# Global Research & Analytics

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INDIAN ECONOMY

# CRISIL Insights

April 2018

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we take a look at how crucial numbers have moved since the NDA government swept to power with an overwhelming mandate in June 2014.

## 47 months later

Four years of the Narendra Modi-led National Democratic Alliance (NDA) have been a mixed story of good luck on oil, reforms and repair, disruptions, and slower growth. As the government's present term draws to a close, we take a look at how crucial numbers have moved since it swept to power with an overwhelming mandate in June 2014. We assess the government's performance through three lenses:

- Macroeconomic environment: The macroeconomic parameters have generally shown improvement with lower volatility. India's gross domestic product (GDP) grew at 7.3% per year in the past four years, which was lower than the trend of 7.6% in the preceding decade. The growth slowdown was partly a result of policy choices aimed at improving macroeconomic parameters such as inflation and fiscal deficit. The slowdown became more pronounced in fiscal 2018 due to demonetization and Goods and Services Tax (GST) related glitches in an environment of drying up of good luck factor from crude oil. Retail inflation declined through the four years aided by soft food inflation and proactive steps from government.Improving twin deficit was another hallmark of the NDA regime though some of the gains were reversed in fiscal 2018 with 30 basis points (bps) slippage in fiscal deficit/GDP and surge in the current account deficit. Despite the pick-up in foreign direct investment, there was no notable uptick in private investment. Another worrying aspect of last four years has been the surge in non-performing assets of the banking sector.
- Business sentiments: Reforms and improvement in macroeconomic balances were not enough to move business sentiments materially, as per the surveys by the Reserve Bank of India (RBI), the National Council of Applied Economic Research, and business chambers (Confederation of Indian Industry, Federation of Indian Chambers of Commerce and Industry). After being hit by demonetization and GST disruptions in 2017, business sentiments have started recovering.
- Global positioning: Even with growth slowdown, India still stands tall as the fastest-growing country in BRICS (Brazil, Russia, India, China and South Africa). India has also improved its global competitiveness position and ease of doing business rank due to reform focus of the government. However, corruption ranking, after initial improvement, again slipped in 2017.

Net-net, many of the reforms initiated by the Modi government are work in progress and need relentless execution focus. Without doubt, these create an upside to the medium-term growth trajectory. So, the focus in 2018 should be to consolidate action on reforms already announced. GST and the Insolvency and Bankruptcy Code are the key reforms with potential to be game changers for the economy over the coming years.

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| Money and Banking | Industrial Production | Inflation |
|---|---|---|
| Standing pat after de facto tightening | IIP shows healthy growth, helped by low base | Inflation pressures ease further led by food |

## MONEY AND BANKING

- In its first review meeting of fiscal 2019, the RBI's Monetary Policy Committee (MPC) kept policy rates on hold at its April review meeting. The decision was founded on inflation uncertainties
- Given the upside pressures, the MPC will stay vigilant on the evolving inflation scenario and take any rate action with due caution and after weighing the data
- The MPC maintained its neutral monetary policy stance with a focus on maintaining medium-term inflation at 4%
- Liquidity in the banking system dipped further into the deficit zone, for the second month in a row, requiring the RBI to inject funds
- Credit growth grew in double digits, at 10.3%, as of February 16, 2018
- The inflation forecast for this fiscal has been revised down to ~4.7% average, from the ~5% estimated earlier, even as the forecast for GDP is unchanged at 7.4%
- CRISIL expects the repo rate to remain unchanged over the next six months unless the upside risks to the MPC's inflation forecast materialize

## INDUSTRIAL PRODUCTION

- The Index of Industrial Production (IIP) delivered a healthy 7.1% on-year in February, just a tad below 7.4% growth (revised up from 7.1% earlier) in January
- Manufacturing growth at 8.7% was the key driver
- Electricity growth plummeted to 4.5% (from 7.6%)
- Mining sector, after having displayed weak growth in past few months, turned into negative territory (-0.3%)
- According to the use-based classification, infrastructure and construction goods, growing at 12.6%, continued their healthy pace

## INFLATION

- Consumer Price Index (CPI)-based inflation came in at 4.3% in March, after a 60 bps fall to 4.4% in February. The slide was mainly led by lower food inflation
- Although food inflation rate fell more – by 40 bps over February – and overall fuel inflation decelerated by 100 bps, core inflation edged up
- Wholesale Price Index (WPI)-based inflation stood stable in March at 2.5%, taking the average for fiscal 2018 to 2.9%, up from 1.7% in fiscal 2017
- Inflation in housing, the category that had rapidly been pushing up core inflation in the recent past, stood steady for the third month in a row even as other core inflation categories ticked up
- For full fiscal 2018, CPI inflation averaged 90 bps lower at 3.6% compared with 4.5% in fiscal 2017. Most of the fall was on account of food inflation, which fell 240 bps, while fuel inflation rose 260 bps. Core inflation was also moderately lower, falling 30 bps
- CRISIL expects CPI inflation to average 4.6% next fiscal
- The pick-up will be due to rising consumption demand, impact of house rent allowance revisions on housing inflation, and higher global crude oil prices

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| Interest Rate | Rupee | Trade |
|---|---|---|
| Bond market exhales, for now | Rupee ends strong year on weak note | Labor-intensive sectors push exports into the red |

INTEREST RATE

- Yield on the 10-year government security (G-sec) ended March at 7.40%, down 33 bps from February-end
- While yields remained high through the month, the government's announcement at the month-end of a lower market borrowing program for first half of fiscal 2019 compared with the previous year, calmed yields
- Corporate bond yields fell in tandem, with yield on the 10-year paper moving down 40 bps on-month to 7.85% by March-end
- On average, however, corporate bond yields were up 14 bps to 8.16%.
- CRISIL expects the 10-year G-sec yield to settle at 7.6-7.7% by March 2019, compared with 7.62% in March 2018
- There could be some upside to this forecast if: a) oil prices escalate too rapidly, pushing up both inflation and the government's subsidy burden, b) the RBI decides to hike rates faster, should inflation tests the upside, and c) there is a fiscal slippage, leading to higher-than-budgeted market borrowing

RUPEE

- Rupee extended its losses for the second consecutive month, averaging 65 against the US dollar, 1% weaker on-month
- Pressured by a modestly strengthening US dollar, tepid foreign portfolio investor (FPI) inflows, and a rising current account deficit (CAD), the rupee was among the worst-performing emerging market currencies in March
- Nevertheless, the rupee was 3.9% stronger on-year in fiscal 2018, averaging 64.4 per US dollar, marking the first year of appreciation since fiscal 2011
- The home currency's value was also boosted by the dollar, which weakened 2.6% on-year in fiscal 2018. However, the rupee depreciated against the euro, pound and yen by 16.4%, 13.3%, and 5.7%, respectively
- CRISIL expects the rupee to weaken to 66.5 per dollar by March 2019 from 65 in March 2018

TRADE

- Merchandise exports declined 0.7% on-year in March, compared with 4.5% growth in February. This is the fourth consecutive month of slowdown in exports growth
- While growth in imports also slowed for the fourth straight month, it continued to outpace exports growth
- In fiscal 2018, exports grew an average 9.9% on-year, or less than half the 21.2% growth in imports.
- Trade deficit, which was on a declining trend for the past four years, has widened $52 billion on-year in fiscal 2018 to $160 billion
- CRISIL expects trade deficit to widen further in fiscal 2019 as the rise in oil prices and improvement in domestic demand will keep import growth higher than export growth

Source: CRISIL Research

### About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

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