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CRISIL IndiaInsights

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Pain points aplenty

The Indian economy is going through a more-than-anticipated slowdown, as weakness in the real sector and stress in the financial sector are feeding into each other and spiralling down growth. That gross domestic product (GDP) growth in the second quarter this fiscal will print below the 5% logged in the first, appears certain now.

Key short-term indicators such as industrial production, exports, bank credit, tax collections, freight movement, electricity production, and credit, all point to weakening growth momentum. Although inflation spiked, core inflation fell sharply, confirming that demand is slipping. Slowing global growth, falling trade intensity, and uncertainties stemming from trade conflict are hurting, too. Interestingly, this slowdown is atypical, in the sense that it is accompanied by the cleaning-up of the financial sector – something that's happening after almost 20 years. That has the potential to stretch the slowdown, particularly when the policy space to fire the economy in the short run is limited.

Monetary policy, too, has lost its bite. Despite a cumulative repo rate cut of 135 basis points (bps) by the Reserve Bank of India (RBI), lending rates have come down only 20-30 bps. With the slowing economy, the demand for credit has come down, but the risk aversion and weak sentiment mean the willingness to supply credit, too, has reduced. Amid the gloom and doom, the big picture for the medium run remains promising – with 7% per year growth over the medium run. We believe India's transition from around 5% GDP growth in April-June quarter of 2019, to 7% over the next five years, will be complimented by steps that improve the quality of growth.

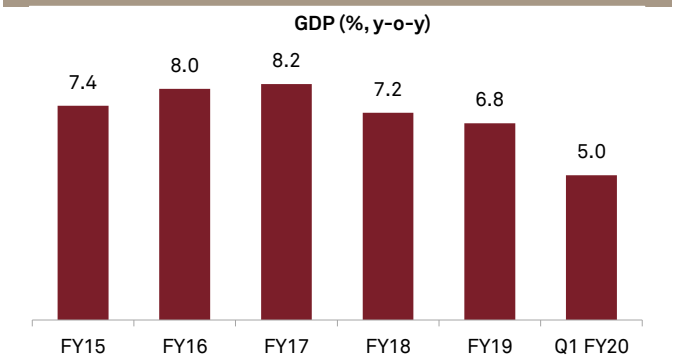
First, healthier corporate balance sheets and a stronger banking sector will underpin recovery. More importantly, the clean-up of the financial system has been accompanied by steps that will improve India's credit culture. We are moving towards a system that not only improves the ability of the banks to recover their debts, but also, for the first time, instils in promoters the fear of losing their companies altogether. Second, reforms such as the Goods and Services Tax and the Insolvency & Bankruptcy Code are expected to improve allocation and efficiency of capital, and create possibilities of an efficiency-led spurt in growth, once streamlined.

All this, however, requires relentless implementation of reforms. The current slowdown provides the government the opportunity to use its abundant political capital to push for hard reforms to make labour laws flexible, make acquisition of land easier, and improve the ease of doing business further.

	FY18	FY19	FY20F
GDP (y-o-y %)	7.2	6.8	6.3*
CPI inflation (%, average)	3.6	3.4	3.6*
Fiscal deficit (% of GDP)	3.5	3.4	3.3#
10-year G-sec yield (%, March)	7.6	7.5	7.1*
Current account deficit (% of GDP)	1.8	2.1	2.2*
Rs per $ (March)	65.0	69.5	71.0

Note: *Due for revision shortly, #Budget target, F = Forecast
Source: National Statistical Office, RBI, budget documents, Ministry of Finance, CRISIL Research

Growth sliding down

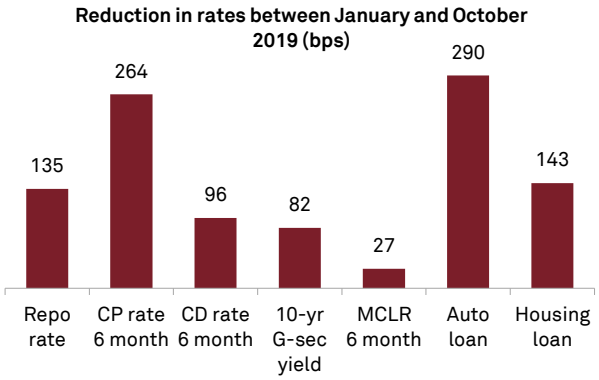


Source: National Statistical Office

Monetary Policy

Cut, it is

- The Monetary Policy Committee, RBI, on October 4, cut the repo rate by 25 bps, in line with expectations
- For faster transmission and greater transparency, the RBI made it mandatory for banks to link all new floating rate personal or retail loans and floating rate loans to MSMEs to an external benchmark, starting October, instead of MCLR-based lending rates
- Reduction in government cash balances with the RBI increased liquidity surplus in October
- Lending rates eased in segments such as housing and auto

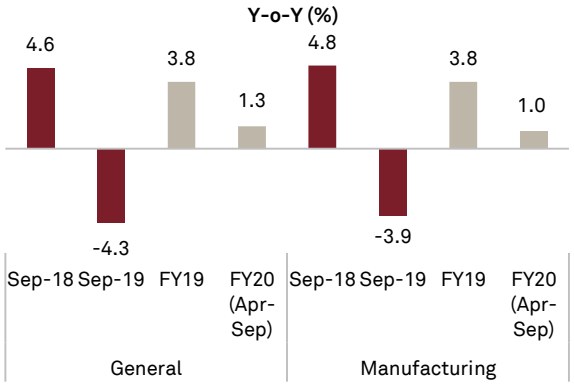


Source: RBI, CRISIL

Industrial Production

Two falls in a row

- Index of Industrial Production (IIP) posted a sharp 4.3% contraction in September from previous month's contraction of 1.4%. This brings Q2 IIP at a 0.4% contraction compared with 3% growth in Q1
- The drop was broad-based, driven by mining, manufacturing and electricity. The loss of momentum in industrial sectors is expected to bring overall GDP growth in Q2, further down
- Lead indicators suggest mixed picture for October

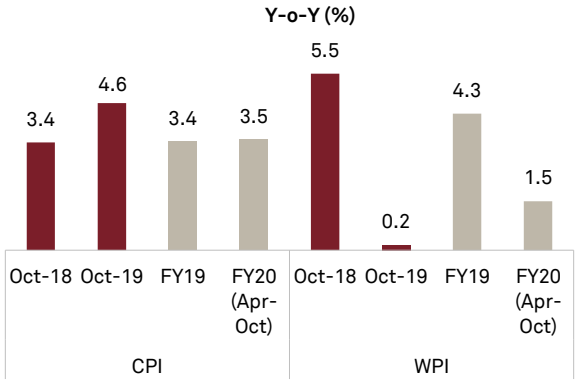


Source: National Statistical Office, CRISIL

Inflation

Ascending on food

- Consumer Price Index (CPI) inflation rose 4.62% in October, up 63 bps from 3.99% in September and the highest in past 16 months, led by higher vegetable inflation
- On the other hand, core softened sharply and fuel remained in the negative territory
- Wholesale Price Index (WPI)-based inflation slowed down from 0.33% to 0.16%, the slowest since July 2016
- CRISIL forecasts CPI inflation to average 3.6% this fiscal, compared with 3.4% in fiscal 2019, on rise in food inflation

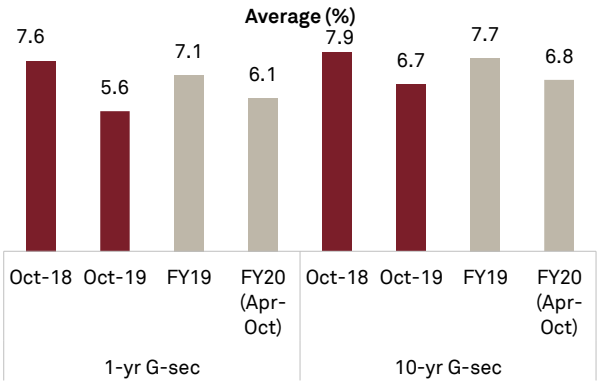


Source: National Statistical Office, CRISIL

Interest Rate

Near-term droop

- Yield on the 10-year government security (G-sec) averaged 6.68% in October, stable compared with 6.67% the previous month
- However, one-year G-sec yields eased 15 bps on-month driven by the RBI's rate cut in October
- Term premium crossed 100 bps, the highest in 20 months
- CRISIL expect the 10-year G-sec yield to settle at 7.1% by the end of this fiscal compared with 7.5% in fiscal 2019-end

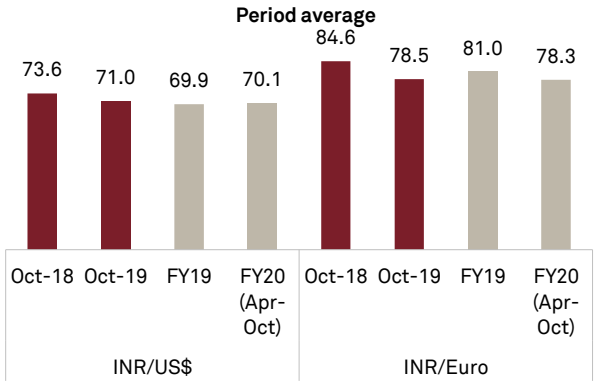


Source: Clearing Corporation of India Ltd, CRISIL

Rupee

Semblance of stability

- The rupee averaged 71.1/$ in October, 0.4% stronger on-month
- Easing of US-China trade tension and progress on Brexit improved risk appetite towards emerging markets. As a result, the dollar weakened and foreign portfolio investor inflows improved
- Falling crude oil prices also supported the rupee
- CRISIL Research expects the rupee to remain stable given the benign oil and global interest rate environment and settle at 71/$ on-average in March 2020 compared with 69.5/$ in March 2019

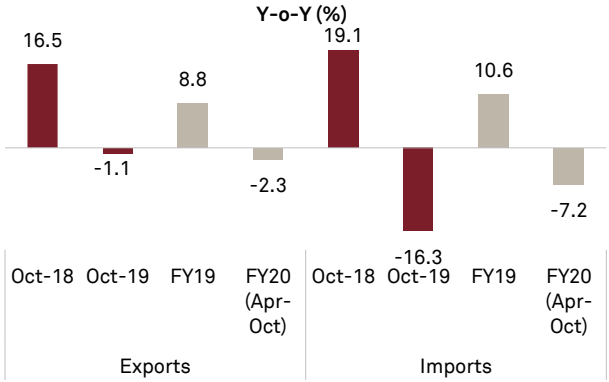


Source: RBI, CRISIL

Trade

Crude pullback in trade

- Merchandise exports contracted for the third month in a row, by 1.1% on-year in October compared with 6.6% in September
- Imports saw the fifth month of decline, with the pace steepening to -16.3% on-year, compared with -13.8%
- Falling crude oil prices was the main factor pulling back export and import growth
- Trade deficit stood at $11.1 billion, $0.15 billion higher on-month, but $7 billion lower on-year



Source: Ministry of Commerce, CRISIL

Global developments

Parameters		US	UK	EA	Japan	China
GDP (q-o-q, annualised %)	Q3-2019	1.9	0.3*	0.2*	0.2	6.0^
CPI inflation (y-o-y %)	Sep'19	1.7	1.7	0.8	0.2	3.0
Trade balance (national currency, billion)	Sep'19	-52.5	-3.4	18.7	-123.0	39.2#
Policy rate (%)	Oct'19	1.50-1.75	0.75	0.0	-0.1	4.2

Note: *Not annualised, ^y-o-y, #$ billion
Source: Statistical bureau, respective countries

- The United States (US) economy grew by 1.9% in Q3, marginally down from 2% in Q2, but better than the consensus forecast of ~1.5%. The US Fed, on October 30, cut its policy rate for the third time this year, and is likely hold it steady through 2020. The cut was along expected lines, made to support economic expansion. On the trade war front, the US and China seem to be edging towards an initial agreement, after having been at loggerheads in the past 16 months
- Showing resilience, the euro area (EA) economy grew 0.2% in Q3, same as in Q2, and above the forecast of 0.1%. But growth continues to remain much below the trend and poses deflation risks. The United Kingdom (UK) avoided recession, growing 0.3% on-quarter in Q3, after having shrunk by 0.2% in Q2. But underlying growth remains weak. The upcoming national election on December 12, 2019 would decide the fate of Brexit, a deal on which was sealed between the UK and the European Union last month
- On account of weakness in the external sector, the Japanese economy slowed sharply to 0.2% in Q3, from 1.8% in Q2. Though the Bank of Japan held policy rates steady in its monetary policy meet on October 31, it suggested the possibly of a rate cut going ahead, given that economic recovery remains fragile on global risks and the impact of recent sales tax hike
- China's Q3 growth slowed from 6.2% in Q2 to 6.0% in Q3, the weakest quarterly growth rate since 1992. High-frequency indicators suggest growth slump in the economy continues. CPI inflation was at 3.8% in October (up from 3.0% in September), the highest in almost eight years. On the other hand, core inflation remained low and stable at 1.5%

Data Summary

	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19
Industrial Production*						
General	4.5%	1.3%	4.6%	-1.4%	-4.3%	-
Mining	2.3%	1.5%	4.8%	0.0%	-8.5%	-
Manufacturing	4.4%	0.3%	4.5%	-1.6%	-3.9%	-
Electricity	7.4%	8.6%	4.8%	-0.9%	-2.6%	-
Primary Goods	2.2%	0.6%	3.5%	1.0%	-5.1%	-
Capital Goods	-2.1%	-6.9%	-7.2%	-21.4%	-20.7%	-
Intermediate Goods	12.5%	12.1%	14.7%	6.9%	7.0%	-
Infrastructure and Construction Goods	3.0%	-1.3%	3.5%	-4.8%	-6.4%	-
Consumer Durables	0.2%	-10.2%	-2.7%	-9.1%	-9.9%	-
Consumer Non-Durables	8.1%	7.4%	8.4%	3.1%	-0.4%	-
Inflation*						
WPI-All Commodities	2.8%	2.0%	1.2%	1.2%	0.3%	0.2%
WPI-Primary Articles	6.8%	6.4%	5.5%	6.5%	5.5%	6.4%
WPI-Manufactured Products	1.5%	1.0%	0.3%	0.0%	-0.4%	-0.8%
WPI-Fuel & Power	2.0%	-2.1%	-3.6%	-3.5%	-7.1%	-8.3%
CRISIL Core Inflation Indicator (CCII)	2.1%	1.7%	1.1%	1.0%	0.9%	0.7%
CPI-(combined)	3.0%	3.2%	3.1%	3.3%	4.0%	4.6%
Current Account						
Exports*	3.7%	-7.8%	1.7%	-6.1%	-6.6%	-1.1%
Imports*	6.1%	-8.6%	-10.4%	-13.5%	-13.8%	-16.3%
FOREX Reserves ($ billion)**	421.9	427.7	429.6	428.6	433.6	442.6
Markets##						
BSE SENSEX	39,714	39,395	37,481	37,333	38,667	40,129
NIFTY 50	11,923	11,789	11,118	11,023	11,474	11,877
SENSEX P/E	29	28	27	26	27	27
Exchange Rate#						
INR/$	69.77	69.45	68.81	71.15	71.33	71.03
INR/GBP	89.65	87.97	85.87	86.49	88.14	89.72
INR/ 100 YEN	78.05	78.39	77.23	79.12	78.54	78.47
INR/EURO	63.44	64.30	63.59	66.94	66.35	65.66
INR/Chinese Yuan	10.19	10.06	9.99	10.08	9.98	10.01
Interest Rates##						
Base rate$	8.95%-9.40%	8.95%-9.40%	8.95% - 9.40%	8.95% - 9.40%	8.95% - 9.40%	8.95% - 9.40%
1-Year GoI Paper@	6.45%	6.20%	6.01%	5.85%	5.75%	5.60%
10-Year GoI Paper@	7.29%	6.94%	6.52%	6.50%	6.67%	6.68%

Note: *Growth y-o-y, #Monthly averages, ##Month-end, @Semi-annualised, $10 banks, **As on October 25, 2019

Source: RBI, Government of India, Bombay Stock Exchange, Central Statistics Office, CRISIL Research

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