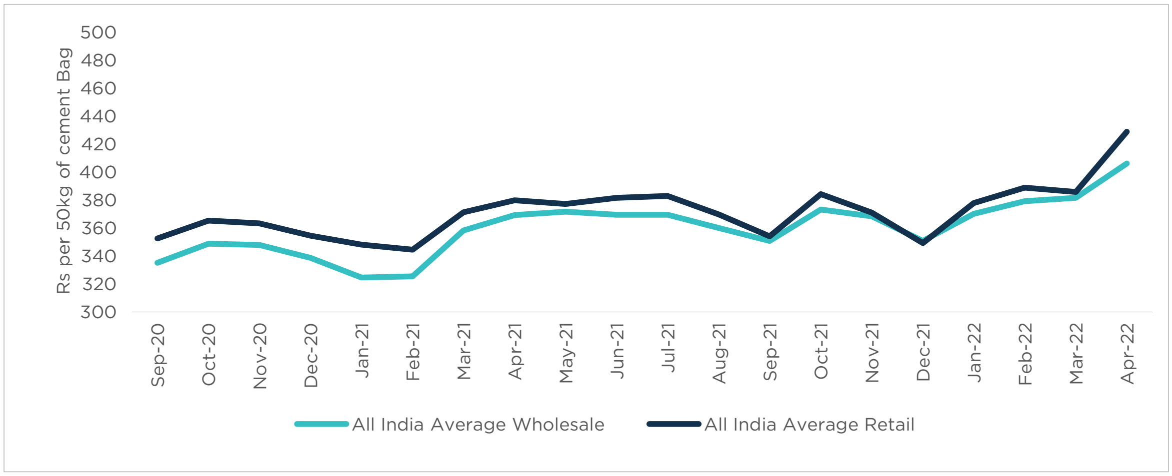
April-March	Production	y-o-y (%)
FY19	337	13.1
FY20	334	-0.9
FY21	296	-11.4
FY22	356	20.3

Source: Office of the Economic Adviser

Movement in Cement Price and Input Cost

All-India retail cement prices remained elevated throughout FY22 barring December, where it bottomed out at Rs 349 per bag, post which the sector witnessed a sharp uptick of 23% in prices in Q4 FY22.

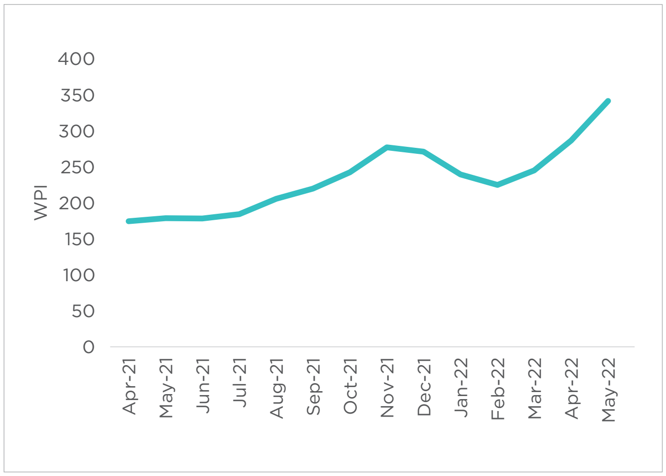
Movement in All India Cement Prices



Source: CMIE

This growth in prices can be attributed to the increase in input costs such as power and fuel cost pressure due to geopolitical tension as well as an increase in freight expenses – together accounting for nearly 50 to 55% of the total expenditure incurred by the cement players. Crude oil prices went up at a whopping rate of 74% in FY22. Tracking this, petcoke has also reported a sharp increase of ~71% y-o-y as per the WPI index. Moreover, international coal prices soared to USD 294.42/MT (record high), sequentially higher by 50% on account of Potential disruption in Russia's coal exports amid its ongoing conflict with Ukraine has impacted prices to a major extent. Diminishing inventory levels, owing to the widening of the demand-supply gap (primarily caused by rebounding demand and pandemic-related supply constraints across the globe), have aggravated pricing pressure. Indonesia's temporary ban (ban is lifted) on coal exports had intensified the current tightness in the market, thereby increasing the pricing pressure. Also, the surge in crude oil prices has raised freight costs significantly resulting in diesel prices doubling up from the price point at the beginning of the year. Elevated input costs, coupled with high freight and fuel expense, have aggravated the cost pressure, which in turn has impacted the profitability of cement companies.

Movement in Petcoke Price Index



Source: CMIE; CareEdge Research

International Coal Prices (South Africa)

Source: CMIE; CareEdge Research

Outlook

CareEdge Research believes the industry is likely to move at high single-digit growth on account of government thrust for infrastructure and strong traction seen in capital expenditure. Owing to strong momentum in housing, infrastructure, and industrial development, the cement industry in India is set to see an upswing in demand in FY23. However, headwinds arising out of rising cost pressure could create some stress on the profitability of cement companies. Resultant price hikes by cement producers will become evident and might sustain in the near term.

The long-term outlook for the cement industry remains positive and is expected to be driven by infrastructure impetus provided by the government. In the Union Budget FY23, the Government has further increased allocation towards capital expenditure by more than 35% from around Rs 5.5 lakh crore as per FY22 RE (Revised Estimates) to around Rs 7.5 lakh crore as per FY23 BE (Budget Estimates) which augurs well for the cement industry. Further, the Government schemes aimed at affordable housing such as Pradhan Mantri Awas Yojana (PMAY) are likely to drive demand for low-cost housing. The Government has announced that 80 lakh houses will be completed for both rural and urban and allocated Rs 48,000 crore for this purpose. In addition, several other schemes aimed at the development and improvement of public infrastructure: roads, highways, metros and railways, airports, ports, logistics Infrastructure, etc through schemes such as PM GatiShakti, National Infrastructure Pipeline (NIP), Urban Rejuvenation Mission: AMRUT and Smart Cities Mission to name a few are also expected to lead to the creation of demand for cement.

While, the demand outlook looks robust for the long term, cement companies are likely to face near-term headwinds in terms of elevated input costs, led by geopolitical tensions arising out of the Russia-Ukraine crisis. As a result, margins pose downside risks owing to rising input costs (Petcoke, imported coal and freight cost) resulting in the cash flows of the companies remaining susceptible.

Coal

Outlook - Stable =

Hitting New Milestones

India's coal production for FY22 reached a new milestone of 777 Million Tonnes (MT) for the first time compared to 716 MT and 731 MT in FY21 and FY20, respectively. While the degrowth in FY21 was on account of the pandemic-induced lockdowns and lower than expected electricity and fuel demand, the high growth of 8.6 per cent in FY22 (on the lower base) was driven by the post-pandemic opening of the economy and induced demand for electricity and fuel.

Coal Production from April to March

Production (in MT)	FY22	FY21	FY20	Growth % (FY22 vs. FY21)	Growth % (FY21 vs. FY20)	Growth % (FY22 vs. FY20)
CIL	622.6	596.2	602.1	4.4	-1.0	3.4
SCCL	65.0	50.6	64.0	28.5	-21.0	1.6
Captives	89.6	69.2	65.3	29.5	6.0	37.3
Total	**777.3**	**716.0**	**731.4**	**8.6**	**-2.1**	**6.3**

Source: Ministry of Coal; CareEdge Research

Coal Production for April-May

Producer	Production (MT) up to May		Growth %
	FY23	FY22	FY22/FY21
CIL	108.2	84.0	28.8
SCCL	11.4	10.3	10.3
Captives	18.4	10.6	73.9
Total	**138.0**	**104.9**	**31.6**

Source: Ministry of Coal; CareEdge Research; Note: CIL- Coal India Limited, SCCL- Singareni Collieries Company Limited

For the first two months of FY23, coal production has hit 138 MT, a 31.6% rise over the corresponding period in FY22, which was impacted by the Covid -19 induced lockdowns. Coal India Limited's (CIL) contribution to the total coal production fell to 78% in the first two months of FY23 against 80% in FY22, while SCCL's share declined from 9.8% to 8.2%. However, the share of Captives has grown to 13.4% from 10%.

This changing mix of the source of domestic coal production – in favour of Captives – is on account of consistent initiatives by the Ministry of Coal to increase domestic coal production and to promote private participation. Presently, 106 coal blocks have already been allocated and mine opening permissions have been received for 47 coal blocks. This is expected to increase to 60 coal blocks during FY23. These measures are likely to significantly ramp up domestic production, driven by Captives, thereby reducing the country's import dependence on coal.

Sectoral Coal Supplies

The share of coal despatched to the power sector increased to around 83 per cent in FY22 from 79 per cent in FY21. Unlike the power sector, the share of coal despatch to captive power plants reduced from 7 per cent in FY21 to 4 per cent of the total coal despatched in FY22 and the share of coal despatch to others also reduced from 15 per cent in FY21 to 13 per cent in FY22. The non-power sector, except Captive power plants, did not witness any major change in the supply.

Coal Despatch

Sectors	Despatch (in MT)			Growth (%)		
	FY22	FY21	FY20	FY22 vs. FY21	FY21 vs. FY20	FY22 vs. FY20
Power	677.7	544.1	567.3	24.6	-4.1	19.5
CPP*	35.6	45.8	53.1	-22.2	-13.7	-32.9
Others**	104.9	101.6	86.9	3.3	16.8	20.6
Total	**818.2**	**691.4**	**707.2**	**18.3**	**-2.2**	**15.7**

Source: Ministry of Coal; CareEdge Research
*CPP- Captive power plants. **Others – cement, steel, sponge iron, fertilizers, textiles, chemicals, paper & pulp, and other basic metals

The share of coal despatch to the power sector increased significantly by around 19% during the two-month period April–May 2022 as compared to the same period in FY22. The share of coal despatch to power and CPP reached around 133.2 MT i.e. around 89% of the total coal despatch as against nearly 87% in FY22.

Coal Despatch up to May FY23, FY22

Sectors	Despatch up to May		Growth (%) (FY23 vs. FY22)
	FY23	FY22	
Power	127.8	107.0	19.5
CPP*	5.4	7.9	-31.6
Others**	16.3	17.8	-8.7
Total	**149.5**	**132.7**	**12.7**

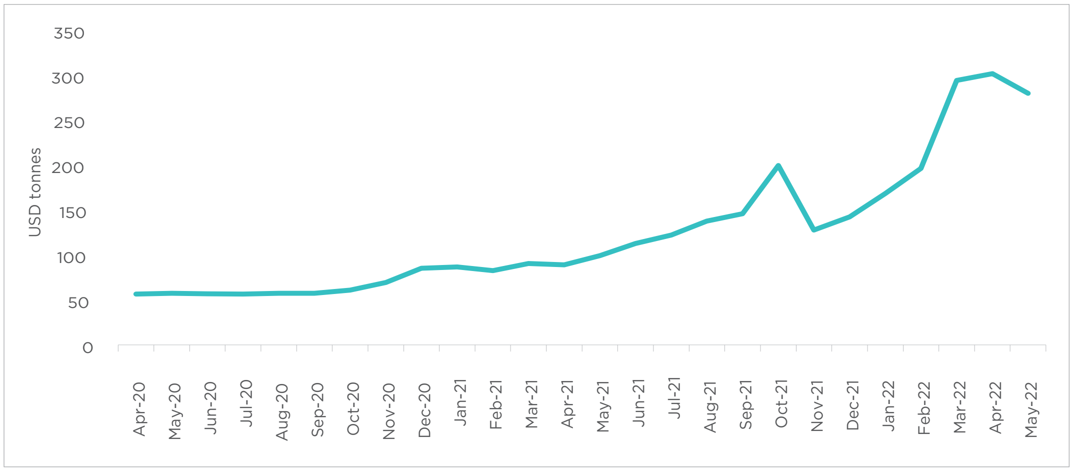
Source: Ministry of Coal; CareEdge Research
*CPP- Captive power plants. **Others – cement, steel, sponge iron, fertilizers, textiles, chemicals, paper & pulp, and other basic metals

The increased supply to the power sector was majorly on account of increased demand for electricity during April-May 2022 due to the summer season. The share of coal despatch to 'others' also declined while volumes saw degrowth by around 8.7% on a base of 17.8 MT during FY22 to 16.3 MT during FY23 (for the two-month period).

Coal Prices

Coal prices of South African thermal coal, a global benchmark, have been on an upward trajectory since December 2021 and the geopolitical tensions between Russia-Ukraine had pushed up the international coal prices. The global benchmark had crossed its all-time high price of around USD 200 per tonne (which was seen in October 2021) and peaked at around USD 300 per tonne in April 2022. In May 2022, the global benchmark coal prices declined to USD 280 per tonne. The prices are registering a declining trend for the first time since November 2021 in May 2022.

International Coal Prices (South Africa)



Source: World Bank; CareEdge Research

Outlook

The coal industry in FY22 witnessed many interruptions due to demand-supply mismatches, rake shortages and high international coal prices. The demand for both thermal and coking coal is expected to remain strong as economic activities have started showing signs of recovery since Q4FY22.

Additionally, there was a sharp increase in power demand in the last few months due to a heat wave in most parts of the country, which led to domestic coal production not keeping pace with the demand from power plants - resulting in shortage of coal at the power plants. Measures taken by the government to resolve these issues - including introduction of new norms to keep adequate coal stock at the power plants has helped avoid a repeat of the recent power crisis when a significant capacity of generating station had to be shut down due to coal availability issues.

On the other hand, the Government is continuing to take measures to ramp up power generation from renewable energy sources (like solar, wind) to meet the medium and long-term demand for power in the country. The transition to renewable energy sources will also help India meet its climate change targets and phase down the demand for coal over the long term. Switching to the green sources will also help India to curb its expected growth in emissions from its dependency on fossil fuels, and begin the shift to a net zero economy.

Going forward, CareEdge Research estimates domestic coal production to cross 850 million tonnes during FY23. This considers the domestic coal production of 205 million tonnes in Q1 of FY23 (a strong 32% y-o-y growth over Q1 of FY22). However, the monsoon season holds the likelihood of coal mines being flooded in certain regions, and will likely hamper domestic coal production as well as transportation, thereby impacting the volumes for Q2 FY23. This is expected to revive in the second half of the year as it generally contributes around 60% to the total coal production.

Consumer Foods

Outlook - Positive +

At Healthy Levels

Constituting dairy products, beverages (alcoholic & non-alcoholic), vegetables & fruits, chocolates, and confectioneries, India's consumer food business is one of the major gainers of the country's increased urbanisation, increase in the number of working women, growing standards of living, rising number of supermarkets online delivery. In Q1 FY22, even as the second wave of Covid-19 hit, net sales in the segment grew 6% as compared with Q1 FY20. This could be attributed to the lockdowns being more localised and staggered in nature, which led to more accessibility of products for consumers. Consumers also avoided panic buying and pantry loading, and this ensured comparatively lesser disruptions to the supply chains of industry players.

The Q2 and Q3 of FY22 witnessed a double-digit growth of 18% and 17%, respectively, as compared with corresponding quarters in FY20 primarily due to a rise in demand and a significant increase in prices of consumer food and beverages. The record increase in costs of vegetable oils, including palm oil, packaging, freight etc encouraged industry players to undertake price hikes and pass on the elevated costs to consumers. Sales in Q4 FY22, too, increased by 29% compared to that in Q1 FY20. (It is to be noted that FY22 sales have been compared with FY20 to understand if the sales improved or lagged in FY22 compared to pre-Covid year i.e. FY20).

Quarter-wise y-o-y Change in Net Sales of Industry Players (in Rs crore)

Period	FY20	FY21	FY22	Y-o-Y growth/ de-growth (%) FY21 vs FY20	Y-o-Y growth/ de-growth (%) FY22 vs FY21	Y-o-Y growth/ de-growth (%) FY22 vs FY20
Q1	22,154	18,395	23,390	-17	27	6
Q2	20,732	20,918	24,421	1	17	18
Q3	20,187	20,181	23,599	0	17	17
Q4	19,483	21,912	25,190	12	15	29
Full Year	**82,557**	**81,406**	**96,600**	**-1**	**19**	**17**

Note: Based on financials of 79 companies

Source: Ace Equity

The outbreak of Covid-19 and the imposition of restrictions from the last week of March 2020 had affected several industries, including consumer foods. As hotels, restaurants and bars were asked to remain shut, the out-of-home consumption of consumer food and beverages came to a near standstill. The stores selling necessities were allowed to function even during the lockdown. FMCG players initially witnessed disruptions in their supply chain networks due to restrictions and gradually several partnered with third-party vendors and food delivery apps to ensure food delivery. The demand for in-home consumption of food increased as offices resorted to work working from home and even schools, colleges etc began conducting classes, and lectures online and as the restrictions were gradually lifted, the demand for out-of-home consumption started recovering.

Outlook

Supported by an increase in disposable income, favourable demographics, brand consciousness, and growth of e-commerce platforms, the domestic consumer food industry is projected to have a positive outlook in the near-to-medium term. The rise in the share of women workforce is expected to double-income households and thereby boost the propensity to spend. This, in turn, is also expected to increase the demand for ready-to-eat food items.

The demand for consumer food like out-of-home consumption food and beverages is also seen recovering. With inflation in input costs not showing any signs of abatement in the near to medium term, industry players are likely to continue to undertake price hikes to deal with such inflationary headwinds. Moreover, the ongoing Russia-Ukraine crisis is also expected to further pressure the input costs due to rising commodity prices.

The share of unorganised players is likely to decrease leading to an uptick in the consumption of branded products with high quality, nutrition credentials and an increase in consumption from smaller towns and cities through online portals.

Household & Personal Products

Outlook - Positive +

The household and personal products segment, which comprises categories such as washing powder, soaps, hair oil, shampoo, oral care etc, saw the net sales in Q1 FY22 grow by 13% compared with Q1 FY20. The growth was primarily on account of pandemic-induced restrictions being more localised, which ensured more accessibility of products. Lesser disruptions to supply chains and the absence of panic buying also helped, but the net sales in Q1 were lesser than the rest of the quarters of the financial year as the second wave still impacted consumer sentiment.

Sales in Q2, Q3 and Q4 in FY22 registered a strong growth of 26%, 28% and 45%, respectively, compared with corresponding quarters in FY20. Interestingly, while this growth was supported by a rise in volumes, it was led by price hikes undertaken by the manufacturers. The record increase in costs of crude oil, packaging, freight and raw materials such as palm oil (one of the key raw materials for manufacturing soaps and skin care products) led to such price hikes being undertaken by industry players.

Quarter-wise y-o-y Change in Net Sales (in Rs crore)

Period	FY20	FY21	FY22	Y-o-Y growth/ de-growth (%) FY21 vs FY20	Y-o-Y growth/ de-growth (%) FY22 vs FY21	Y-o-Y growth/ de-growth (%) FY22 vs FY20
Q1	18,162	17,001	20,474	-6	20	13
Q2	18,218	20,274	22,919	11	13	26
Q3	18,493	21,307	23,629	15	11	28
Q4	15,904	20,729	23,020	30	11	45
Full Year	**70,777**	**79,310**	**90,042**	**12**	**14**	**27**

Note: Based on financials of 23 companies

Source: Ace Equity

The pandemic severely impacted consumption demand as consumers looked to lower expenses and cut down on unnecessary purchases. The nationwide lockdown during the June 2020 quarter constrained supplies as the factories remained shut and only the movement of essential items was allowed. The spread of Covid-19 caused significant financial distress to households who became prudent in terms of spending on discretionary products and focused on savings instead.

On the other hand, pandemic resulted in huge demand for household and hygiene products. The demand for disinfectants and cleaning supplies witnessed a turnaround during the pandemic year and sales of various home care products started to bolster.

However, demand for products that help in personal grooming such as hair oils, hair dyes etc remained much lower due to a combination of the lockdown during Q1 FY21, people spending more time in isolation and indoors and a shift in priorities towards the purchase of essential items. As restrictions were eased and Covid-19 cases were brought under control, demand witnessed recovery every quarter and for the full year FY21, sales grew by 12% as compared with FY20.

Outlook

The demand for household and personal care products will continue to register growth. With inflation in input costs not showing any signs of abatement in the near to medium term, industry players are likely to continue to undertake price hikes and pass on the rising costs to end users. Also, there has been a growing consumer inclination toward hygiene and sanitation. Moreover, the ongoing Russia-Ukraine crisis is also expected to further pressurise the input costs due to rising commodity prices and disruptions in the global supply chain.

The outlook for the sector remains positive on the back of growth in the e-commerce industry, favourable demographics, increase in disposable income among other enablers. The rise in the share of women workforce is expected to lead to double-income households and thereby increase the household's propensity to spend on discretionary products. The share of unorganised players is likely to decrease following higher demand for branded products from smaller towns and cities through online portals.

IT Software

Outlook - Positive +

Adapting to New Normal

The IT industry not only plays a key role by contributing to positioning the country as a preferred investment destination for global investors but also creates large-scale employment and generates significant export revenues. Emerging technologies and a rise in demand for collaborative applications, application platforms, security software, system & service management software, and content workflow & management applications now offer an entire gamut of opportunities for top IT firms in India through cost-effectiveness, speedy deliveries, high reliability, great quality. In FY21, with the outbreak of Covid-19, the industry lagged sales growth in Q1FY21 but recovery was seen from Q2FY21 onwards. The industry registered a strong rebound in H2FY21 across all parameters, backed by growth across key verticals and geographies.

In FY22, clients accelerated their technology investments and IT services players expanded their products and service offerings to cater to the new demands of an expanding set of clients. The outbreak of Covid-19 highlighted the need to adopt technology across various sectors to become more efficient and effective and remain relevant in the dynamic business environment. The net sales growth in FY22 has been 19% YoY supported by growing demand for differentiated cloud and digital capability across segments. The IT players are changing their service offerings and focusing on delivering customer-centric solutions.

Net Sales of IT-Software Industry (in Rs Crore)

Period	FY20	FY21	FY22	Y-o-Y growth (%) FY21 vs FY20	Y-o-Y growth (%) FY22 vs FY21	Y-o-Y growth FY22 vs FY20
Q1	91,197	94,024	1,09,575	3.1	16.5	20.2
Q2	94,292	97,873	1,16,006	3.8	18.5	23.0
Q3	97,068	1,02,000	1,22,871	5.1	20.5	26.6
Q4	98,668	1,04,651	1,26,295	6.1	20.7	28.0
Total	**3,81,226**	**3,98,548**	**4,74,747**	**4.5**	**19.1**	**24.5**

Note: Financials for 170 companies
Source: Ace Equity

IT majors have seen a strong progression of client addition in existing as well as new geographies and verticals. Sharp revival in deal momentum across client bands with the highest deal pipeline seen in FY22. The client wins in the higher deal-size buckets have significantly increased. The digital transformation spending by global corporations has witnessed a significant uptick supporting the revival in deal momentum for the top 4 IT companies despite the ongoing geopolitical tensions.

Total Clients in Each Band

Full Year	FY21	FY22
+1 million	95	346
+10 million	22	132
+50 million	-1	42
+100 million	-1	25

Note: '+ million denotes client additions data are of top 4 players (Infosys, TCS, Wipro, HCLTech)
Source: Company presentations

The deal momentum was primarily led by cloud-based transformation services undertaken by clients. From a client addition volume perspective, the total additions in greater than USD 1 million deal size of 95 clients for the full year FY21 has more than tripled to 346 in FY22. The client wins in the smaller deal-size buckets significantly increased for FY22. Particularly, a turnaround was recorded in the big-ticket size deals above USD 1 million and USD 10 million leading to a high-quality deal pipeline and profitability in FY22. 24% of the deal wins in greater than USD 10 million, 8% of deal wins in the above USD 50 million categories and 5% were above USD 100 million indicating a large ticket size of the awards by clients across the top 4 IT companies in FY22. Concerning growth by verticals, it has mostly been broad-based and the BFSI vertical continues to have the largest share and also the fastest growth.

Outlook

The digital transformation initiatives grew manifold during the pandemic, with a much greater realization of the need for digitization and data-driven solutions and this trend is expected to continue going forward which augurs well for the IT services industry. The Covid-19 global pandemic has put the technology requirements of global corporations at the forefront and consequently, this deal momentum is expected to continue over the medium term. Companies operating in varied industries are willing to adopt technology in their business processes to become more efficient and effective and remain relevant in the dynamic business environment.

Software technology spending is expected to continue to remain upbeat in the near to medium. Robotics, artificial intelligence, cybersecurity, and IoT, among others are expected to be the key technology focus areas going forward. The software industry has been re-aligning its offerings to cater to the evolving requirements of its clients emerging technologies like 5G, Internet of Things, Advanced Data Analytics, Artificial Intelligence, Cloud computing, robotics and blockchain will redefine the future of technology-led transformation.

Overall, Indian IT industry witnessed a strong client addition during FY22 supported by growth, vendor consolidation and various transformation initiatives like cloud adoption and digital initiatives by clientele across various verticals. CareEdge Research expects the broad trends in demand outlook and technology driven spending to continue during FY23, however, slowdown in the key markets of US and EU, uncertainties arising from global macro-economic slowdown, and currency volatility can potentially play a spoil sport with respect to corporations spending on technology and may lead to postponing some of these spends. Also, with significantly increased employee attrition levels across most players, there has been a surge in employee costs, which is the single largest expense item for the sector, which will potentially impact the operating margins of the players.

Steel

Outlook - Stable =

On a High

The domestic steel production was at its highest at 114 million tonnes in FY22 (up from 96 million tonnes in FY21), an increase of 18.1% (y-o-y), on account of the revival in economic activities and low-base effect. During April and May 2022, the production grew by 9.6% to 19 million tonnes as compared to the same period of FY22.

India's steel consumption was at 106 million tonnes in FY22, up from 95 million tonnes in FY21, an increase of 11.4% y-o-y on account of increased consumption by the government on developing infrastructure as well as the resumption of economic activities and construction work on low-base effect. During April and May 2022, the consumption grew by 9.6% to 18 million tonnes as compared to the same period of FY22.

Steel Production & Consumption (million tonnes)

Finished Steel	FY21	FY22	Growth (%)	April-May'21	April-May'22	Growth (%)
Production	96	114	18.1	18	19	5.6
Consumption	95	106	11.4	17	18	5.9

Source: CMIE

Steel Trade Data

India exported a record high of 13.5 million tonnes of steel in FY22 and continued to remain a net exporter. Exports from India grew at a healthy CAGR of 27% from 8.4 million tonnes in FY20 to 13.5 million tonnes in FY22 led by international factors like environmental concerns surrounding China's steel industry, and an uptrend in global steel prices and higher demand from European nations.

India's import of steel has however degrown by 30.9% to 4.7 million tonnes in FY22 from 6.8 million tonnes in FY20, which was driven by improved capacity utilisations as well as on-streaming of large capacities that were acquired by incumbents through bankruptcy proceedings.

Exports and Imports (million tonnes)

Finished Steel	FY21	FY22	Growth (%)	April-May'21	April-May'22	Growth (%)
Exports	10.8	13.5	25.10	2.2	1.5	-29.80
Imports	4.8	4.7	-1.70	0.8	0.7	-5.40

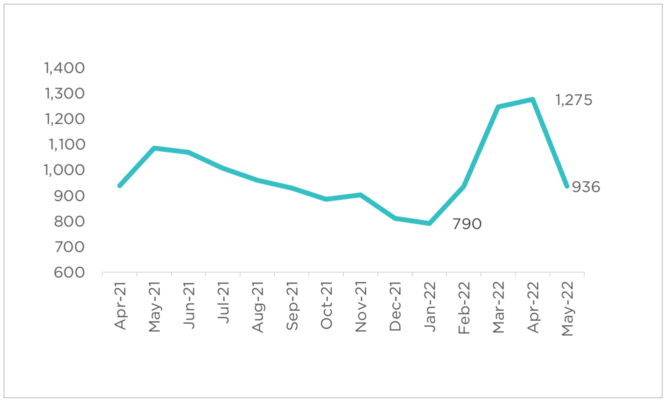
Source: CMIE

Steel Prices

During FY22, international steel prices averaged at USD 962 per tonne (Rs. 71,700 per tonne), which was higher than the domestic prices of Rs. 65,085 per tonne. This, in turn, encouraged Indian steel players to increase exports of steel from India.

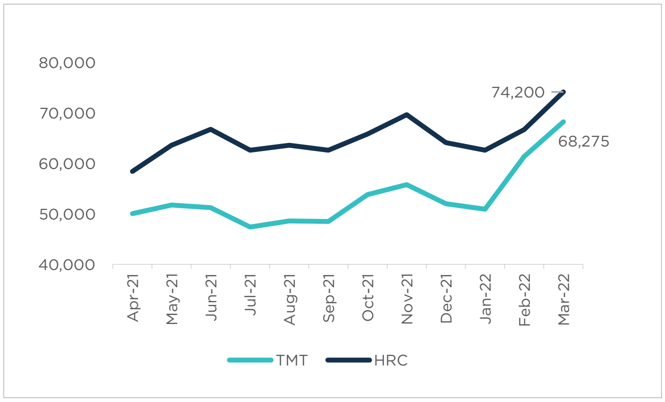
International steel prices were on an uptrend and rose significantly to upwards of USD 1,200 per tonne in March and April 2022 due to the geopolitical tensions around Russia. The prices, however, declined by 27% to USD 936 per tonne in May 2022 due to weak international demand.

International Steel Prices (USD /tonne)



Source: Industry Sources

Domestic Steel Prices (Rs. /tonne)



Source: Industry Sources

Given the significant increase in domestic steel prices, the government on May 21, 2022, imposed a 15% export duty on a range of finished steel products - making exports less attractive. In addition to this, the import duty on steel raw materials was cut – leading to a lowering in the cost of domestic steel production as well as domestic capacity utilisations. This is likely to enhance the availability of steel in the domestic market.

Outlook

The imposition of export duty will lead to a de-growth in exports from India for FY23. The reduction in import duty on various raw materials will help reduce domestic steel prices in India and encourage domestic production.

Steel production in India will be driven by:

- An increase in allocation of capital expenditure by 36% y-o-y at Rs. 7.5 lakh crore in Union Budget 2022-23.
- The budget has infrastructure push towards seven engines (roads, railways, airports, ports, mass transport, waterways and logistic infra).
- Approval of Production Linked Incentive (PLI) Scheme for specialty steel.
- Pradhan Mantri Awas Yojana (PMAY) scheme.
- Jal Jeevan Mission.

Apart from these, a revival in economic activities will also support domestic steel consumption and will aid steel production in India.

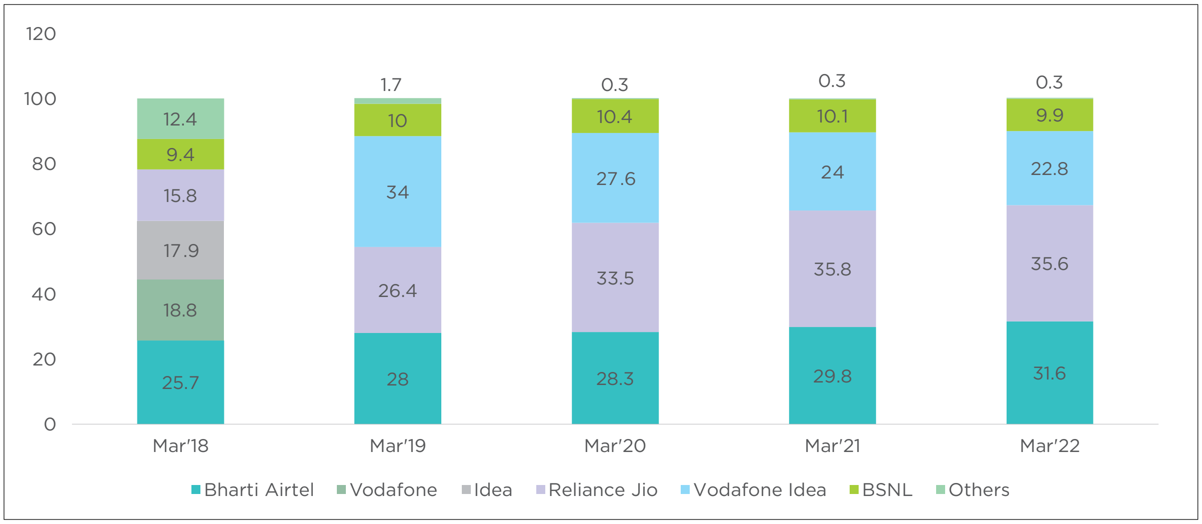
Telecom

Outlook - Stable =

Consolidation Aplenty

Telecom is an oligopolistic industry with three large players namely Reliance Jio followed by Bharati Airtel and Vodafone-Idea comprising a market share of around 90%. The telecom industry has witnessed rapid consolidation among players in the past few years. Since the phase of consolidation, the telecom industry has witnessed significant changes with respect to industry structure (number of telcos), the trend in Average Revenue per User (ARPU), broadband subscriber base, and data usage by subscribers among others.

Player-wise Market Share in Terms of Total Subscribers (%)



Source: TRAI
Note: Others in Mar'18 includes Aircel, Telenor, Tata, Rcom and MTNL

During 9MFY21, the incumbent telcos had increased tariffs for base post-paid plans and had tweaked tariff plans for their customers. Here it is important to note that the telcos had already undertaken price hikes (of up to around 40%) for their prepaid users since December 2019, thereby, supporting the ARPU of Rs.96.2 in 9MFY21. The telecom industry's ARPU increased by 13.2% y-o-y during the

9MFY22 and averaged at Rs.108.9. In addition to this, the increase in ARPU was also supported by increased data consumption and low data prices.

Performance Indicators of Telecom Industry

Revenue and Wireless Data Usage	9M FY21	9M FY22	y-o-y (% change)
Average revenue per user (ARPU) (in Rs)	96.2	108.9	13.2
Average outgo per GB data (in Rs)	10.8	9.7	-10.2
Average data usage per subscriber per month-GSM (in GB)	12.1	14.6	20.7
Subscriber Base	**As on Mar'21**	**As on Mar'22**	**y-o-y (% change)**
Telephone subscribers base (in million)	1201	1167	-2.8
Broadband subscribers base (in million)	778	788	1.3

Source: Telecom Regulatory Authority of India (TRAI)

The average data consumption was up by 20.7% at 14.6 GB for each subscriber per month during 9MFY22 supported by evolving needs of people on account of Covid-19 era. The pandemic encouraged online activities like work from home, virtual education among others. Further, higher usage of video streaming applications, online games etc. was witnessed with subscribers adapting to indoor entertainment options. In addition to this, the subscriber base of 4G users is also expanding thus aiding the data consumption. Moreover, cheap data prices also prompted higher data usage. The data prices declined by 10.2% to Rs.9.7 for per GB data during 9MFY22.

The need for data usage also added more subscribers to the broadband base. The broadband subscriber base grew by 1.3% y-o-y to 788 million as of March 2022. As of March 2022, the telephone subscriber base declined by a marginal 2.8% to 1,167 million.

In FY22, to address the liquidity crisis arising out of the new definition of Adjusted Gross Revenue (AGR), the Union Cabinet approved major reforms in the telecom sector on 15 September 2021. Nine structural reforms and five procedural reforms plus relief measures were announced for the telecom service providers. These reforms are to provide relief to the telcos by easing liquidity and cash flow. In January 2022, Vodafone Idea opted for this reform and for converting the interest on the spectrum and AGR dues into government equity.

Outlook

The outlook of the telecom industry will be supported by expected growth in the proliferation of broadband subscribers and data consumption. Apart from this, an uptick in the ARPU level of the telecom industry will also benefit the telcos' revenues and profitability going forward. In addition to this, 5G spectrum auctions will provide opportunities for the growth of the telecom sector.

To speed up the process of the 5G spectrum, the government made certain provisions in June 2022 for enabling the setting up of a Captive Non-Public Network (CNPN) for enterprises. While this will enable flexibility for enterprises to select the best option for them that suits their specific needs and prioritise or manage traffic, it may result in a loss in services that telcos could provide to enterprises for 5G which will likely affect the revenue source of the telecom sector. This is because the 5G market in India currently has more use cases for enterprises compared to that consumer use cases.

To provide some respite to telcos, the government, however, has facilitated certain reliefs as mentioned below: -

- No spectrum usage charges for spectrum acquired in this auction.
- Doing away with the requirement of submitting a financial bank guarantee equivalent to one annual instalment.
- No mandatory requirement to make upfront payment by the successful bidders.
- Payments for spectrum can be made in 20 equal annual instalments to be paid in advance at the beginning of each year.
- The bidders would be given an option to surrender the spectrum after 10 years with no future liabilities with respect to balance instalments.

These provisions will help ease the cash flow burden of the telecom sector to an extent and aid in dealing with cost factors while rolling out 5G.

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