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UNLOCKING INDIA'S ECONOMIC REVIVAL WITH CAPEX CARD

SEPTEMBER 15, 2022 | ECONOMICS

FOREWORD

Investment push can be a strong force that can help the Indian economy to move to a higher and sustained growth trajectory. The central government has aptly identified investment as the growth engine and budgeted a strong capex of Rs 7.5 lakh crore for FY23 (25% y-o-y growth). In the year so far (Apr-July 2022), it has recorded a strong capex growth of 63% and has achieved 28% of the budgeted capital expenditure.

While most of the state governments have also budgeted for a strong capex growth in FY23, their aggregate spending has been relatively weak so far. Aggregate capex spending by 21 states in Apr-July 2022 is found to be marginally lower than the corresponding period of the previous year. While the Centre will be disbursing Rs 1 lakh crore of interest-free loans to the state governments for capex, it would be critical for the state governments' capex to pick up in the months to come. States such as Madhya Pradesh, Gujarat and West Bengal have budgeted for good growth in capex for FY23 and have achieved a fair portion of it in the first four months.

A coordinated push by the Centre and state governments will be required to provide the much-needed impetus to India's growth at a time when capex by the private sector has been slow.

A study of 659 listed non-finance companies shows growth in capex by 22% in FY22, led by sectors such as telecom, oil & gas, power, retailing, and iron & steel. Investment project data (CMIE) also shows some signs of improvement in Q1 FY23.

Interestingly, the share of the private sector in new investment projects announced in Q1 FY23 has jumped above 90% indicating increased intent by private players to invest.

The capex revival by India Inc. is skewed with few sectors and few big players contributing to the chunk of the investment. The small and mid-sized players remain hesitant in midst of all the global and domestic economic uncertainties. However, given the deleveraging in the last few years and with improving capacity utilisation levels, we could see improvement in capex by the corporate sector. The most critical aspect would be the sustenance of the demand recovery that we are witnessing.

The recent fall in global commodity prices and consequent easing of input prices are supportive of investment uptick. However, the volatility in commodity prices remains a challenge. While interest cost is rising for corporates, we do not see that as a big deterrent for the capex cycle, as we do not see interest rates rising sharply from the current levels. However, we need to be cautious of the global slowdown and tightening of financial conditions globally as that would adversely impact India's economic revival.

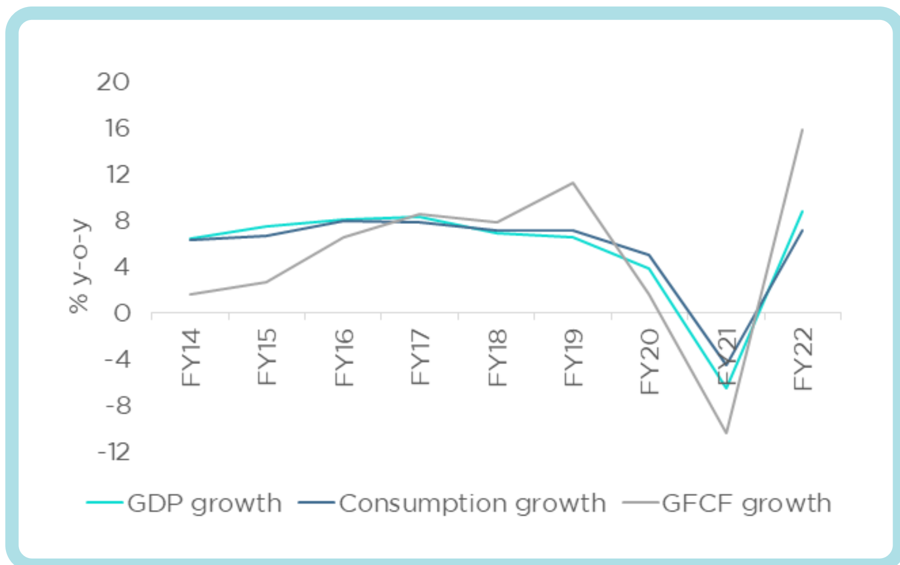
Rajani Sinha
Chief Economist

Contributing over 60% to the GDP, consumption has historically been the driving force in India's economy. But to achieve a high growth trajectory in the long term, high capital spending has to be the way. Not only does it have a strong multiplier effect on the economy, but the capex-led new capacity building also helps create employment and in turn generates durable and equitable demand.

According to an RBI (Monthly Bulletin, December 2020), the investment multiplier in India is estimated to be around 2.45 for Centre and 2 for states , while the consumption multiplier is less than unity. Niti Aayog, the apex public policy think tank of the government of India, has propounded that this multiplier is even larger during economic contractions.

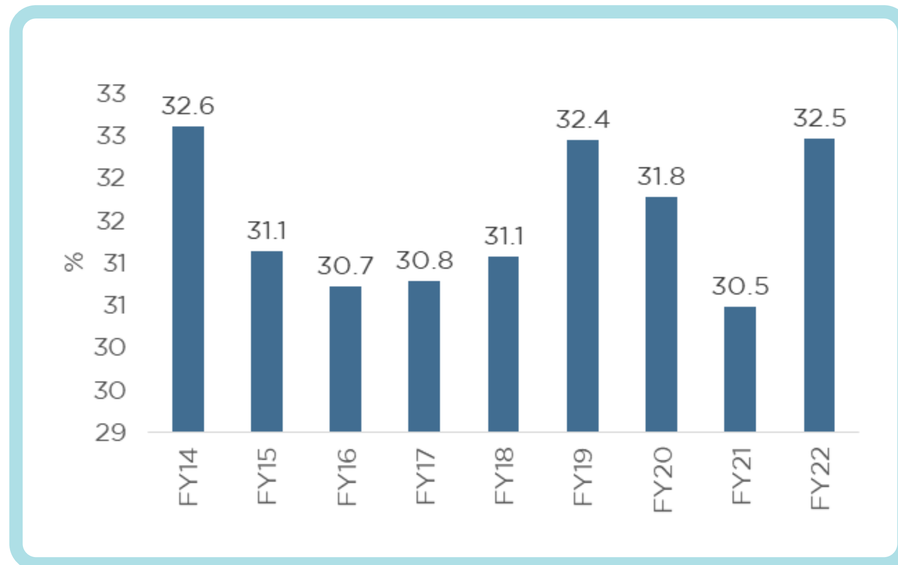
To make the most of this opportunity, the government has ramped up capital expenditure to overcome pandemic-led disruptions. To promote India as an investment-friendly destination and crowd-in private funds, the government has announced a host of schemes such as the Production Linked Incentive scheme (2020), National Infrastructure Pipeline (2020), PM Gati Shakti (2021), relaxation in FDI norms, and corporate tax cuts among others.

Exhibit 1: Investment vs. GDP Growth



Source: MOSPI

Exhibit 2: GFCF as % of GDP



Source: MOSPI

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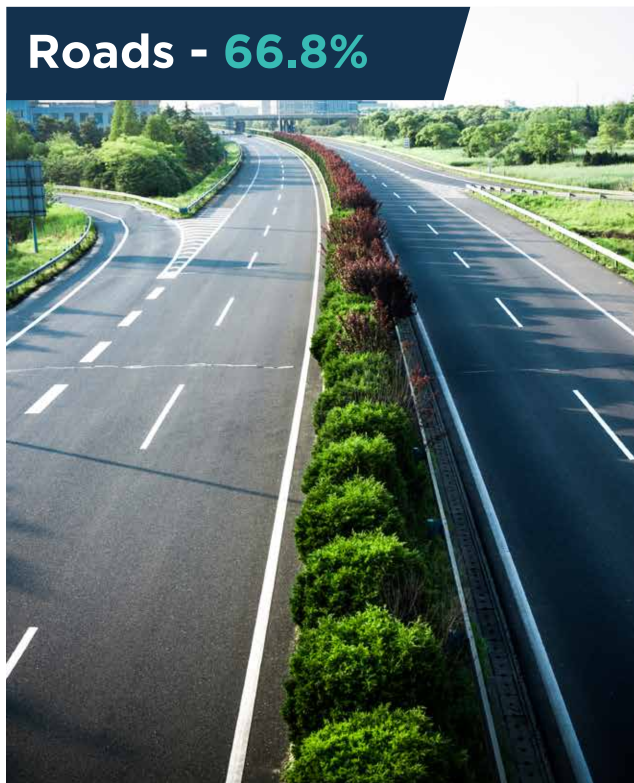
CENTRE FRONTLOADS CAPITAL SPENDING TO SPUR ECONOMIC GROWTH

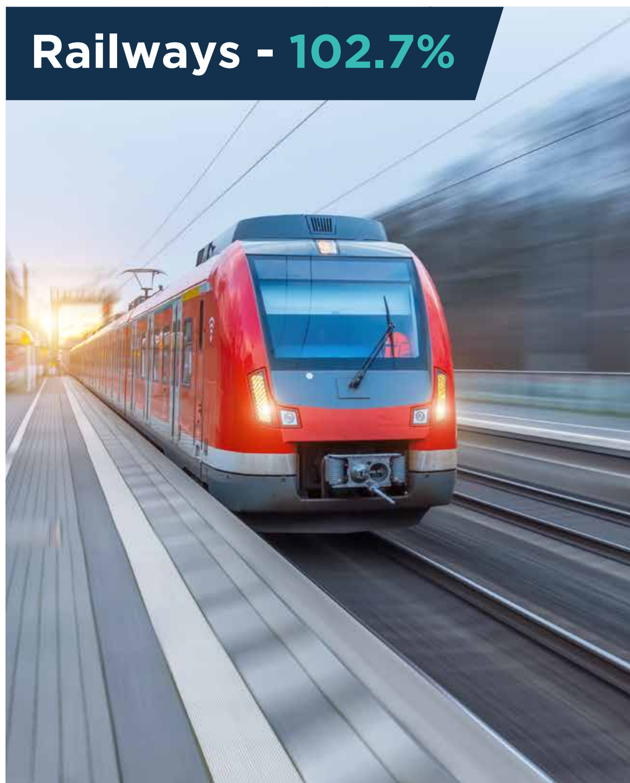
Centre's Capital Spending Up by 62.5% During April-July FY23

Focus Areas of Capex (y-o-y% Growth During April-July FY23)

Roads - 66.8%



Railways - 102.7%



Defence - 40.6%

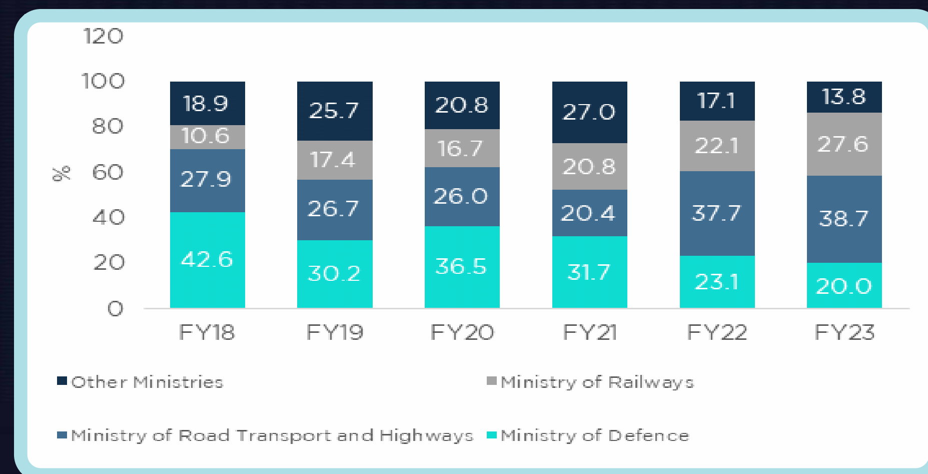
The quick revival from the Covid-19-led economic slump was backed by public investment resulting in a sharp rebound in gross fixed capital formation (GFCF) in FY22. The ratio of GFCF to GDP (constant prices) rose to 32.5% in FY22 from 30.5% in FY21 (Exhibit 2). In absolute terms, gross fixed capital formation grew by nearly 16% (y-o-y) and by about 4% compared with the pre-pandemic level (FY20). This was supported by a higher capital expenditure by the central government which has been on the uptrend in recent years. The union government accelerated the pace of capital spending in FY22 to compensate for the muted investor sentiment among corporates. More than 60% of the capital spending was concentrated in employment- generating sectors such as road, railways and defence. A higher level of capital expenditure in the railways sector aligns with the vision of making it 'an engine of national growth' by 2030 as outlined in the Economic Survey 2021-22.

Continuing with the momentum, the government has budgeted for an all-time high capital spending of Rs 7.5 lakh crore in FY23, 24.5% more than the revised figure for FY22. In an encouraging sign, the Centre has already achieved 27.8% (Rs 2.1 lakh crore) of the capital expenditure target in the first four months (April-July) of the current fiscal. Overall, central government's capital expenditure rose by 62.5% (y-o-y) in April-June of the current fiscal.

Roads and highways, railways and defence remained the top three major areas of capital expenditure. However, over the years the share of defence in total capital spending has come down while that of roads and railways has increased (Exhibit 3). In the April-July period of FY23, capital spending on railways and roads and highways jumped by 102.7% and 66.8% (y-o-y), respectively. Both these sectors accounted for more than 60% of the total capital spending.

In addition, Central public sector enterprises (CPSEs) have also stepped up their spending on capital formation in the first quarter of the current fiscal. These entities spent Rs 1.37 lakh crore in Q1 FY23, which is about 21% of their annual target (Rs 6.61 lakh crore). In FY22, these entities achieved only 79% (till February 2022) of their annual capex target of Rs 5.95 lakh crore.

Exhibit 3: Share of Ministries in Centre's Capex (April – July)

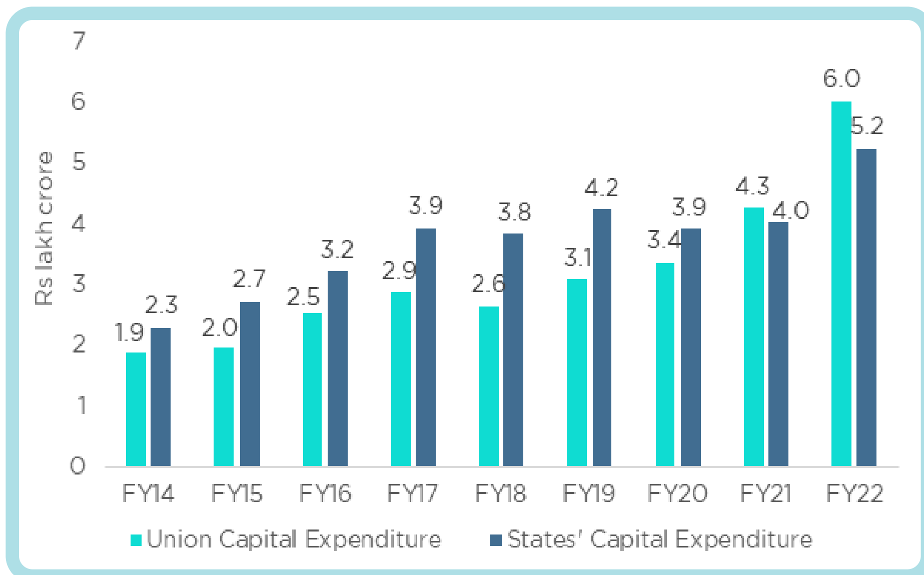


Source: Controller General of Accounts (CGA)

STATES' CAPITAL EXPENDITURE CATCHING UP

While capital expenditure by the Centre has been robust, state governments have lagged due to liquidity constraints during the pandemic years. Usually, the combined capex by the states is higher than that of the union government, but the aggregate data for 27 states shows that in FY21 and FY22, their total capital expenditure was lower than that of the Centre. (Exhibit 4).

Exhibit 4: Centre vs. States Capital Expenditure*



Source: Comptroller and Auditor General of India (CAG) and CGA;
*Note: States' capital expenditure is for a total of 27 states

Capital spending by the states had a slow start in FY23 owing to the concerns of cessation of GST compensation and lower market borrowings by the states due to delays in the Centre's approval. The combined capital spending by 21 states in Q1 FY23 was 9% lower on a y-o-y basis. However, it picked up pace in July and their combined capital expenditure in April-July 2022 was only marginally lower at Rs 90,613 crore compared with Rs 90,736 crore in the corresponding period of the previous fiscal. These 21 states have budgeted for a strong 39% increase in their capital spending in FY23 compared with the actual combined capital spending in FY22.

Large states such as Uttar Pradesh, Madhya Pradesh, Gujarat, Maharashtra and Karnataka drove capex spending, accounting for nearly 54% of the total in the April-July period. Of these 21, states such as Madhya Pradesh, Gujarat, West Bengal, Kerala and Chhattisgarh have budgeted for good growth in capex and have also achieved a fair portion of it in the first four months of FY23 (Table 1).

Table 1: States' Capex Profile

	April-July FY23		FY23
	Actual Capex (Rs crore)	**Capex as % of BE**	**% growth in BE***
Uttar Pradesh	12,767	10.3	76.5
Madhya Pradesh	11,201	24.5	12.2
Gujarat	8,989	25.0	27.4
Karnataka	8,077	18.5	-13.4
Maharashtra	7,716	11.8	40.1
West Bengal	5,706	17.2	88.1
Rajasthan	5,605	16.1	33.0
Odisha	4,590	11.8	66.9
Bihar	4,239	13.7	28.4
Kerala	4,119	27.6	7.6
Telangana	3,939	13.2	2.1
Chhattisgarh	3,045	20.0	40.0
Nagaland	2,728	16.4	71.1
Haryana	2,335	10.5	127.0
Jharkhand	1,644	9.9	78.0
Himachal Pradesh	1,168	20.7	-4.3
Uttarakhand	1,167	10.8	43.9
Punjab	1,149	10.5	33.9
Sikkim	217	13.2	20.6
Tripura	181	3.4	267.0
Mizoram	30	1.1	161.6
Total	90,613	15.0	38.9

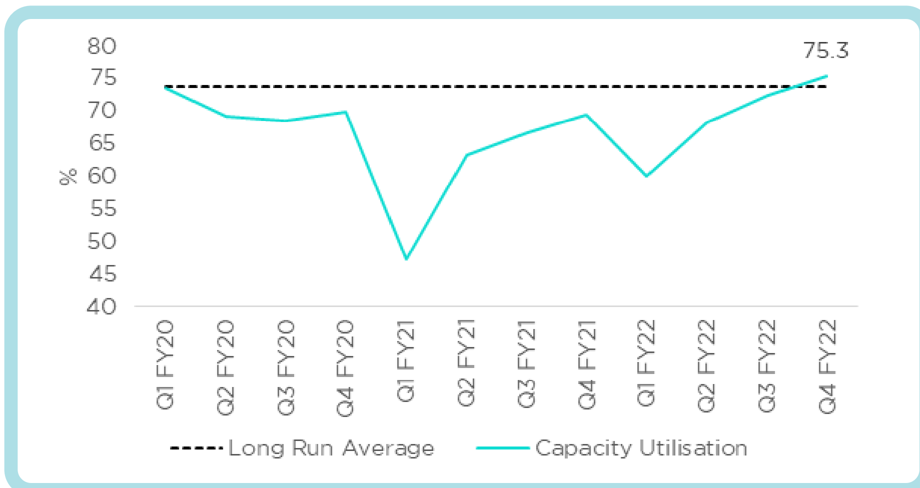
Source: CAG; *Over actual of FY22

States usually follow the policy of wait and watch and accelerate their capex efforts only in the last quarter of the fiscal. This is to ensure that they adhere to the fiscal consolidation norms. Therefore, to encourage early capital spending by states, the Centre has front-loaded the tax devolution to states. It has released two instalments of tax devolution to states amounting to Rs 1.17 lakh crore in August, against the regular monthly devolution of Rs 58,333 crore. Furthermore, the centre has also announced an interest-free loan of Rs 1 lakh crore to the states to enable them to accelerate capital expenditure. While expenditure of Rs 80,000 crore of the total loan amount is at states' discretion, an amount worth Rs 20,000 crore has been earmarked for specific investment schemes like PM Gati Shakti, Pradhan Mantri Gram Sadak Yojana, urban sector reforms, and laying of fibre-optic cables under Digital India Initiative. So far, Rs 34,000 crore of the interest-free loan has been allotted to 13 states and this amount is expected to rise to Rs 70,000 crore by the end of the second quarter. This combined with a rebound in economic activities is expected to mobilise enough revenue for states to push for higher capital expenditure. Consequently, we could see an improvement in the state's capital spending in the coming months which will complement the efforts of the Central government.

PRIVATE INVESTMENT ON THE VERGE OF RECOVERY

While public investment steered India's post-pandemic economic revival, private investment remained lacklustre and limited to certain sectors. Despite the abundance of liquidity and lower borrowing costs as a result of accommodative policies, investment sentiments were hurt due to the uncertain economic environment globally and weak consumption demand. The capacity utilisation in the manufacturing sector declined to a mere 47.3% in Q1 FY21 as compared to 69.9% in Q4 FY20. However, following a post-pandemic revival in demand the capacity utilisation level in the manufacturing sector has been showing a rising trend since Q2 FY22. In the last quarter of FY22, it climbed to 75.3%, above the long-run average of 73.7%. The capacity utilisation needs to be maintained between 75-80% to fuel fresh investments in the economy.

Exhibit 6: Capacity Utilisation Level



Source: RBI

Though India's private capex cycle has been slow to gather pace, the outlook for coming quarters looks positive. With capacity utilisation rising above 75 coupled with an improving demand scenario, we could expect the private investment cycle to accelerate. The easing of commodity prices and consequent weakening of input prices for many sectors will support firms' margins and in turn incentivise firms to undertake fresh investments. Improvement in corporates' profitability will also aid private capex cycle revival. Though the government's continued thrust on capital spending is a welcome move, increased private participation is warranted to unleash the animal spirits in the economy.

CAPEX BY INDIA INC. SHOWS SIGNS OF REVIVAL

Capital Spending by India Inc. Up by 22% y-o-y in FY22

s Driving Capex
2 (% Share)

37%
21%
18%
13%
5%
5%

Our analysis based on data for 659 listed non-finance companies shows that capital expenditure by companies rebounded in FY22 with a growth of 22% (y-o-y) following a decline in FY21 (Exhibit 7). However, it remained below pre-pandemic levels seen in FY19 and FY20 as businesses were cautious to incur fresh investments due to a combination of factors such as high inflation, muted demand, subdued business sentiments and an uncertain economic environment.

The top five sectors in which capital expenditure was concentrated in FY22 were telecom, oil & gas, power, retailing, and iron & steel with a share of 63% in total capex. Some of the major players incurring capex in these five sectors were Reliance Industries Limited, Bharti Airtel Limited, Oil & Natural Gas Corporation Limited, NTPC Limited, Adani Green Energy Limited, JSW Steel Limited and Tata Steel Limited.

The capex revival by India Inc. is skewed with few sectors and few big players contributing to the chunk of the investment. The small and mid-sized players are hesitant in midst of all the global and domestic economic uncertainties. With capacity utilisation levels improving we are likely to see increased participation from the other smaller players. The critical aspect will be the maintenance of the demand momentum. Having said that, global slowdown, volatile commodity prices and tightening financial conditions would dampen investment sentiments.

Exhibit 7: Capex by India Inc.

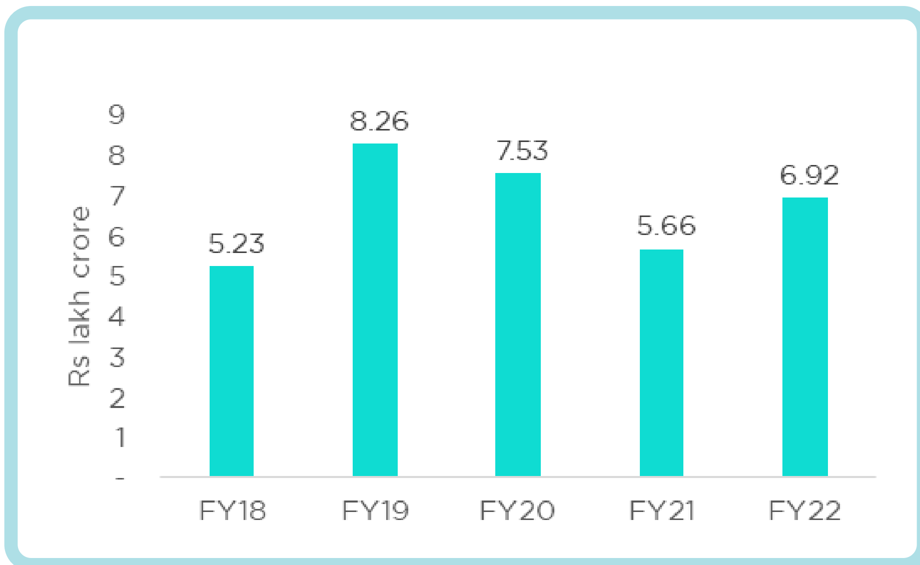
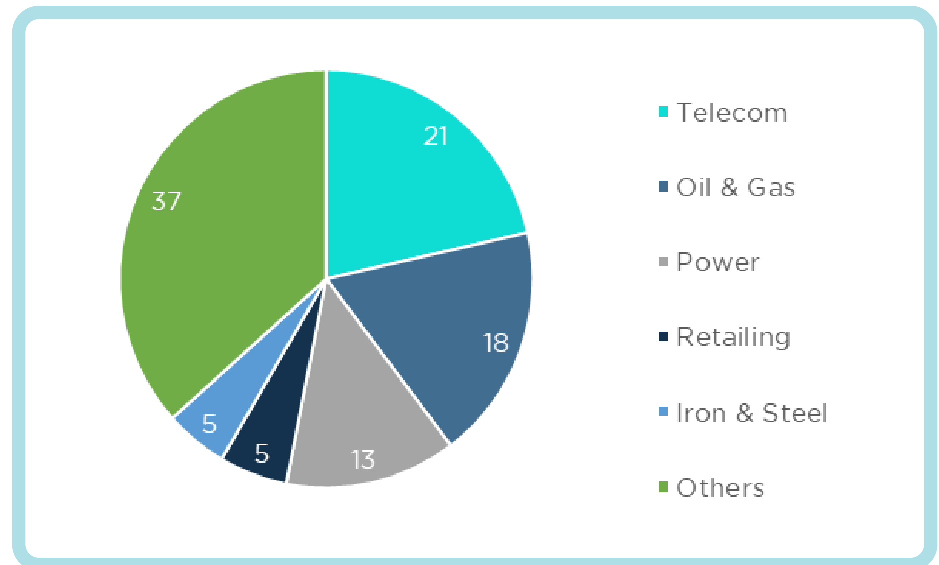


Exhibit 8: Capex by Top 5 Sectors in FY22 (% Share)



Source: Ace Equity; CareEdge; Note: Numbers based on data of 659 non-finance companies

Company	Sector
Reliance Industries Limited	Telecom, Retail, Oil & Gas
Bharti Airtel Limited	Telecom
Oil & Natural Gas Corporation Limited	Oil & Gas
Indian Oil Corporation Limited	Oil & Gas
NTPC Limited	Power
Adani Green Energy Limited	Power
JSW Steel Limited	Iron & Steel
Tata Steel Limited	Iron & Steel

Source: Ace Equity; CareEdge; Note: Numbers based on data of 659 non-finance companies

Note:

Formula used for capex calculation is (Gross Block + CWIP) of current year – (Gross Block + CWIP) of previous year.

In this total capex calculation, there would be some instances where Gross Block would have gone up because of Capex by these players outside India, but such cases in overall calculation will not be significant. This calculation could also have some instances where Gross Block has gone up simply because of an acquisition, but again this number will not be significant in aggregate capex calculation.

MIXED SCORECARD FOR INVESTMENTS IN Q1 FY23

In Q1 FY23, the share of projects under implementation in the total projects outstanding inched up marginally to 60.8% from 59.5% in the previous quarter, as per CMIE data. The projects under implementation were driven by the government with a share of nearly 67%.

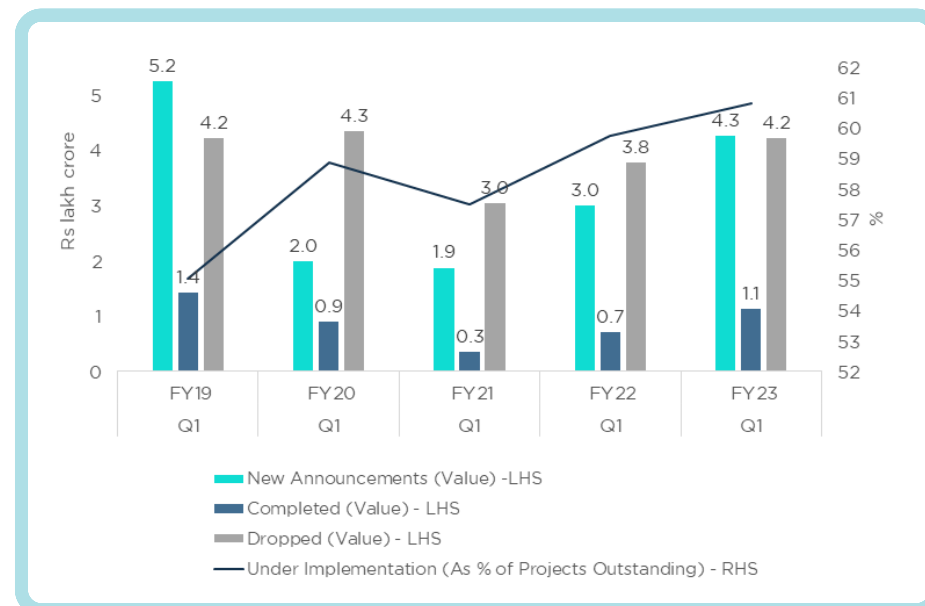
The investment projects completed remained buoyant at Rs 1.1 lakh crore in Q1 FY23, when compared to projects completed worth Rs 0.9 lakh crore seen in the pre-pandemic period of Q1 FY20. However, the projects completed dipped by 11.4% in Q1 FY23 when compared with the previous quarter. The projects completed were steered mainly by the private sector with a share of 55% in the total, up from 33.6% in the previous quarter. This increase in the share of private sector appears encouraging from the perspective of a pick-up in the private capex cycle. Services were at the lead comprising a 52.8% share in the total. Within services, 73.5% of the projects were focused in the transport services category (including air, railway and road transport services).

In Q1 FY23, the new investment projects announced remained upbeat recording a 42.5% y-o-y growth. Sequentially, the new investment projects announced fell sharply by 45.3% q-o-q in the first quarter of the current fiscal after having steadily risen in the last five quarters. The sequential fall could be attributed to the high number of new projects announced in Q4 FY22. In an encouraging sign, the share of the private sector in new investment projects announced inched up to 74% in FY22 from 55.3% in FY21. In Q1 FY23, new projects announced by the private sector have been upbeat with a share of 91.8% in total. This shows that the private sector is showing increased intent to invest.

However, it is to be noted that the investment projects dropped have remained over Rs 4 lakh crore in the latest two quarters, as against a quarterly average of Rs 3.4 lakh crore in the previous year.

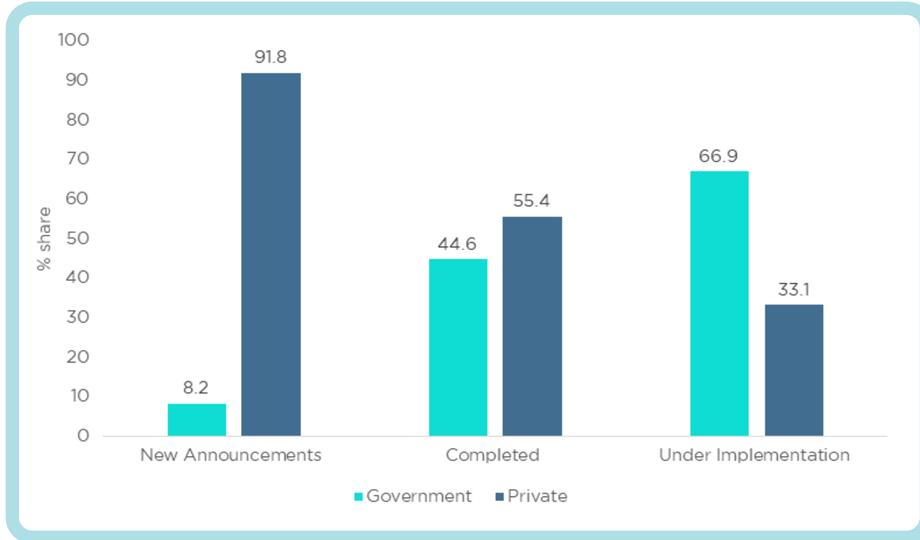
In a nutshell, there are some signs of improvement in capex in the coming quarters going by the data on new investment projects announced and completed. However, it is yet difficult to draw a very conclusive trend from this data.

Exhibit 9: Overview of the Investment Scenario



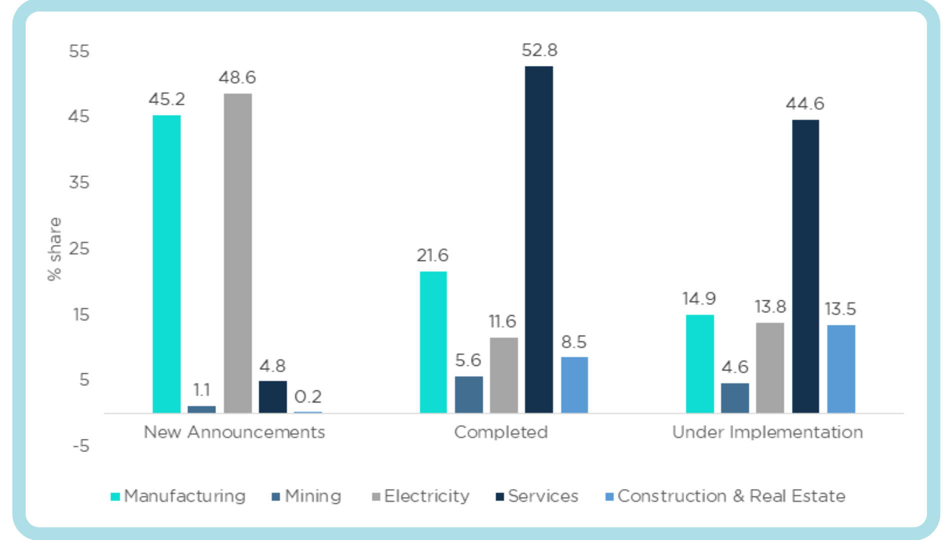
Source: CMIE

Exhibit 10: Investments by Ownership – Q1 FY23



Source: CMIE

Exhibit 11: Investments by Industry – Q1 FY23

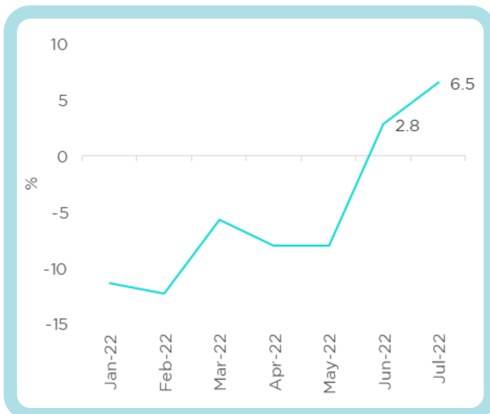


Source: CMIE

CAPITAL GOODS PRODUCTION & IMPORT SIGNAL RECOVERY

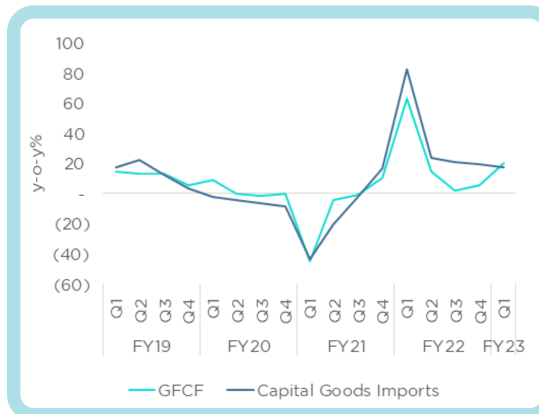
From the standpoint of production of capital goods, IIP capital goods have breached the pre-pandemic level since June 2022 and have recorded an encouraging growth of 6.5% in July when compared with the corresponding month of the pre-pandemic period (2019). This trend will have to be closely monitored over the coming months as a litmus test for the sustenance of demand for capital goods in the economy. Capital goods imports grew by an encouraging 20.1% during the April-July period of FY23. This could be taken as another indicator pointing towards a likely pick up in the investment cycle (Exhibit 13).

Exhibit 12: IIP-Capital Goods (% Growth over 2019)



Source: MOSPI

Exhibit 13: Capital Goods Imports and GFCF



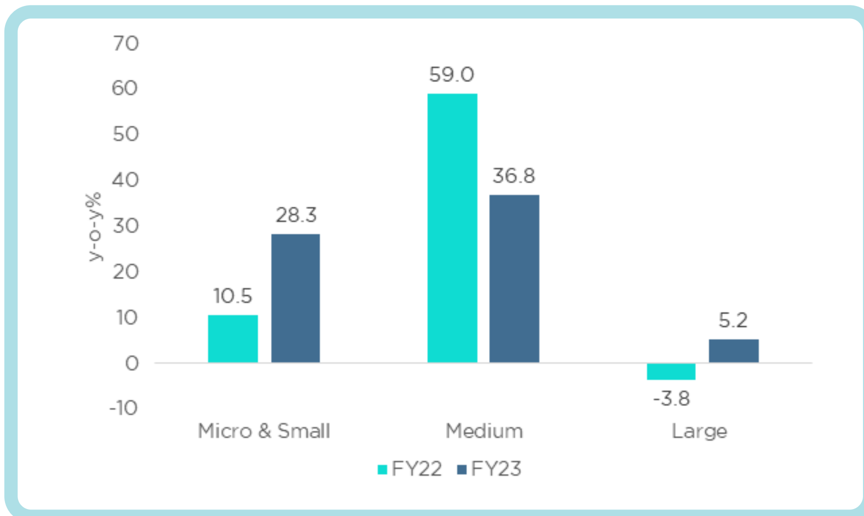
Source: CEIC, MOSPI

SOURCES OF FUNDING

Bank Credit

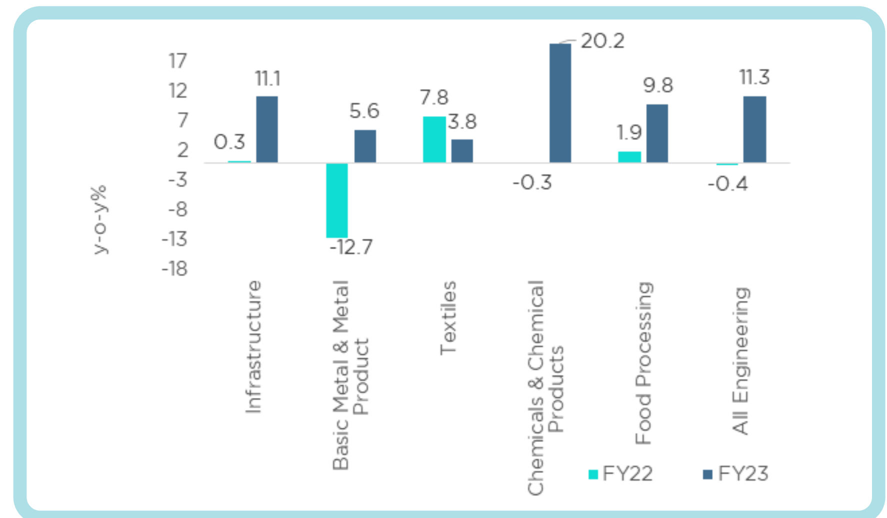
Bank credit growth is a crucial indicator for gauging the consumption and investment demand in the economy. Data up to July 2022 shows that gross bank credit grew by a healthy 14.5% y-o-y. Credit to industry accelerated to 10.5% y-o-y (as against 0.4% last year). However, the growth in credit disbursed to large enterprises remained relatively low at 5.2%. While credit growth to large enterprises is still low, it is showing a gradual improvement in the last few months. Of the total industrial credit disbursement, credit to large enterprises constitutes a share of nearly 75%. Within the industry, credit to Infrastructure (which constitutes a share of 38% of the total credit disbursement) grew by 11.1% in July 2022 as against a growth of 0.3% last year. Other industries such as chemicals and engineering goods have also logged double-digit credit growth (Exhibit 15). However, we have to take into account that apart from investment demand, the increase in bank credit would also be reflective of higher inflation and working capital requirements.

Exhibit 14: Gross Bank Credit Deployment to Industries (April-July Period)



Source: CEIC

Exhibit 15: Industry-Wise Deployment of Gross Bank Credit (April-July Period)

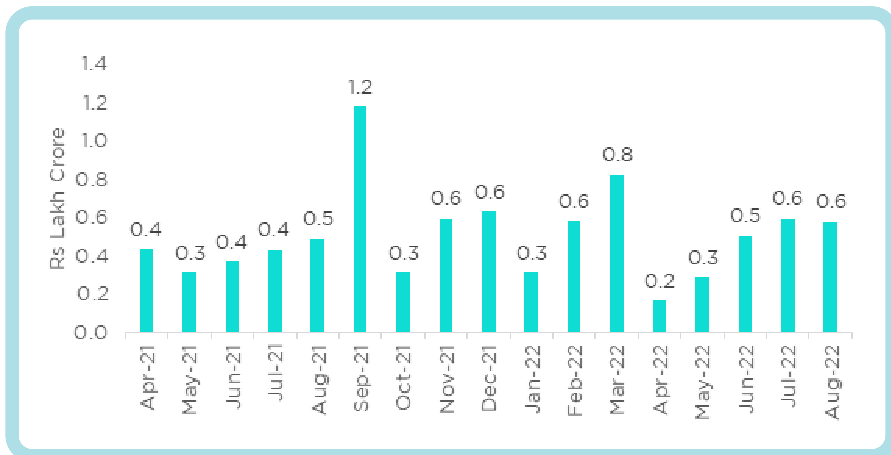


Source: CEIC

Corporate Bond Issuances

So far in FY23, corporate bond issuances have been at Rs 2.1 lakh crore, 4.8% higher than the same period last year. Moreover, the pick-up in issuances since May 2022 appears encouraging. The rising bank lending rates could result in some preferential shifts of the corporates towards the bond market to meet their funding requirements. The gradual pick-up in the investment cycle should improve the prospects of the bond market.

Exhibit 16: Corporate Bond Issuances

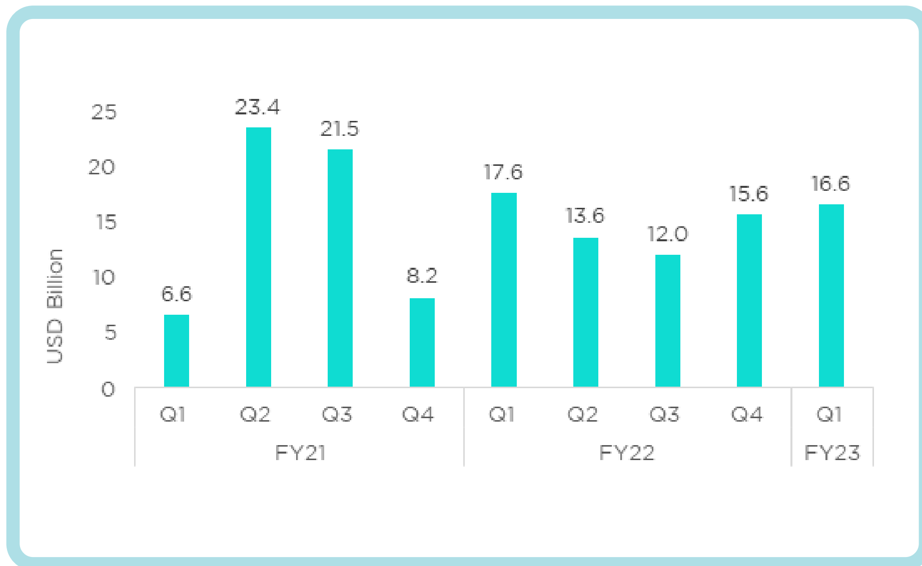


Source: Prime Database; Note: Data extracted as on 7 September 2022

External Sources

On the external funding front, annual Foreign Direct Investment (FDI) inflows in the last two years have remained largely stable above USD 58 billion. FDI inflows climbed to USD 16.6 billion in Q1 FY23 from USD 15.6 billion in the previous quarter. Annual External Commercial Borrowing (ECB) inflows remained close to USD 35 billion in FY21 and FY22, moderating from USD 51 billion in FY20. In Q1 FY23, ECB inflows dropped to a low of USD 3.4 billion (Exhibit 18). With rising interest rates globally, we could see a moderation in ECB inflows in FY23.

Exhibit 17: Trends in Foreign Direct Investment



Source: CEIC

Exhibit 18: Trends in External Commercial Borrowings

Source: CEIC

WAY FORWARD

So far in the year, the Centre's capital expenditure has seen a promising growth of 62.5% y-o-y and CareEdge believes schemes such as the National Monetisation Pipeline, Gati Shakti, and PLI should help in the recovery of the capex cycle. The state governments have also budgeted for a strong capital expenditure, with the aggregate budgeted capex for 21 states at Rs 6 lakh crore – 39% higher than the actual capex of last year. Though the capex by state governments has been slow to pick up, the Centre's disbursement of interest-free loans should aid in the rebound of the capex cycle by states in the coming months.

As far as the private sector is concerned, there has been deleveraging in the last few years. Now with the capacity utilisation levels improving to 75%, the ground is set for pick up in the investment cycle. The most critical aspect now would be the sustenance of demand recovery that we are witnessing. While the recent fall in global commodity prices and consequent easing of input prices are supportive of investment uptick, the volatility in commodity prices remains a challenge.

Interest rates have been rising with RBI hiking the repo rate by 140 bps since May 2022. CareEdge expects the repo rate to rise further by 50 bps in the current year, moving towards a positive real rate of interest. While interest cost is rising for corporates, that is unlikely to be a big deterrent for the pick-up in capex. However, we need to be cautious of global uncertainties and volatilities. The impending global slowdown would hurt the Indian economy and domestic business sentiments. While the private sector continues to be cautious in midst of all the economic uncertainties, there are signs of recovery in the capex cycle in the months to come.

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