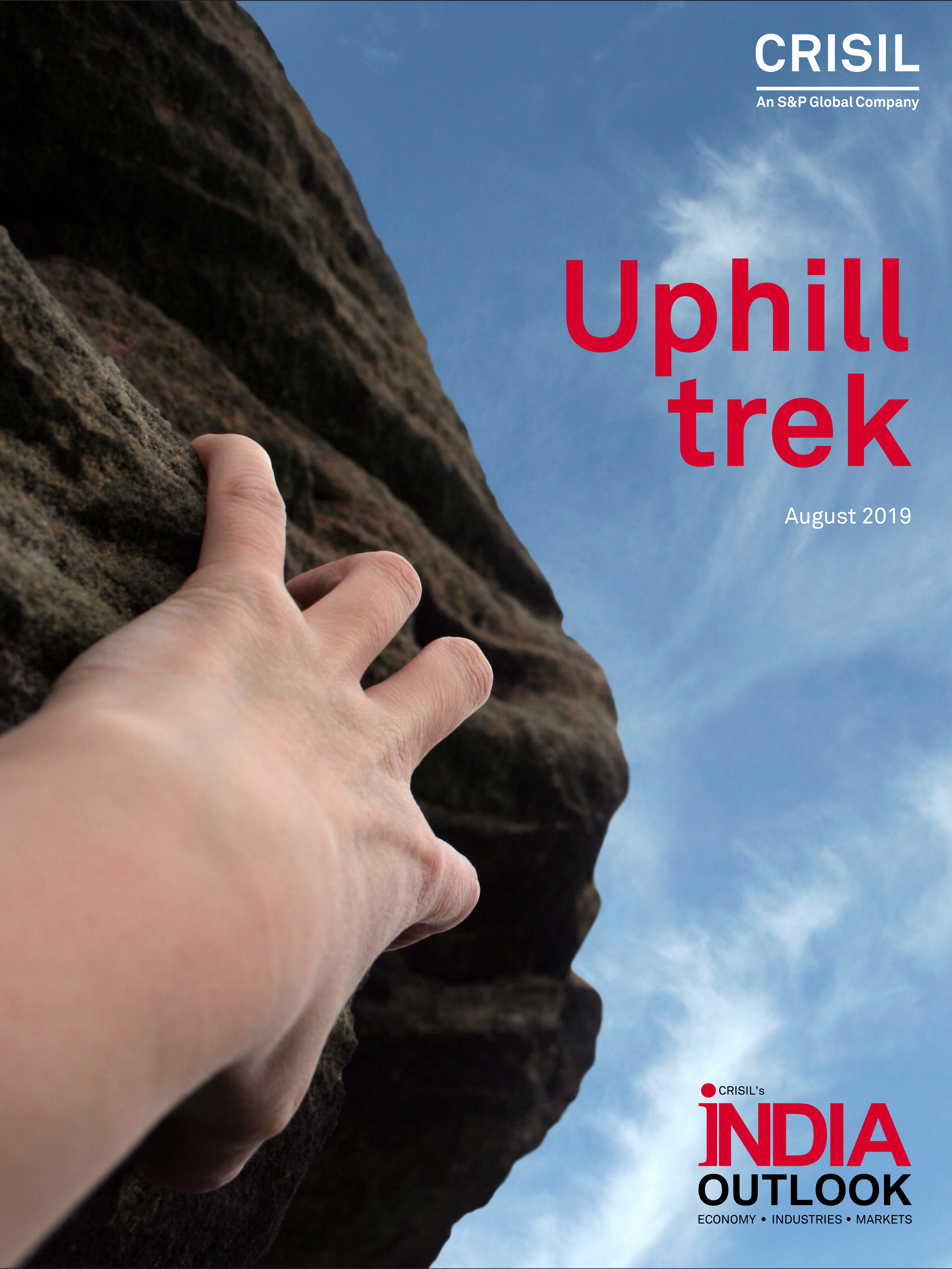

CRISIL
An S&P Global Company

Uphill trek

August 2019

CRISIL's
INDIA OUTLOOK
ECONOMY • INDUSTRIES • MARKETS

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Executive **summary**

With the Indian economy caught in crosswinds, we now expect gross domestic product (GDP) to grow 6.9% this fiscal, or 20 basis points lower than what we had envisaged earlier.

The revision factors in a triangulation of downside risks: inadequate monsoon, slowing global growth, and sluggish high-frequency data for the first quarter.

The slowdown would be pronounced in the first half, while the second half should find support from monetary easing, consumption and statistical low-base effect.

Agricultural terms of trade are also expected to improve with a pick-up in food inflation. In addition, farmers would benefit from income transfer of Rs 6,000 per year announced by the Centre, and farm loan waivers in a few states.

Policy action looks attuned to consumption than investment demand, which means consumption will be the first to ascend as the tide turns.

But all that might not be enough to pitchfork growth this fiscal to, or above, the past 14-year average of 7% per annum.

So what is behind the slackening?

GDP grew at an impressive 8.2% in fiscal 2017, the fastest in a decade. Then a cyclical downturn got triggered because of disruptions wrought by policy initiatives and reforms, and rising global uncertainty stemming from trade disputes.

Weak global growth and falling trade intensity shrank India's overall exports pie, and a gradual pick-up in crude oil prices fanned further headwinds. The rollout of Goods and Services Tax (GST) also had a knock-on effect on exports growth in the year of implementation because of delay in refunds to exporters.

Simultaneously, the farm front continued to flounder. Terms of trade for agriculture deteriorated in fiscals 2018 and 2019, and weak wage growth further affected rural incomes.

In all that time, public sector banking also remained incapacitated, primarily because of rising bad loans.

The onset of the non-banking financial company (NBFC) crisis in September 2018 aggravated the situation. Given that NBFC penetration is high in certain household consumption segments, the stress that ensued further impacted demand.

With access to funding becoming challenging and NBFCs caught up in managing liquidity, their growth halved to a multi-year low in the second-half of last fiscal, and remains impacted.

On the bright-side, banking sector non-performing assets (NPAs) are expected to decline anew to ~8% by March 2020, given lower accretion and increased recoveries. Credit growth should also grind up to 14%, the highest in five fiscals. Seasoning of retail portfolio and performance of the small and medium enterprise (SME) portfolio after the restructuring period will be the key monitorables.

Growth for NBFCs, mainly in the retail segment, is expected to pick up gradually. Also, NBFCs have used this opportunity to correct their asset-liability mismatches, and have reduced reliance on short-term market borrowings, which is a structural positive for the sector.

At the same time, funding access has not normalised for the sector, and asset quality risks in the wholesale book, especially developer funding, have increased.

Also, corporate revenue is set to grow at a slower 7.5-8.0% this fiscal, reversing the trend of double-digit growth in the past two fiscals.

A trifecta – of spurt in cost of compliance because of changes in regulation, tightening liquidity, and moderating income growth – is expected to impact sales volume in the automobiles sector. And how farm incomes pan out will weigh on rural demand-driven segments.

In other words, most consumption segments will pull revenue growth into single digit this fiscal. And weak prices of commodities such as steel and crude oil would exacerbate the pain.

As for industrial capex, it would remain moderate given the weak demand. Over the past few years, infrastructure investments (including public and private) have driven capex. But over the next three years, lower spending, such as on roads, is expected to drag growth in infrastructure investments to ~6% compound annual growth rate (CAGR) over the next three fiscals compared with 10% in the last three fiscals.

With public spending continuing to dominate investments, funding will remain a monitorable. This is also important because entities behind major infrastructure investments such as the National Highways Authority of India have run up debt significantly in the past few years.

And how has policy responded to the ructions?

Monetary policy has focused on inflation control ever since the inflation targeting framework was adopted. To be sure, given our history, high core inflation rates, and the difficulty in assessing inflation (it has surprised on the downside), caution was warranted on rate cuts because of the chance of a spike in high real interest rates. In hindsight, however, one could say policy was tighter than warranted by the inflation trajectory. To boot, transmission of rate cuts is also chronically sluggish.

Fiscal policy, on the other hand, has had low wherewithal to pump the prime, given the glide path set out by the Fiscal Responsibility and Budgetary Management Act.

The upshot? GDP growth falling to a 20-quarter low of 5.8% in the last quarter of fiscal 2019. If it's any consolation, in the last seven fiscals, there have been seven instances when quarterly GDP growth fell below 6%.

The crucial question, therefore, is whether a trough is in sight.

Given the fiscal constraints, public spending is unlikely to have the heft to pull growth above 7%.

And some of the recent, and much-needed, reforms would pay off only over the medium term.

There would, therefore, be some near-term onus on monetary policy to stimulate growth. But how effective that can be is the big question.

So fingers crossed for now.

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Contents

Anatomy of a **slowdown**

Amid the murmur of slowdown and growth forecast cuts, two questions are gaining decibels: What is hampering growth? Is the slowdown here to stay?

Here's what we think:

The problem statement

GDP growth slowed to a five-year low of 6.8% in fiscal 2019 on-year, with the last quarter growth printing at 5.8%. Growth has been on a cyclical downturn since fiscal 2017, when it peaked at 8.2%. Disruptions and reforms marked the economy, particularly after 2016. These, together with adverse exogenous developments, have impacted growth.

Five things that shaped today's economy

We explain the past growth trajectory and predict this fiscal's path through five frames:

- **Disruptions and reforms** led to a drift down
- **Global environment** half empty, half full
- **Farm sector** pines for level-playing field
- **Monetary and fiscal policy** tied down by targets
- **Financial sector** frictions resurface

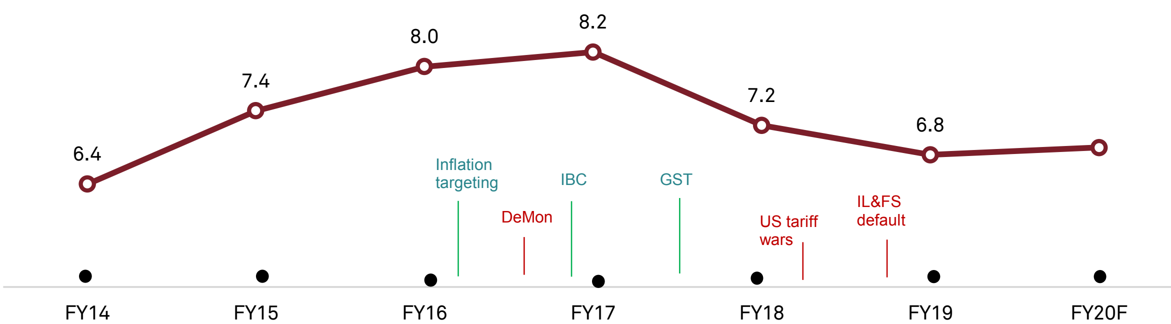
Disruptions and reforms - led to a drift down

- **The three major disruptions since 2016 were:** Demonetisation, United States (US)-China trade spat, and the Infrastructure Leasing and Financial Services (IL&FS) debacle. Fiscal 2017 was synonymous with demonetisation. Just as its effects were petering out, came the NBFC credit crunch in 2018, caused by the IL&FS crisis. By 2018-end, weakening global trade and GDP growth, led by US-China tariff wars, had caught up

- **The three key economic reforms were:** Adoption of inflation targeting framework by the Reserve Bank of India (RBI), and implementation of the GST and the Insolvency and Bankruptcy Code (IBC). Reforms, in general, could be short-term disruptive and long-term supportive. We saw the first part happen around the GST. Though not inflationary, it did disrupt export growth in 2017, when global growth was at its highest since the financial crisis

- **In fiscal 2020, we expect to see continued streamlining of GST and IBC processes. That should gradually relay into greater efficiency and growth over the next few years**

Growth as a steeplechase



Note: F=forecast
Source: National Statistics Office (NSO), CRISIL Research

Monetary and fiscal policies – tied down by targets

- Monetary and fiscal policies are two key instruments to fight a cyclical downturn
- However, the fiscal and monetary authorities have, by and large, chosen restraint over using these instruments to stoke growth
  - Inflation control has preoccupied monetary policy since targeting was adopted. In hindsight, sub-target inflation rates could have afforded a more accommodative stance. But given the history of high inflation, high core inflation rates, and difficulty in assessing inflation (which surprised everyone on the downside), caution was exercised on rate cuts, leading to high real interest rates
  - Fiscal policy, too, has not been used to pump-prime the economy. The combined fiscal deficit of the Centre and the states stands high. The government intends to pare it down this fiscal, despite growth headwinds. To be fair, there is hardly any fiscal wiggle room with the government, and that justifies its prudent fiscal stance
  - In calendar 2019, though, monetary policy has turned growth-supportive. The Monetary Policy Committee slashed the repo rate thrice by 25 basis points (bps) each, and changed the stance to 'accommodative'. However, anaemic transmission means growth will lift off with a lag
  - We expect the rate cuts to transmit by the second half of fiscal 2020. But the fiscal policy's ability to pump-prime the economy will remain constrained, owing to high debt levels

Combined fiscal deficit and real interest rates are high

	FY14	FY15	FY16	FY17	FY18	FY19	FY20 forecast
Repo rate (%)	8.00	7.50	6.75	6.25	6.00	6.25	
CPI inflation (%, y-o-y)	9.4	6.0	4.9	4.5	3.6	3.4	
Real interest rate (%)	-1.4	1.5	1.9	1.8	2.4	2.9	
Fiscal deficit (C+S)(% of GDP)	6.7	6.7	6.9	6.9	6.4	5.8	

C+S: Centre and state
Source: NSO, RBI, Budget documents, CRISIL

● Worse ● Stable ● Improvement

Global environment - half empty, half full

- The global growth environment is gloomy:
  - Global growth and trade intensity have declined post the global financial crisis, making export-led growth a more distant possibility
  - At this juncture, the risks to the global economy are tilted to the downside because of uncertainty around US-China trade war and the Brexit outcome
  - Crude prices were favourable in the first three years of National Democratic Alliance (NDA) I, which created tailwinds for India's growth, inflation, and fiscal deficit. However, that has moved up since fiscal 2018, reversing the advantage

- The global scenario holds out a mixed bag for this fiscal:
  - Slowing global growth and strong rupee are bad for exports; escalation of the US-China trade war could create further downside risks
  - Softening policy stance in advanced countries would lead to capital inflows, currency appreciation, and support soft interest rate policy
  - Oil prices will be shaped by the interplay of two opposite forces: geopolitics offsetting the price-depressing impact of weak global growth

The world offers little comfort

	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Global growth (%, y-o-y)	3.4	3.5	3.4	3.3	3.7	3.6	
Crude oil average (US$/ barrel)	107.5	85.7	47.4	48.5	57.4	70.1	

Source: International Monetary Fund (IMF), CRISIL

Financial sector – frictions resurface

- The banking sector's NPA ratio worsened throughout the UPA-II term and is still quite high
- No sooner did the NPA ratio started improving in fiscal 2019, the NBFC stress started building up
- Stress in NBFCs percolates faster, owing to greater interconnectedness (to mutual funds, banks, and corporate sector) vis-à-vis public sector banks
- **For fiscal 2020, bank credit growth might improve somewhat, but NBFC credit looks subdued, despite the partial guarantee scheme announced in the Union Budget 2019-20**

Farm sector – pines for level-playing field

- Worsening agricultural terms of trade has squeezed farm income
- Non-food inflation continued to surpass food inflation in the past two years, amounting to income transfers from rural to urban areas
- **Farm income could get a leg-up from the government's income transfer scheme, and a rise in food prices would boost the terms of trade**

Financial sector still nursing its wounds, farmers' woes aren't done yet

	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Terms of trade (Rural food/non-food prices)	1.0	1.0	1.0	1.0	1.0	0.9	
GNPA/advances (%)	3.8	4.3	7.5	9.5	11.5	9.3	

Source: NSO, CRISIL

Fiscal 2020 macro outlook

GDP growth (% y-o-y)

	FY19	FY20F
GDP growth (% y-o-y)	6.8	6.9

- Growth is expected to remain subdued on account of risks from monsoons, weakening global growth momentum, and weak first quarter performance indicated by high frequency data
- It may pick up in the second half supported by softer interest rates and budgetary measures that push consumption

Consumer price index or CPI inflation (% y-o-y)

	FY19	FY20F
CPI inflation (% y-o-y)	3.4	3.8

- Inflation could see some upside from higher food prices on account of base effect and possible risks from inadequate monsoons
- Consumer-friendly fiscal policy and softer monetary policy stance also add to the upside

Current account deficit (% of GDP)

	FY19	FY20F
Current account deficit (% of GDP)	2.1	2.2

- Exports face risk from slowing global growth and trade as a result of US-China trade tensions
- While trade diversion of goods hit by US-China tariff war is an opportunity for India, sustaining growth in exports in those sectors will require improved competitiveness
- India remains vulnerable to any sharp rise in oil prices

Exchange rate (Rs/$) March average

	FY19	FY20F
Exchange rate (Rs/$) March average	69.5	71.0

- Given India is a current account-deficit country, the rupee is vulnerable to volatility from oil prices and tariff wars
- However, softening monetary policy stance in advanced economies and expectation of a rate cut in the US could bring in foreign capital flows and check the rupee's depreciation

Fiscal deficit (% of GDP)

	FY19	FY20F
Fiscal deficit (% of GDP)	3.4	3.3

- Meeting the fiscal 2020 target will be a challenge unless growth stays on track, the government achieves its aggressive divestment target, and GST revenue rises as envisaged

10-year G-sec yield (%) March average

	FY19	FY20F
10-year G-sec yield (%) March average	7.5	7.1

- Reduction in the fiscal deficit target for fiscal 2020 and further easing of monetary policy could help soften bond yields from March 2019 levels. But the government's fiscal health remains a key risk
- Global interest rates too are benign. S&P Global expects one rate cut by US Federal Reserve this year

Parts of the problem

GDP is the sum of consumption, investment, government spend, and net exports. Here, we consider consumption and investment, and exports. What has been their role in the current slowdown? This section breaks it down, and joins the dots to fiscal 2020.

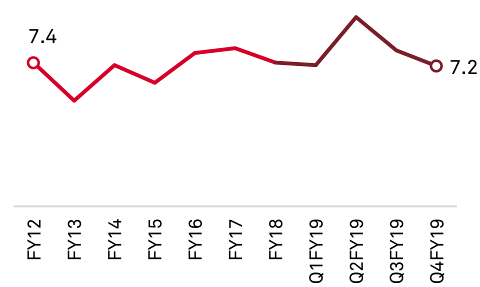
Consumption

The chips are down as income, credit and sentiment slip

Consumption has been the bulwark of growth in recent years. Hence, a slowdown in consumption has triggered slower GDP growth. Sluggishness in rural demand, dent in exporters' incomes, and tighter credit flow to the retail sector in wake of the NBFC crisis started telling on consumption demand, especially in the second half of fiscal 2019. Though, for the fiscal as a whole, private consumption growth was higher at 8.1% on-year compared with 7.4% in fiscal 2018, consumption suffered in the second half. Growth slid to 7.7%; nearly 100 bps lower than in the first half.

Over the past few years, households dipped into their savings and leveraged themselves to finance consumption. Higher leverage played a critical role in supporting the consumption boom. However, post the NBFC credit crunch, credit has become somewhat inaccessible to the riskier customer profile, somewhat constraining households' ability to spend. The box *Savings investment conundrum* (Annexure 1, Page 41) delves deeper into implications of a savings slowdown.

Private consumption slowed in the second half (%, y-o-y)

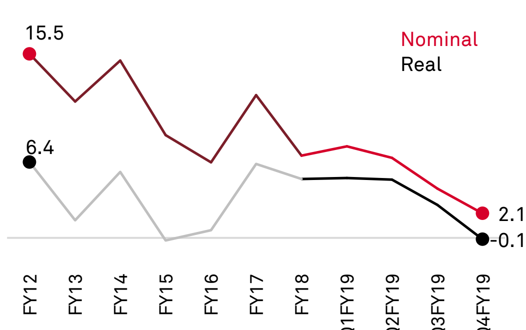


Source: NSO, CRISIL

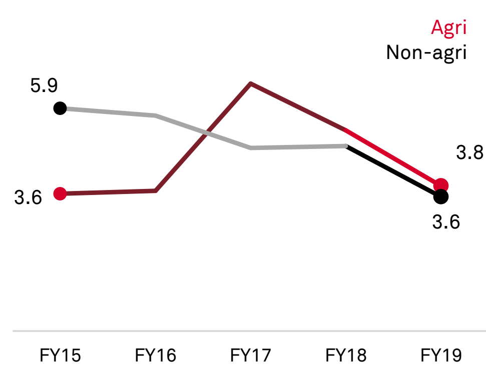
What has stifled consumption?

Rural incomes are running low

Agriculture GVA (%, y-o-y) shows an income squeeze for farmers



Rural wages slow down (%, y-o-y)

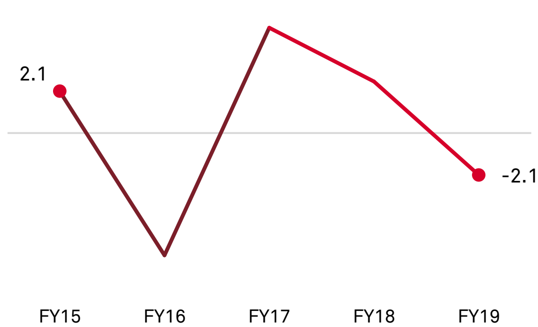


Source: NSO, RBI, CRISIL

- The rural sector was hit hard by a double whammy of sub-normal rains for two consecutive years and falling food prices
- Some support came from government spends on rural roads and affordable housing construction, which provided employment and incomes
- However, for the farm economy, terms of trade worsened over time as it faced higher non-food inflation, even as farm produce prices fell. Overall, growth in rural incomes decelerated. The squeeze, particularly in farm incomes, was also visible in the closing gap between nominal and real agriculture gross value added (GVA) growth in the past two fiscals. This gap is taken as proxy for agriculture prices/incomes. The box *Why India badly needs a good monsoon year* (Annexure 2, Page 42) examines further the consumption slowdown.

Exporter income in labour-intensive sectors muted

Exports of labour-intensive sectors slump (%, y-o-y)

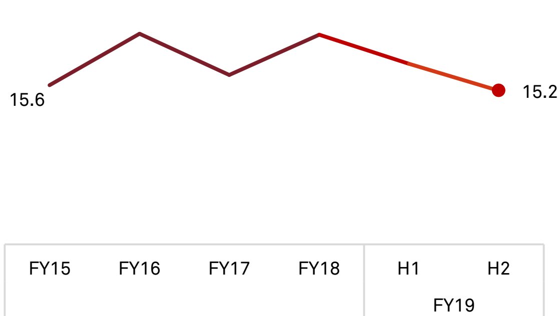


Source: Ministry of Commerce, CRISIL

- The export slowdown, which intensified in fiscal 2019, mainly affected labour-intensive sectors, denting export incomes

Credit is harder to come by

Retail credit growth slowed (banks + NBFCs) (%, y-o-y)



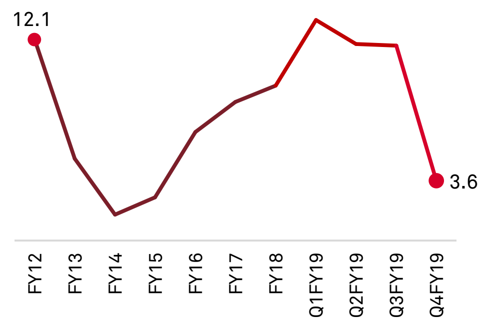
Source: RBI, CRISIL

- In the past few years, rising importance and penetration of NBFCs helped fund retail credit demand. Higher leverage played a critical role in supporting the consumption boom. However, post the NBFC credit crunch, credit has become a tad inaccessible to the riskier customer profile, somewhat constraining households' ability to spend.

Investments
Appetite lost, not found

In fiscal 2019, fixed capital investment continued to be held back by weak private sector sentiment and corralled fiscal space. Yet, fixed investment growth rose to 10% on-year from 9.3% in fiscal 2018, mainly on the back of higher government spend (Centre, central public sector enterprises, and states). However, it slipped to 7.6% in the second half from 12.5% in the first

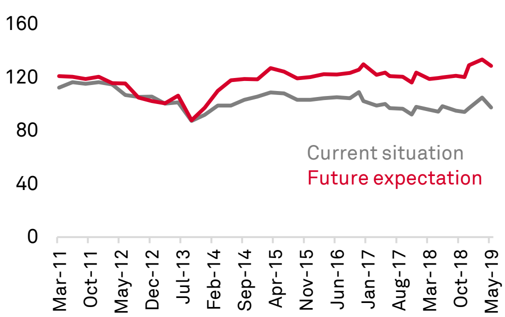
Fixed investment slumps in Q4 (%, y-o-y)



Source: NSO, CRISIL

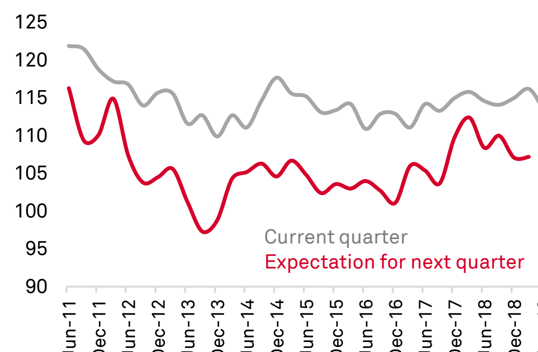
Why is private fixed investment not back?

Consumer confidence index shows better expectation for future



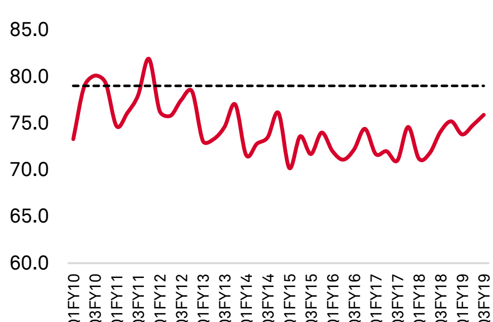
Source: RBI, CRISIL

Muted business sentiments

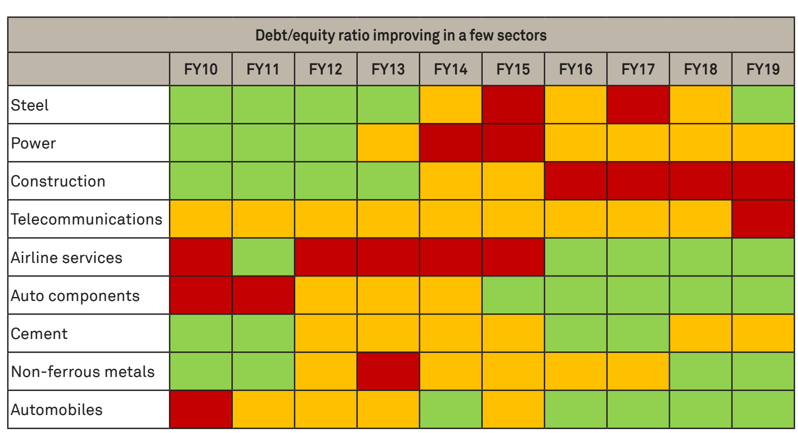


Source: RBI, CRISIL

Capacity utilisation rates (%) are still away from optimum



Source: RBI, CRISIL



Source: CRISIL

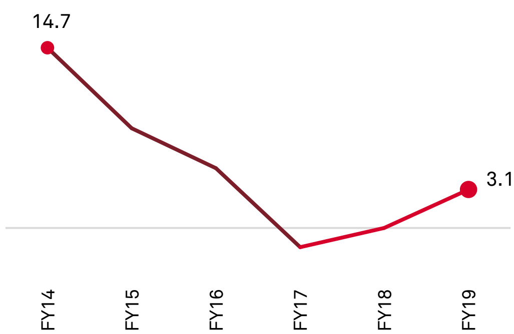
- Listless domestic consumption and export demand, amid already low capacity utilisation, has reduced manufacturers' appetite to invest. Business expectations remain muted, while consumer expectations, which saw a mild bump-up in the interim, have flopped back

- Among infrastructure segments, high leverage – despite some easing lately – continued to constrain investment plans

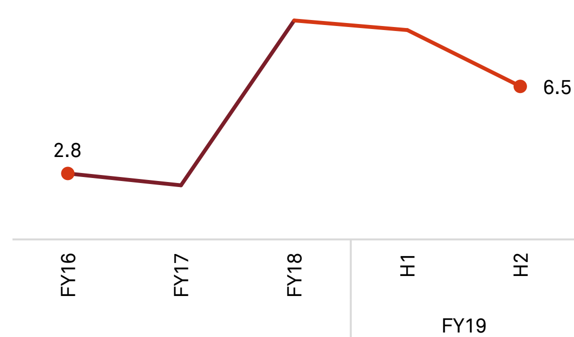
- CRISIL Research finds capital expenditure suffered led by lower investments in steel, cement, and non-ferrous sectors. The first half of fiscal 2019 did see some capacity additions in select sectors, as utilisation rates increased, but rates were below optimum level seen prior to fiscal 2010. Further, large companies, especially in steel and cement, have focused on asset acquisition in the past three fiscals, weighing on fresh investments

- Foreign investment (measured by net foreign direct investment or FDI) weakened in recent years

Industrial credit offtake still in a funk (%, y-o-y)



Credit offtake by MSMEs is dormant (%, y-o-y)



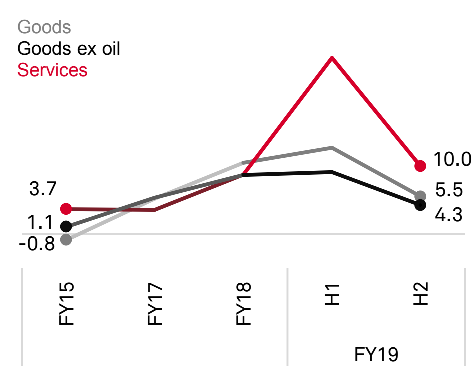
Source: RBI, CRISIL

- Credit offtake by industry is still sluggish. Micro, small and medium enterprises (MSME) offtake had fallen, mirroring the impact of slowing exports and adverse effects of demonetisation and GST implementation. Sectors such as mining, textiles, leather products, rubber and plastic, basic metals and products, and iron and steel saw credit offtake slowing down significantly in the second half of fiscal 2019

Exports
Wrestling with rising global risks

After a brief recovery in fiscals 2017 and 2018, exports growth slipped in fiscal 2019. Exports followed the slowdown in global growth in fiscal 2019, particularly in the second half when escalation of US-China trade tensions started having a material impact on global trade and investment flows. India's goods exports (especially ex-oil) faced a greater setback than services exports.

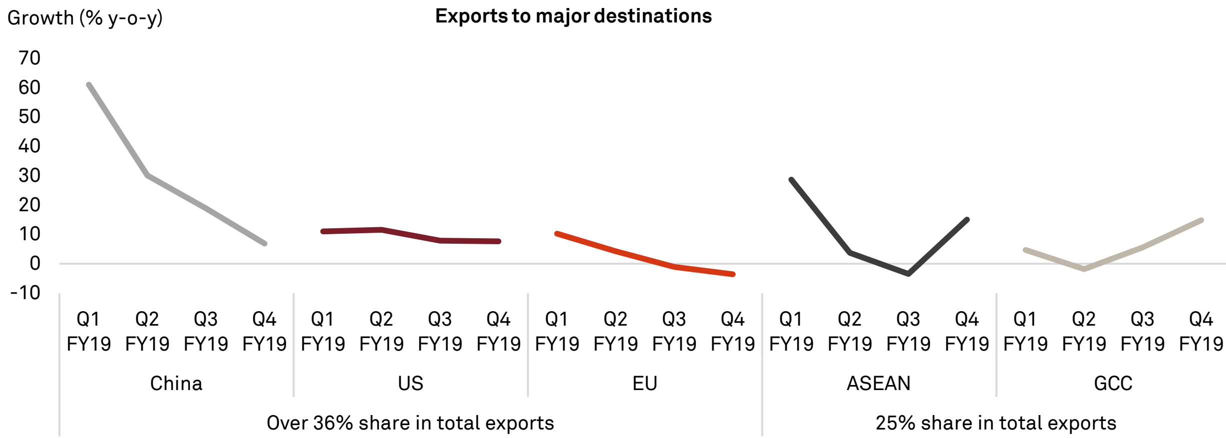
Exports show a dip (%, y-o-y)



Source: Ministry of Commerce, CRISIL

The drivers of exports slowdown

- India's goods exports saw the sharpest slowdown to the European Union (EU), the US and China in fiscal 2019. However, certain exports to China saw a sharp rise, such as cotton, organic chemicals and petroleum products – on which China had imposed import tariffs on US goods. The benefits of such import substitution were large enough to help India reduce its trade deficit with China in the fiscal



Note: ASEAN = Association of Southeast Asian Nations, GCC = Gulf Cooperation Council
Source: Ministry of Commerce, CEIC, CRISIL

- Among the principal export sectors, labour-intensive sectors such as gems and jewellery, readymade garments, and marine products saw the sharpest decline

Source: Ministry of Commerce, CEIC, CRISIL

- Export prospects in fiscal 2020 depend on how India wades through the evolving global trade scenario. The ongoing US-China trade war has sprung challenges as well as opportunities for growing exports. The box *The opportunity in every crisis* (Annexure 3, Page 43) delves deeper into how India can tackle such challenges and reap the evolving opportunities

In annexures:

- Higher investment needs are chasing lower savings, Page 41
- Why India badly needs a good monsoon year, Page 42
- The opportunity in every crisis, Page 43

Corporate revenue **hits a bump**

Revenue growth to moderate this fiscal as consumption slows and metal prices fall

Benign inflation and sales volume recovery post demonetisation and GST helped India Inc log a stellar revenue growth of 11% on-year in fiscal 2019, breaking a trend of 5% average revenue growth in the preceding four years.

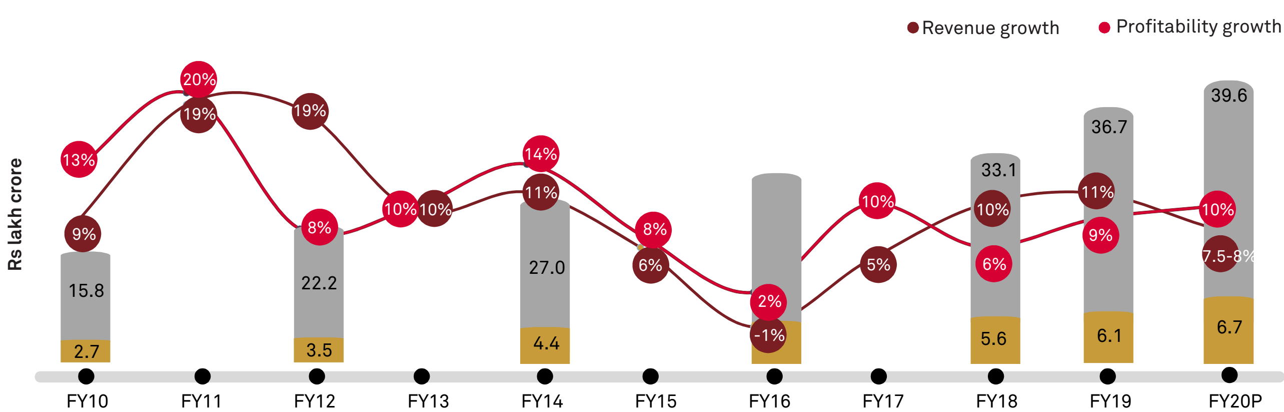
In fiscal 2020, however, revenue is expected to grow much slower, at 7.5-8.0% on-year. This is largely because of a moderation in sales volume in key consumption sectors such as automotive, softening of commodity prices affecting the metals sector, and a lack of fillip to export-linked sectors from the currency.

Profit, though, is expected to outpace revenue growth in fiscal 2020, rising 10% on-year, compared with 9% growth in fiscal 2019, riding on improving profitability in consumer discretionary sectors such of airlines and telecom, which saw sharp contractions last year. Softening metal and coal prices will support margin expansion in these sectors. Margins of the construction and steel sectors, though, are expected to shrink.

The situation is contrary to the past two fiscals, when profit growth at 6% had lagged revenue growth following a sharp fall in the profits of consumer discretionary services such as airlines and telecom, and surging prices of commodities such as crude oil and metals.

Excluding airlines and telecom, however, profit growth would largely mirror the revenue growth of 8% on-year in fiscal 2020.

Revenue growth to soften 300-350 bps on-year to 7.5-8.0% in fiscal 2020



P: Projected
Note: Sample for 800+ listed companies (non-oil and non-BFSI).
Profitablity refers to EBITDA
Source: Company reports, CRISIL Research

Diagnosis of slowing revenue growth in fiscal 2020 divulges the following key attributes:

- Significant slowdown in construction commodities, as steel prices weaken in fiscal 2020 from the peak of 2019
- Consumption-linked sectors, especially high-ticket purchases, to moderate in fiscal 2020
- Export-linked sectors return to real growth led by rupee stabilisation

Downshift in consumption and softening of metal prices to weigh on revenue growth

	13% Consumer discretionary products		5% Consumer discretionary services		4% Consumer staple FMCG		5% Construction EPC		16% Construction commodities		18% Export linked		17% Investment and utilities	
	Revenue	Profit	Revenue	Profit	Revenue	Profit	Revenue	Profit	Revenue	Profit	Revenue	Profit	Revenue	Profit
9 yr CAGR FY09-FY18	13%	15%	8%	4%	11%	14%	9%	10%	5%	4%	14%	13%	8%	11%
4 yr CAGR FY14-FY18	7%	9%	2%	(0%)	5%	9%	6%	8%	3%	7%	9%	6%	3%	8%
FY19	10%	7%	13%	(33%)	9%	14%	9%	(3%)	17%	30%	14%	20%	6%	5%
FY20P	6%	5%	10%	30%	7%	7%	9%	(1%)	6%	4-5%	7-8%	7.5-8%	5-6%	6%

Notes: 1) Consumer discretionary products include passenger vehicles, two-wheelers, auto components, paper, tyres, cotton yarn and consumer durables; consumer discretionary services include airlines, telecom and media; consumer staples (FMCG); construction commodities include steel, ceramic tiles and cement; export-linked sectors include pharma, information technology and textiles-RMG); investment & utilities include capital goods, power and commercial vehicles.
2) 'Others', which is not displayed in the chart, include diversified sectors such as non-ferrous metals, mining, and sugar (non-oil and non-BFSI).
3) Figures next to icons indicate revenue share
Source: Industry, CRISIL Research

Consumer discretionary products

- **Automobiles (passenger vehicles and two-wheelers):** Despite flat growth in passenger vehicle sales volume, revenue is projected to grow 5% this fiscal on rising vehicle prices and inter-segmental shift. Revenue growth of two-wheelers is expected to moderate significantly to 3% from 13% on-year in fiscal 2019, primarily because of sales growth slowdown. Meanwhile, lower raw material prices will support the sector's profit this fiscal

- **Consumer durables:** The sector will be supported by healthy growth of the air-conditioning and washing machine segments amid lower raw material cost

Consumer staple products

- **Fast-moving consumer goods (FMCG):** Revenue growth is expected to slow down on account of moderation in sales volume, especially in the first half of fiscal 2020, and more so in rural areas as indicated by leading FMCG players. Profit margins, though, are projected to be stable

Consumer discretionary services

- **Airlines:** Revenue growth is expected to be a modest 4% on-year in fiscal 2020, on account of change in mix from long-haul to short-haul. Margins, though, are expected to recover to fiscal 2017 levels of 7-8% in fiscal 2020, spurred by a rise in domestic fares and a reduction in excise on aviation turbine fuel (ATF)

- **Telecom:** The sector is on track to see a significant bump up in profit in fiscal 2020, after a plunge in fiscal 2019, led by 10% on-year growth in average revenue per user (ARPU) and 20% decline in access charges

Construction and linked commodities

- **Cement:** Despite a sharp slowdown in sales volume growth, from 12% on-year in fiscal 2019 to 6-7% on-year in fiscal 2020, revenue and profit are expected to expand at a healthy pace on improving realisation (5-6%) and lower power and fuel cost

- **Construction:** Margins are expected to deteriorate because of a change in the revenue mix; revenue will be driven by less profitable sectors such as roads, power transmission and distribution (T&D), water supply, and irrigation

- **Steel:** Lower on-year realisation because of weak global cues and rising iron ore cost are expected to weigh on the sector's revenue and profitability in fiscal 2020

Export-linked sectors

- **Pharmaceuticals:** An improving product pipeline will benefit the profit spreads of pharmaceutical players as currency tailwind abates

- **Information technology (IT):** Revenue and profitability growth are expected to moderate in fiscal 2020 as benefit accruing from currency depreciation abates

Investment-linked sectors

- **Commercial vehicles:** Moderation in volume growth, especially of the medium and heavy commercial vehicle (MHCV) segment, will weigh on growth in fiscal 2020. The axle norms created 20% additional capacity in this sector, leading to volume decline, more so in the MHCV segment. Further, rail BTKM (billion tonnes km) also shows a moderating trend, led by a slowing Index of Industrial Production that aggravated the problem for transporters and, hence, commercial vehicle (CV) sales

Airlines, cement and telecom sectors to drive profit

	Industry size (Rs lakh crore)	FY20 Revenue growth	FY20 EBITDA growth	FY20 Margin expansion
Cement	1.6	13-14%	24-25%	150-200 bps
Pharma	2.3	9-10%	16-17%	100-150 bps
Construction	8.6	8-9%	(1-2%)	(100 bps)
IT	8.8	8-9%	~5%	(50-100 bps)
Consumer durables	0.8	7.5-8.5%	18-19%	50-75 bps
Telecom	1.5	~7%	32-33%	600-650 bps
FMCG	1.6	7%	7%	0 bps
Power generation	1.9	6-7%	5%	(50 bps)
Passenger vehicles	1.7	5%	5%	0 bps
Auto components	3.5	5%	5%	0 bps
Airlines	1.1	4-5%	NM	(1100 bps)
Two-wheelers	1.1	3%	3%	0 bps
Steel	4.6	3%	(1-3%)	(100-200 bps)
Commercial vehicles	1.4	2%	3%	0-20 bps

Consumer Products | Consumer Services | Const. and linked commodities | Export linked | Investment linked

Source: Industry, CRISIL Research

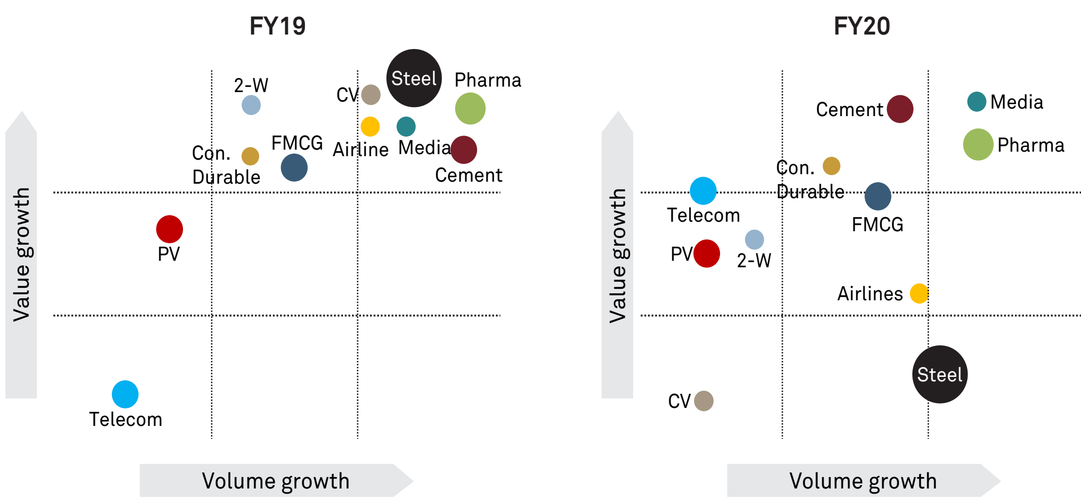
Growth in fiscal 2019 was driven by healthy sales volume across key segments of consumption and construction. However, in fiscal 2020, we expect a trend reversal, with revenue growth propelled by price hikes instead of volume expansion.

For instance,

- **Consumption:** Passenger vehicle and two-wheeler sales are projected to be flat at 0% and -1% respectively this fiscal from 3% and 5% in the last. However, the passenger car and two wheeler segments will still clock revenue growth of 5% and 3% on-year, respectively, because of rising vehicle prices and inter-segmental shift

- **Construction:** Cement demand growth is expected to moderate significantly to 6-7% on-year in fiscal 2020 from 12% on-year in fiscal 2019. However, the sector is still projected to post stellar revenue growth of 12-13% on-year on account of hike in cement prices, especially in the first half of 2020

Volume growth to evade industry in fiscal 2020



PV: Passenger vehicles, CV: commercial vehicles, 2-w: Two-wheelers
Note: Size of bubble indicates revenue size. Volume growth has been indexed to the sector's long period average.
Source: Industry, CRISIL Research

Slowing income growth holding back consumption

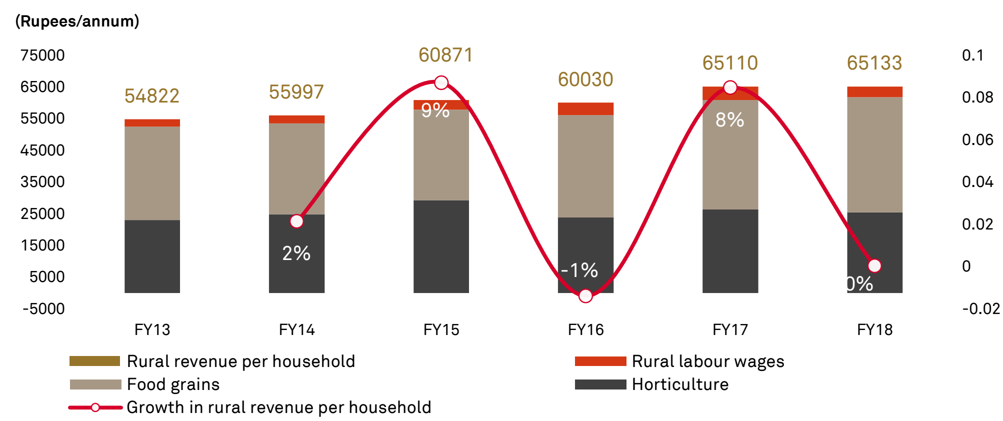
There was slower growth in revenue for farmers in the marketing year 2018 (January to December), as reflected in a moderation in growth in segments such as FMCG, motorcycles and tractors.

Urban income growth has also seen a tepid pace in the last few quarters.

All this has reflected in slowing economic activity. Indeed, GDP growth in the fourth quarter of fiscal 2019 dipped to 5.8% - the lowest in 20 quarters.

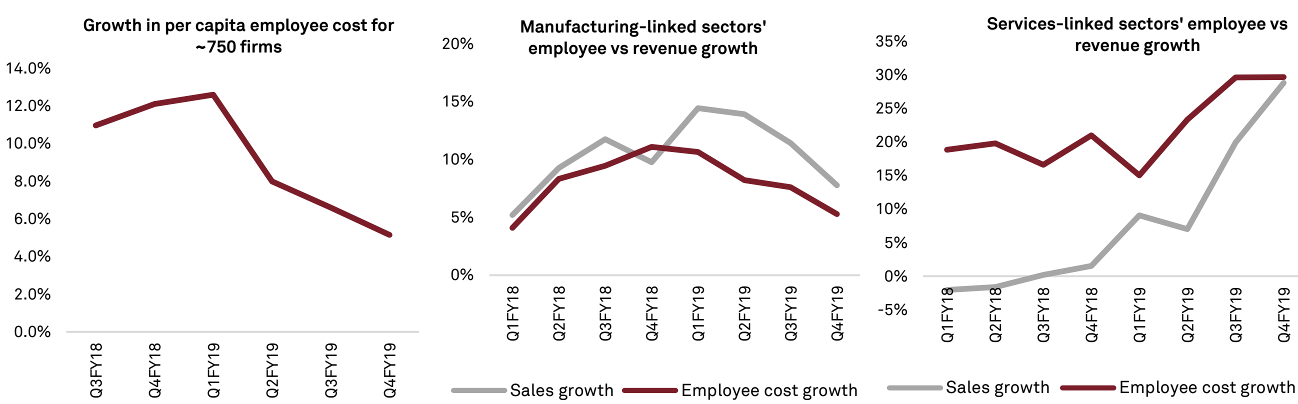
Private final consumption expenditure growth slowed down as well, from 9.8% in the second quarter of fiscal 2019 to 7.2% in the fourth quarter.

Farmer income has been flat on a per-household basis in 2018



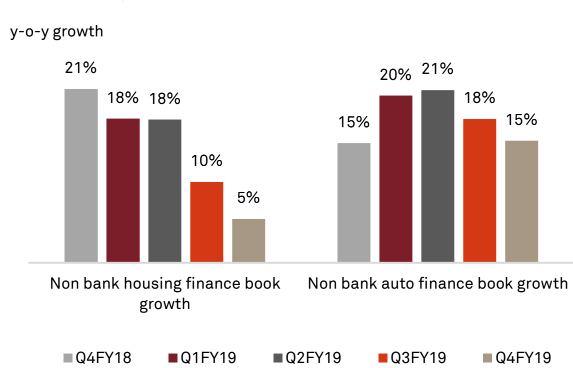
Note: Marketing year is from Jan to Dec
Source: CRISIL Research

Formal sector's employee cost shows moderation; services-linked sectors better off



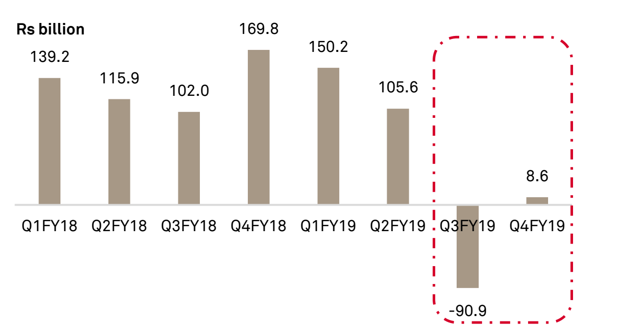
Note: Based on analysis of around 750 listed firms
Source: Company reports, industry

Non-bank quarterly credit growth in housing and auto finance segments



Note: Housing finance data based on 8 HFCs, which account for ~86% of non-bank book; auto finance data based on 10 players, which account for ~75% of non-bank auto finance book.
Source: Company reports

Quarterly addition in non-banks' wholesale finance book



Note: Based on data of 9 non-banks that account for ~75% of wholesale lending book of NBFCs. Close to 2/3rd of wholesale book is towards real estate lending.
Source: Company reports

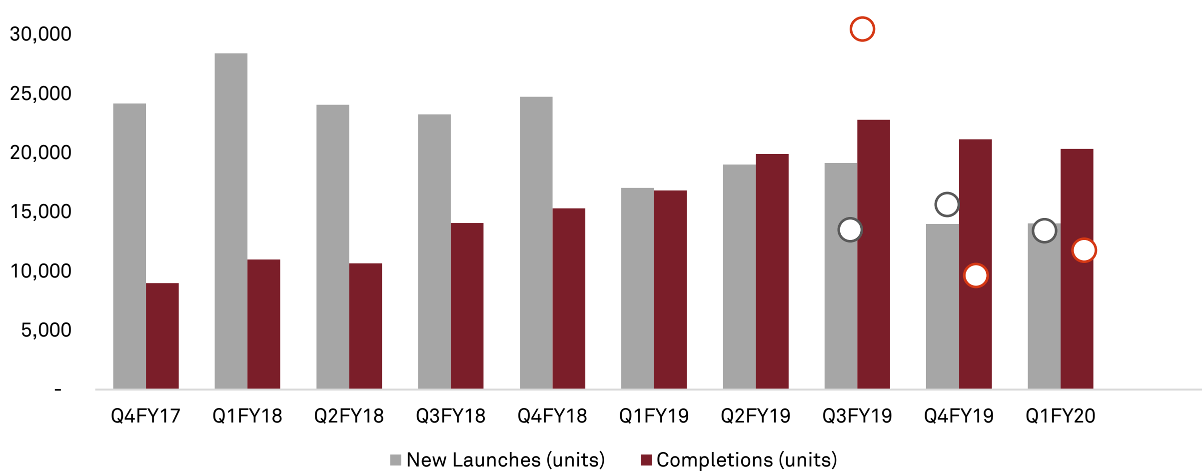
Housing finance book of non-banks decelerates

- Tightening liquidity also slowed down the housing finance book of non-banks in the second half of fiscal 2019, as some players sharpened focus on asset-liability management rather than growing their books
- Although banks have increased efforts towards retail lending (particularly housing finance) over the last few years, they are unlikely to take up the entire market share vacated by non-banks
  - Even in the past, banks have been reluctant to lend to relatively riskier customer profiles (low income, non-salaried, self-employed professionals), which were largely catered to by non-banks
- On the auto finance front, although the major impact has been on account of sales slowdown, liquidity issues have impacted certain financiers. While non-bank captive financiers (35% of outstanding) are unlikely to be impacted due to strong support from original equipment manufacturers, some of the smaller non-captive financiers will find it difficult to raise funds, thereby slowing their growth

Wholesale finance slows sharply

- With banks reducing exposure to real estate developers in the past 3-5 years, non-banks have been the primary lenders to this segment. However, liquidity constraints faced by non-banks since the second half of fiscal 2019 have turned off the tap for real estate developers
  - As non-banks focus on managing liquidity, lending to this segment is likely to remain weak, which may lead to a slowdown in real estate construction activity
- Banks are unlikely to fill the void completely due to a difference in their approach as well as risk appetite. Hence, small- and mid-sized developers will find it extremely difficult to raise additional funds
- The slowdown in real estate construction is likely to have a ripple effect on wage growth as well as demand for materials such as cement and steel

Top four real estate markets show stagnation in project completion, fewer launches



Note: Quarterly numbers are rolling average for past four quarters; Top four markets include MMR, NCR, Bengaluru and Pune. Bubbles plotted for individual quarters. Red bubble indicates quarterly completion, grey indicates launches.
Source: CRISIL Research

- Residential real estate supply in key metros (Bengaluru, Mumbai Metropolitan Region and National Capital Region) has been stagnant over the last six quarters on account of reduced launches and limited project completion
  - Developers have shied away from launching new projects on account of muted end-user demand. CRISIL Research's assessment indicates absorption of new homes has declined at 5% CAGR over the last three years across key metros
- Average completion timeline for residential projects in key metros is 5-6 years
  - Of the total under-construction units as of first quarter of fiscal 2017, 16% were completed till the first quarter of fiscal 2020. This indicates likelihood of significant project completions over the next three fiscals. Of the completed projects, nearly 20% remain unsold

The current slowdown may not be as severe as in the past

Key consumption sectors	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	H1 FY19	H2 FY19	H1 FY20F	H2 FY20F
On the basis of volumes																	
Passenger vehicles (8.5%)	12%	0%	26%	28%	5%	1%	-6%	4%	7%	9%	8%	3%	0%	6%	-1%	-6%	5-6%
Two wheelers (9.4%)	-8%	3%	26%	26%	14%	3%	7%	8%	3%	7%	15%	5%	-2%	10%	-1%	-6%	2%
Tractors (9.2%)	-3%	1%	32%	20%	12%	-2%	21%	-13%	-11%	22%	22%	8%	2%	10%	6%	-2%	6%
Telecom services (17.3%)	50%	42%	39%	37%	11%	-12%	1%	4%	6%	14.20%	-1.50%	-1.80%	-1.50%	-1.20%	-1.80%	-2%	-1.50%
Airline services (~12%)	24%	-11%	15%	19%	13%	-5%	5%	16%	22%	22%	19%	14%	7%	20%	9%	4%	10-1%
AC* (10.5%)	24.60%	10.00%	18.70%	19.60%	-2.00%	-0.30%	3.40%	12.80%	9.70%	9.70%	9.40%	0.00%	13.30%	-2.00%	3.00%	16.40%	8-10%
Television (2.8%)	2.10%	16.50%	4.80%	1.80%	-1.30%	-1.90%	-4.00%	5.70%	3.20%	0.90%	3.00%	5.00%	2.00%	3.30%	6.70%	2.00%	2-3%
Fridge (~8-9%)	11.40%	9.20%	47.30%	12.70%	6.80%	5.10%	3.40%	9.10%	6.10%	7.90%	6.80%	8.10%	10.00%	6.60%	10.00%	10.80%	9.00%
On the basis of revenues																	
FMCG** (11%)	17%	21%	-5%	17%	15%	16%	10%	12%	2%	3%	8%	11%	8%	13%	9%	7-8%	8-10%

Note: All numbers linked to volumes for sectors
**AC: Air conditioner*
***FMCG includes revenues of companies like HUL, Colgate-Palmolive, Marico, Britannia, Dabur and Godrej Consumer Products.*
Numbers in brackets next to name of segment represents average growth rate for that segment between 2007-08 to 2017-18
Source: CRISIL Research

- Less than half the average growth (average between 2008 and 2018)
- Deviation up to half of the average growth
- Above or equal to average growth

- Data shows that fiscals 2013 and 2014 were worst hit by slowdown, and the current one is akin to fiscal 2009 – moderate slowdown, with chances of rapid recovery
- The first half of fiscal 2020, though, is expected to be worse than the second half of fiscal 2019. Moderating urban incomes has worsened the dynamics, along with one-time events such as sharp increase in cost for sub-segments within automobiles and supply disruptions in segments such as airlines
- Large-ticket durables such as cars have seen a much sharper slowdown vis-à-vis other low-ticket segments such as FMCG. Also, car volumes in the last two quarters (including first quarter of fiscal 2020) have seen the sharpest erosion since fiscal 2010
- Sharp increase in cost has dented growth for the highly penetrated and relatively high-ticket size two-wheeler segment which is very sensitive to income and cost
- The current slowdown is driven by both cost as well as income worries. Segments that have seen sharp increase in prices have seen a particularly sharp drop in volume
  - In line with the moderation in rural income, tractor volume has dipped after three good years of growth
  - Urban income uncertainty has risen in manufacturing segments amid lower production, resulting in slower wage growth. Stagnation in completion of real estate projects is also impacting demand, and business income and sentiment.
  - Decline in passenger traffic and telecom subscribers are on account of sector-specific events

Consumption-linked sectors

FMCG and automobiles showing signs of slowdown; airline volumes show an event-based moderation

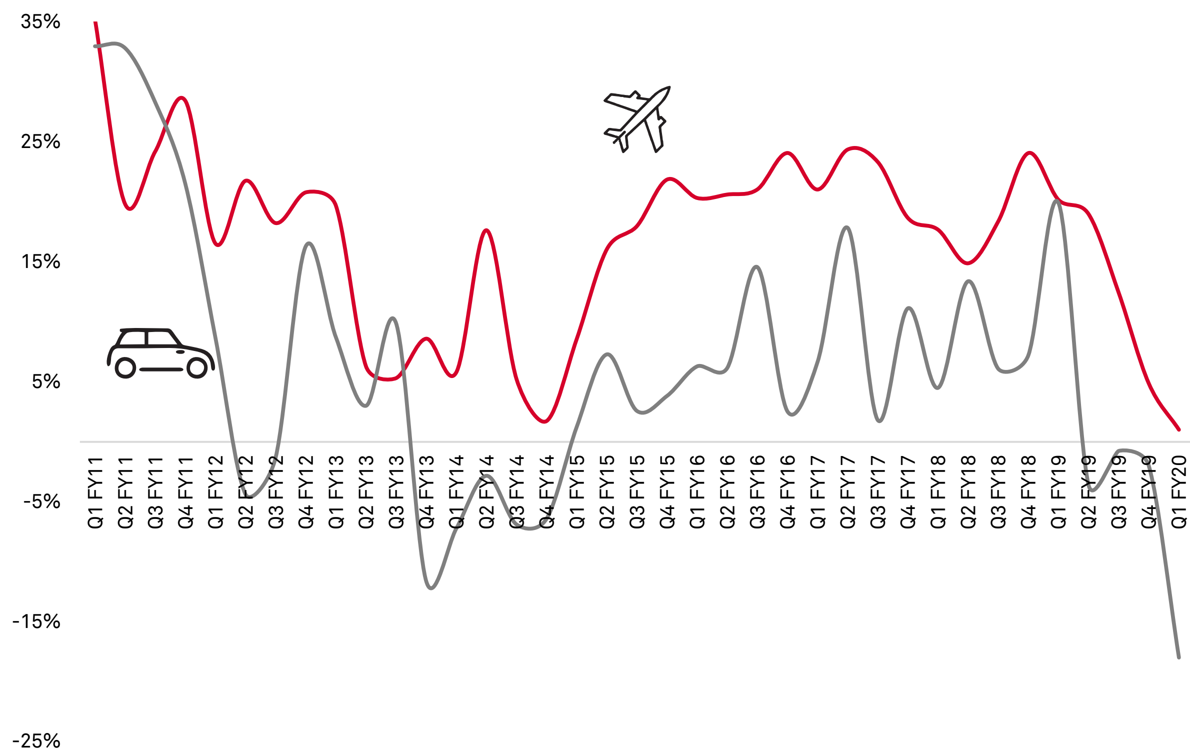
While FMCG volumes slowed moderately, motorcycles have shown a steep decline

Source: CRISIL Research

Pointers

- A 20% rise in the cost of ownership has impacted motorcycle offtake amid lower rural income
- Sharp increase in prices of two-wheelers with Bharat Stage-VI (BS-VI) implementation will trigger advancement of purchases, resulting in recovery to the mean average in the second half of fiscal 2020 over a low base
- FMCG revenue growth is expected to moderate further, albeit not significantly lower than the 36-quarter average

Supply disruptions impact airline traffic; weak urban sentiment and higher cost impact car sales



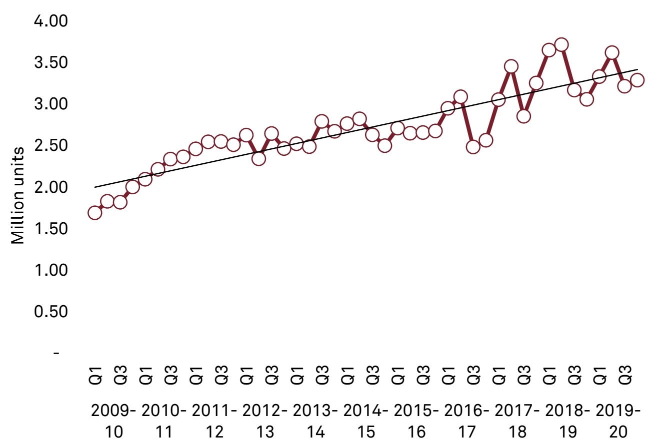
Source: CRISIL Research

Pointers

- Jet Airways was grounded from the fourth quarter of fiscal 2019, impacting airline passenger traffic
- Capacity addition by peers –IndiGo and SpiceJet - to lead to a multiplier growth in the second half
- Weakening urban income and a 6% increase in cost of ownership impacted car sales in the second half of fiscal 2019
- Lack of new model launches added to the woes
- Entry of two players, advancement of purchases prior to BS-VI implementation, and a favourable base will drive growth in the second half of fiscal 2020

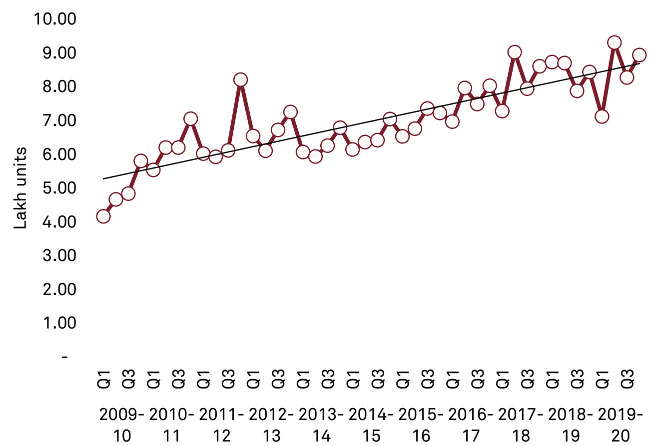
Trend line analysis indicates that despite a better second half in fiscal 2020, due to advancement of purchases linked to BS VI roll-out, volumes would remain below the trend line.

Two-wheeler volume to remain below trend line, with some improvement from current lows



Source: Industry, CRISIL Research

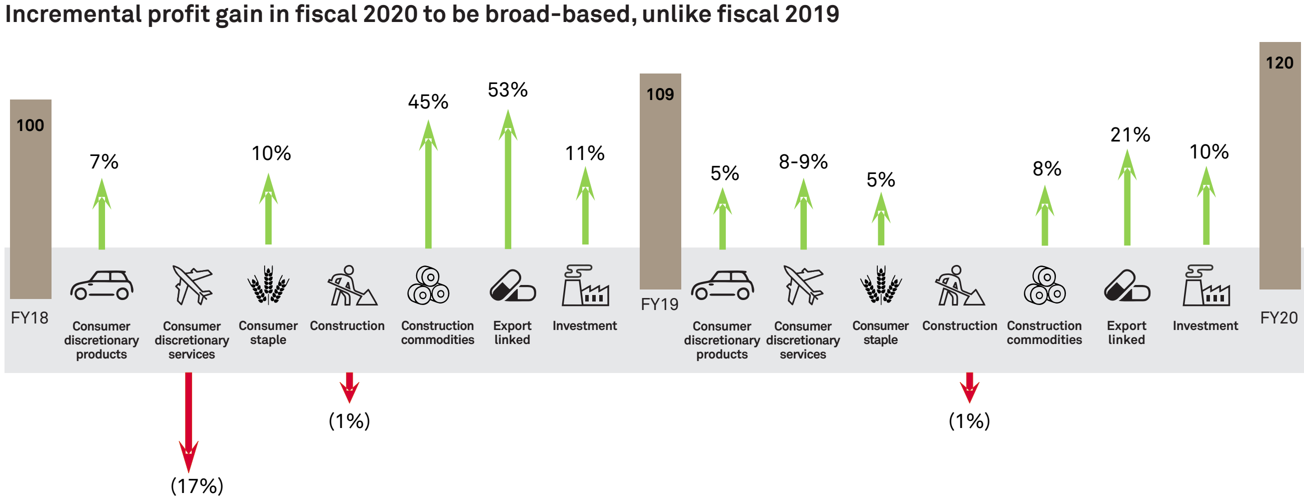
After sharp erosion in two quarters, car volume to recover in second half of fiscal 2020



Source: Industry, CRISIL Research

Profitability

Incremental profit gain in fiscal 2020 to be broad-based, unlike fiscal 2019

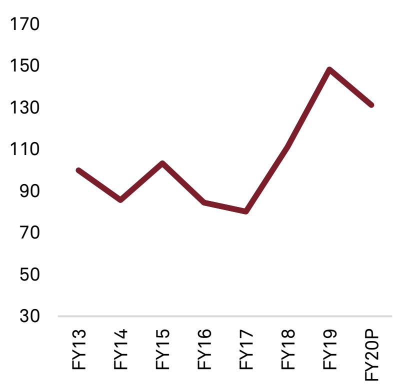


Notes: 1) Percentages refer to share in profit rise between years. For instance, consumer discretionary products contributed 8% of incremental profit gain between fiscals 2018 and 2019.
2) 'Others' not depicted above contribute the balance.
Source: Industry, CRISIL Research

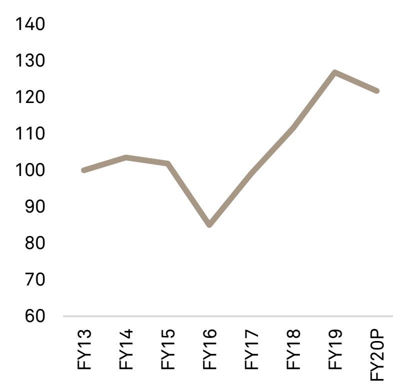
In fiscal 2020, CRISIL Research forecasts a 10% on-year profit growth, primarily supported by healthy growth in export-linked sectors. Consumer discretionary services will also recover from the lows of the last fiscal as telecom sees rising ARPUs and lower access charges. Airlines sector would also benefit from rising air fares and lower aviation turbine fuel prices. Share of construction commodities in incremental profit gain would moderate significantly on account of narrowing profit spreads in the steel space.

Commodity prices

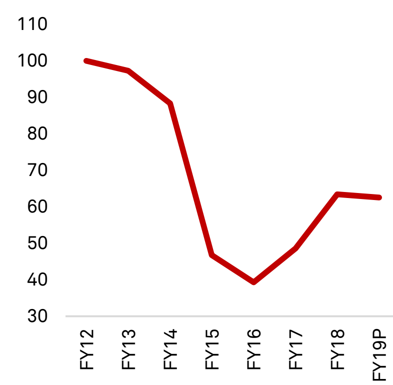
Steel prices



Crude oil prices



E-auction coal prices



P: Projected
Note: Prices have been indexed to 100 in FY13
Source: CRISIL Research

Private investments pushed **back anew**

It’s a double whammy for investments as weak business sentiment and slowdown in consumption push back industrial capex, while lack of private participation limits infrastructure spending.

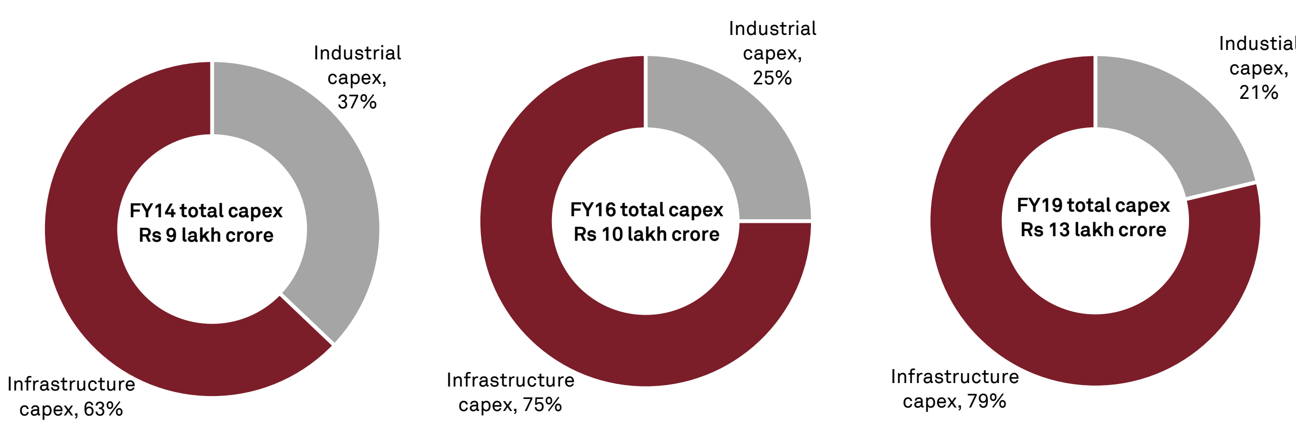
Industrial and infrastructure investments growth is slowing down. But they are telling two different stories.

First, that private firms may postpone their capital expenditure (capex) by a year to the next fiscal , as weak business sentiments and demand slowdown in key sectors would continue to weigh on recovery of investments. Besides, resolution of stressed assets especially in steel and cement sectors, and higher share of brownfield capacity expansion would imply fewer incentives for spending on fresh capacity.

Second, while infrastructure will continue to do the heavy-lifting in investments, greater dependence on public funding and ability of government institutions to borrow and execute will remain the monitorables in key sectors such as roads.

The ability of private players to take up public-private partnership (PPP) projects is likely to remain constrained in the near term given delays in resolution of construction-led stressed assets. Introduction of newer execution models, maturing of funding channels (such as National Investment and Infrastructure Fund), and policy-linked issues (such as land acquisition) will, therefore, remain key monitorables.

Infra drives capital investments as industrials drag their feet



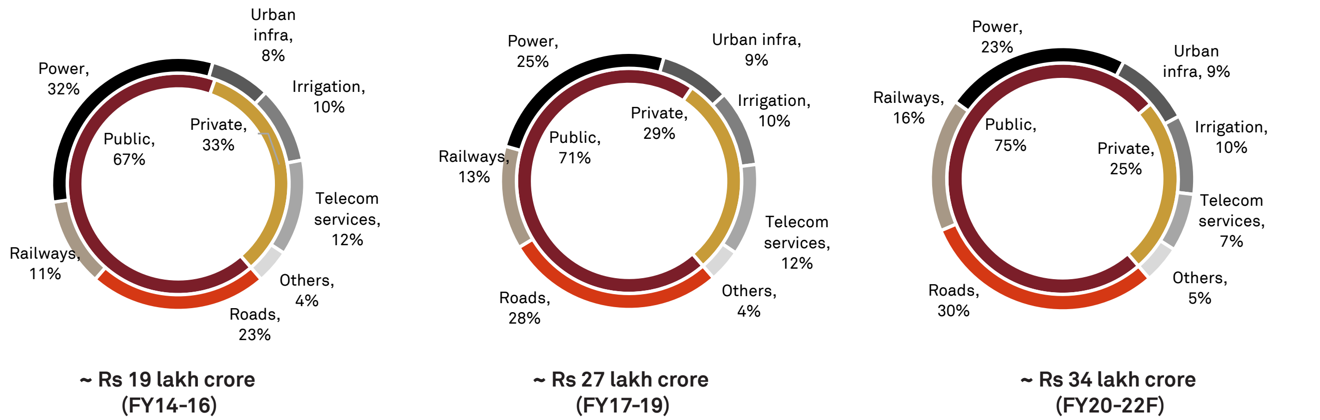
Source: CRISIL Research

Infrastructure investments to slow as external funding, execution remain challenging

Total infrastructure investment is now expected to grow at ~6% annually through fiscal 2022, compared with 10% over the past three fiscals.

A segment-level break-up shows roads and railways comprise a chunk of infrastructure investments, and their share is expected to rise from a third in fiscals 2014 to 2016 to nearly half of the total investments through fiscals 2020-2022. The share of public investments remains high, but lower allocations in the Union Budget 2019-20 could slow down investments in specific segments such as rural roads and national highways.

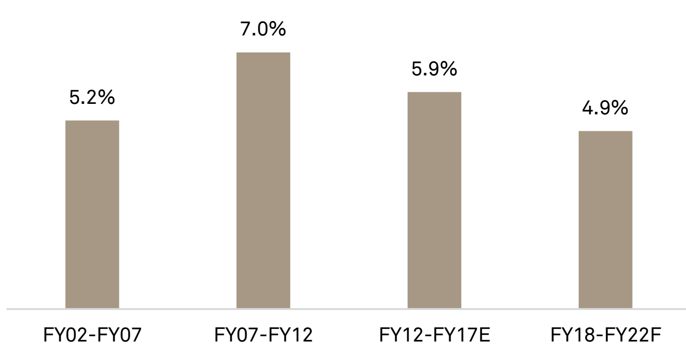
Private share of infrastructure spending to drop further



Source: CRISIL Research

India's infrastructure investments as a percentage of GDP may fall to a 15-year low between fiscals 2018 and 2022. Overall infrastructure spending over the past two fiscals amounted to 5.1% of GDP – the lowest since fiscal 2002 – because of funding challenges for both private and public segments, and a lower-than-expected pick-up in new PPP models. This makes the journey towards the government's target of Rs 100 lakh crore (or 7-8% of GDP) infrastructure spending by fiscal 2024 more challenging.

Infrastructure investments as a percentage of GDP



Note: E - Planning Commission estimates; F - CRISIL's forecast
Source: Industry, Planning Commission

Given the rising share of public investments in India, funding remains a monitorable. In the Union Budget 2019-20, Internal and Extra Budgetary Resources (IEBR) accounts for nearly 55% of allocations to roads and railways. A large proportion of IEBR for both these segments would be external borrowings. For instance, borrowing by the National Highways Authority of India (NHAI) quadrupled to Rs 1.85 lakh crore in fiscal 2019 from Rs 0.5 lakh crore in fiscal 2016. While the future funding requirement of NHAI would remain a key monitorable, our analysis indicates the debt required would need to double in the next three fiscals, factoring in our execution forecast (see Annexure 4, Page 44). Also, the situation gets accentuated given that financial closures for new models such as the hybrid annuity model (HAM) have been delayed in the past.

Growth expectations and the share of public investments in key infrastructure segments

	Investments (FY20-22F) Rs lakh cr	Next 3 years CAGR	Estimated share of public over 3 years	Share of debt in spends
Roads	10.2	7%	84%	75-80%*
Power	7.7	7%	74%	70%
Railways	5.5	15%	80%	45%
Urban infra	3.2	10%	90%	35-40%
Irrigation	3.3	8%	100%	70%
Telecom	2.4	(20%)	<10%	70%

Source: CRISIL Research
*Note: In the second column, red indicates lower growth rate, orange indicates similar growth rate and green indicates higher expected growth rate over the past three-year period; In the third column, red indicates higher public spending, orange indicates similar public spending and green indicates lower public spending over the past comparable period; *Number for roads denotes only NHAI dependence.*

- Growth in road investments is expected to moderate from 17% on average to 7%. While segments such as rural roads had lower allocation in the Union Budget 2019-20, others, such as national highways, remain heavily dependent on public investments. Therefore, the fund-raising capability of NHAI becomes crucial to ensure a pick-up in infrastructure investments

- In the power sector, investments in conventional energy generation projects are expected to decline significantly, while renewable energy projects will continue the momentum. Investments in T&D will be led by central sector schemes such as Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY) and Integrated Power Development Scheme (IPDS) in distribution, inter-regional as well as intra-regional transmission projects and renewable energy-related transmission projects such as green energy corridors. However, a revival of distribution segment in terms of both operational and financial performance is a must for sustained growth in investments in the generation segment

- The rail segment has achieved its targets over the past three fiscals, growing at an average annual growth rate of 15%. The trend is expected to continue, given that they have access to funds from bilateral agencies and higher budgetary support (see Annexure 5, Page 46)

- Urban infrastructure has been an under-penetrated area, though it logged annual average growth of 20% in spending between fiscals 2016 and 2019. As schemes linked to Atal Mission for Rejuvenation and Urban Transformation and Swachh Bharat mission, and Smart Cities mature, we expect spending to grow at a moderate 10% during the next three years until fiscal 2022. Further, the role of urban local bodies will also rise over the next few years for segments such as water supply and sanitation

- In the irrigation segment, fast-track completion of old projects has led to a 10% growth in spending over the past three fiscals. Project completion will continue to drive 8% growth during fiscals 2019 to 2022

- Telecom saw the launch of 4G services, led by 5% average annual growth in network capex. We believe the 5G launch is some time away, and the auction of airwaves is unlikely this year. Hence, capex growth for the next three years is expected to decline at an average annual rate of 20%

Industrial investments: Recovery unlikely anytime soon

Capex of large non-infrastructure companies (refer to set considered in revenue and profitability chapter) has declined 4% over the past five fiscals. While capex by the oil and gas sector logged a 5% CAGR, that of non-oil industrials declined 8% due to lower investments by steel, cement, and non-ferrous metal sectors.

If we consider a wider universe of ~37,000 companies, capital investment fell 6% in fiscal 2018. In comparison, capex of large companies – which constituted two-thirds of the aggregate capital investments in fiscal 2018 – declined 4.5% in fiscal 2018 (see Annexure 7, Page 49). The share of large firms is expected to increase, as large capital investments in key industrial sectors such as steel, non-ferrous metals, auto components and cement would largely be undertaken by these firms. For instance, the share of large companies in the steel sector's capacity is expected to rise from 55% currently to 58% over the next three fiscals.

We expect capital investments to dry up (decline by 2-3% in fiscal 2020), as weak sentiment weighs on recovery. While the utilisation of the industrial sector has inched up in recent years, it is below the optimum level seen in fiscal 2010. Further, large companies have focused on asset acquisitions in the past three fiscals, weighing on fresh investments. Also, large sectors would see higher brownfield capex, which is less capital-intensive.

Most capital-intensive and stressed sectors have seen improving credit profiles among their corporates, as highlighted in the table below. A healthy rise in profitability and cash flow, especially in key stressed sectors, has resulted in improving credit profiles of companies. This has kept the debt-weighted credit ratio for CRISIL-rated companies at a modest level of 1.65. The credit ratio has improved significantly in steel, followed by construction.

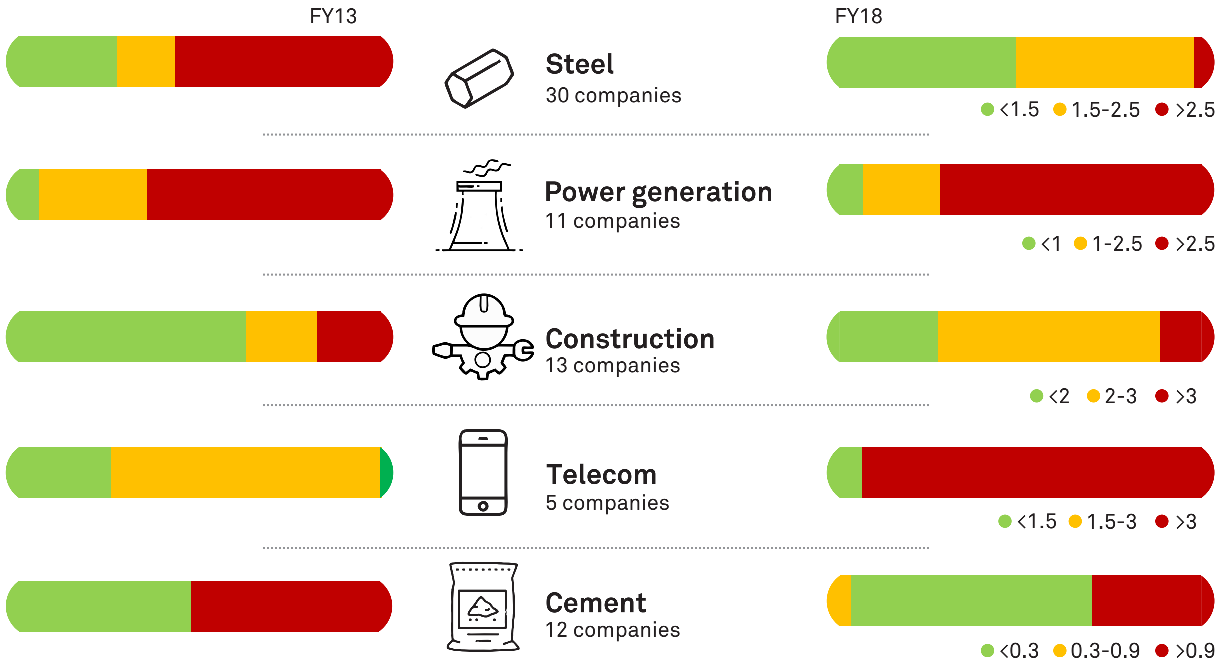
Debt-to-equity improves to green zone across key capital-intensive sectors

	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Airline services (2)	NM	2.30	24.1	56.7	NM	NM	3.5	1.4	0.6	
Auto components (52)	1.50	1.39	1.33	1.26	1.32	1.13	1.14	1.10	0.97	0.95
Cement (11)	0.31	0.40	0.43	0.44	0.46	0.48	0.39	0.37	0.50	
Construction (28)	1.37	1.63	1.97	2.21	2.49	2.64	3.38	3.42	3.39	
Non-ferrous metals (4)	1.31	1.08	1.67	2.29	1.69	1.49	1.39	1.37	0.97	
Automobiles (7)	4.85	1.83	1.86	1.85	1.30	1.89	1.03	1.25	0.99	
Power generation(11)	0.98	1.38	2.00	2.41	2.50	2.49	2.44	2.69	2.68	
Steel (29)	1.65	1.49	1.51	1.78	2.18	2.55	2.25	2.52	2.25	
Telecommunications (4)	0.68	1.16	1.32	1.54	1.32	1.44	8.88	9.62	7.06	NM

Note: Capital-intensive sectors have been depicted for the analysis above for all leading companies in the sectors above; Color coding is based on the long period average for the specific sector; Power generation excludes NTPC and NHPC; Number in bracket indicates sample size for the set; NM = Not meaningful
Source: Company reports

Considering the debt spread by leverage across key capital-intensive sectors, we observe that steel and construction have displayed a marked improvement, while power and telecom remain a drag.

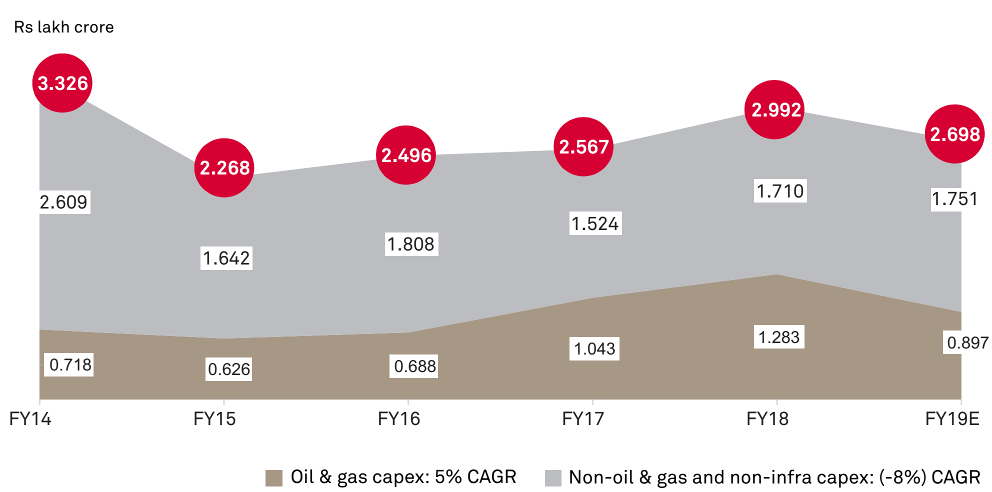
Debt spread by leverage (D/E ratio) improves for steel and construction; power and telecom still in the red



Note: The above graph explains the debt spread by gearing for the specific sector. Benchmarks are based on long period average for each specific sector.
Power generation excludes NTPC and NHPC
Source: Company reports

Despite an improvement in the credit ratios in key sectors, a revival in private capex still has a long way to go.

Capital investments by 750+ large industrial companies (non-infra) on a downward trajectory

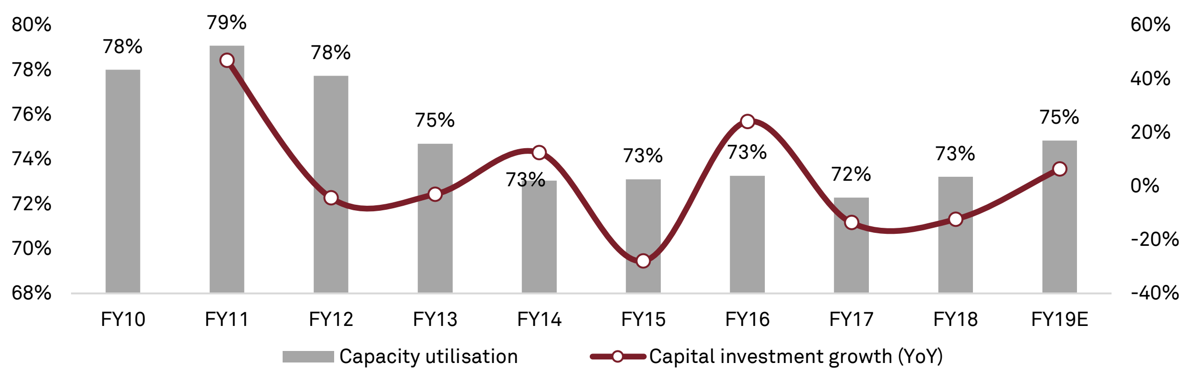


Source: Company reports, CRISIL Research
Note: CAGR mentioned for period intervening fiscals 2014 and 2019

Capital investments have declined, led by the twin impact of lower utilisation (though it is improving) and the acquisition spree of large companies, especially in industrial sectors such as steel and cement.

- Lower utilisation: The industrial sector's capacity utilisation fell from a healthy 79% in fiscal 2011 to 72% in fiscal 2017 because of weak demand across key segments. While utilisation has improved in the past two fiscals, investment will take some more time to recover given muted sentiment and acquisition by large companies

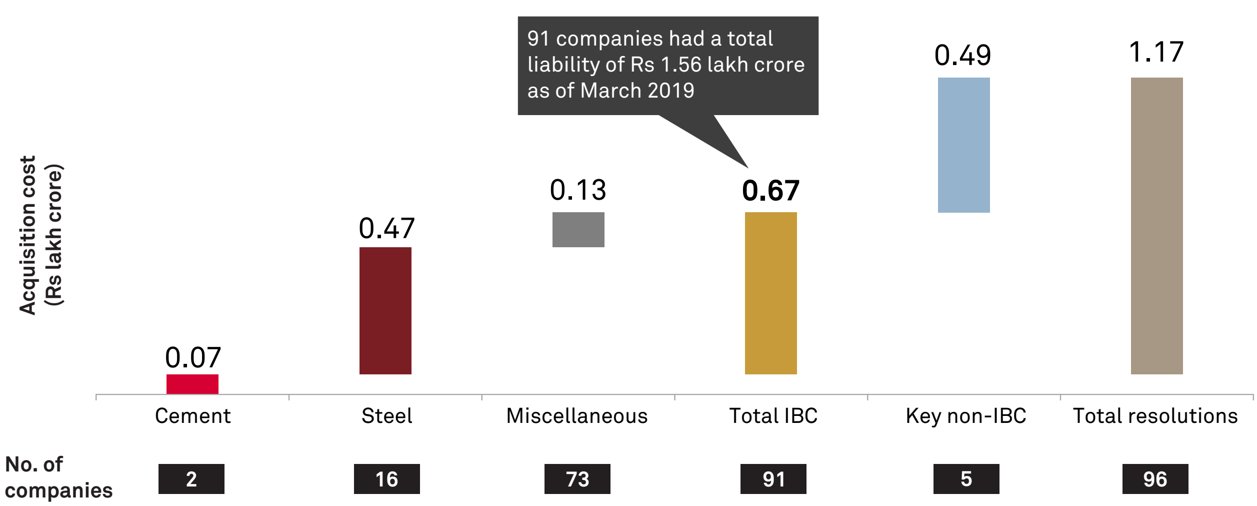
Capacity utilisation trending down, marring pick-up in industrial capex



Note: Capital investment growth traced for around 800 companies (refer revenue and profitability chapter)
Source: RBI, CRISIL Research

- **Acquisition of assets:** About 91 companies were acquired for Rs 67,400 crore in the past three fiscals under the Insolvency and Bankruptcy Code (IBC), 2016, clearing Rs 1.56 lakh crore of liabilities. Another five large companies were also acquired outside IBC for Rs 50,000 crore in the cement and power sectors. While this has helped banks clean their balance sheets, it has weighed on fresh investments

About 96 companies have been acquired in the past three fiscals



Source: IBC, Industry, CRISIL Research
Note: Non-IBC sample is only for large companies in the cement and power sectors that got resolved outside IBC

We believe capital investments would be stagnant in the near term, because of:

- **Rising but low utilisation:** While utilisation has inched up in fiscal 2019, it is still at a sub-optimal level, especially in small and mid-size firms in key sectors.

- **Continued capacity acquisition:** Players in key sectors, such as steel, cement and paper, will continue to acquire assets and scale up these underutilised capacities. For instance,

  – 40-50 million tonne (MT) of cement capacities are expected to be acquired in the medium term (next 3-5 fiscals)
  – 11-13 MT of steel capacities will be acquired in the near term (1-2 years), apart from other smaller capacities in the medium term

- Rising share of brownfield capacity expansions: With players focusing more on expansions at current and acquired units, capital investments will be lower, as brownfield expansion is less capital-intensive. For instance,

  – More than 90% of capacity addition in the steel sector will be in brownfield projects over the next five fiscals (brownfield steel capacity is 30-40% less capital-intensive than a greenfield unit)

The downturn in the auto segment will add to the agony.

We expect industrial capex in the oil and gas and other key sectors to decline marginally in fiscal 2020 to an estimated Rs 1.78-1.80 lakh crore, compared with ~Rs 1.83 lakh crore in fiscal 2019.

Sectoral capital investment trends for key sectors (Rs lakh crore)

	FY15	FY16	FY17	FY18	FY19	FY20P
Oil & gas	0.63	0.69	1.04	1.28	0.89	0.88-0.89
Steel	0.36	0.29	0.21	0.18	0.21	0.24-0.25
Cement	0.16	0.11	0.15	0.15	0.11	0.14-0.15
Automotive	0.17	0.18	0.15	0.23	0.18	0.15-0.16
Auto-components	0.09	0.14	0.17	0.18	0.24	0.19-0.20
Non-ferrous metal	0.05	0.09	0.06	0.08	0.18	0.16-0.17
Aggregate	1.45	1.5	1.78	2.10	1.83	1.78-1.80

Note: Oil-and-gas capex only for public sector (private share in capex is limited)
Source: Industry, CRISIL Research

- **Oil and gas:** While upstream oil and gas capex will be healthy, weaker downstream capex in the natural gas sector will weigh on growth in fiscal 2020. Also, capex by standalone refiners is expected to be muted

- **Steel:** Brownfield capacity expansions by JSW Steel and Tata Steel will aid a healthy revival in the sector's capex in fiscal 2020. However, in the medium term, we expect no major capex push, as more assets get acquired and large players expand their existing and acquired units. About 22 MT of acquired/ under-acquisition NCLT-I steel capacities have land and/ or clearance available to expand capacity to 41 MT

- **Cement:** Lower utilisation (<70% in the past three fiscals) and a slew of capacity acquisitions weighed on the investment cycle in the sector. Around 49 MT of capacity changed hands in the past four fiscals. In the near term, capacity expansion will be driven by large players adding capacity. In the medium term, the rising proportion of clinker expansion plans will infuse investments

- **Automotive and auto components:** Weak automotive demand amid increasing cost of ownership across vehicle segments and new supply by two new players will limit capital investment in the near term

- **Non-ferrous metals:** Greenfield capital investment by Nalco and capacity expansion by other private players on the alumina front will drive investments in the sector

In annexures:

- Borrowings, budgetary support to determine execution pace of roads, Page 44
- Railways: LIC and bilateral agencies will continue to aid growth, Page 46
- Power: Low intensity and gestation capex drive lower investments, Page 47
- Large 800+ listed companies constitute two-thirds of capital investment mix for 37,000+ companies, Page 49
- Capital goods and imports trend lower, led by a weak capital investment cycle, Page 50

Financial sector: **retail does well**

Composition of credit is changing

The wagon wheel of total credit in the Indian financial system has four components – public sector banks (PSBs), private sector banks, non-banks (including NBFCs and housing finance companies or HFCs, but excluding government-owned NBFCs) and financial institutions (FIs; including government-owned NBFCs).

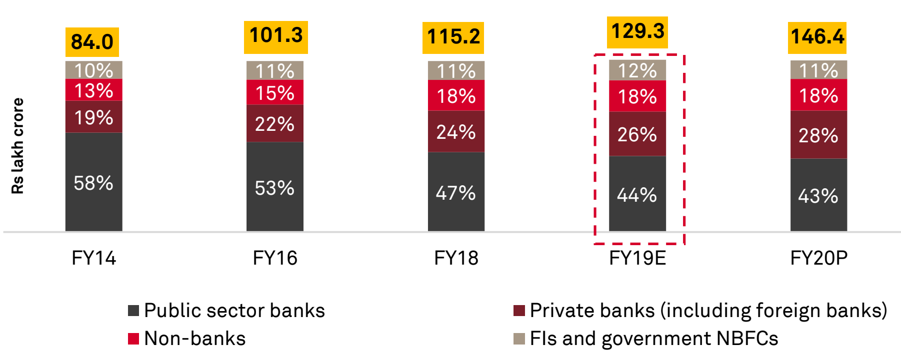
A close reading of the composition of total credit shows two clear trends in recent years.

First, private sector banks have continued to gain share at the expense of PSBs, which have been beset with challenges. And this is expected to continue despite some pick-up in PSB growth.

Second, non-banks have seen a trend reversal. Between 2014 and 2018, the share of non-banks in the overall credit pie increased continuously, going from 13% to 18%. However, this was arrested in fiscal 2019 as access to funds became challenging.

With banking sector growth continuing to tick up, the share of non-banks in the pie is expected to remain at a similar level for the next couple of years at least.

Private banks gain, non-banks hit a bump



Note: Numbers in yellow boxes indicate the total credit pie; Bank credit is of scheduled commercial banks and excludes exposure to financial sector; NBFCs = NBFCs (excluding government owned NBFCs) + HFCs; FIs = All-India financial institutions + government owned NBFCs; E = Estimated; P = Projected
Source: RBI, company reports, CRISIL estimates

Credit growth looking up for banks, driven by retail lending

Bank credit is expected to grow at ~14% in fiscal 2020, faster than the 12% seen in fiscal 2019, and well above the 8% in fiscal 2018.

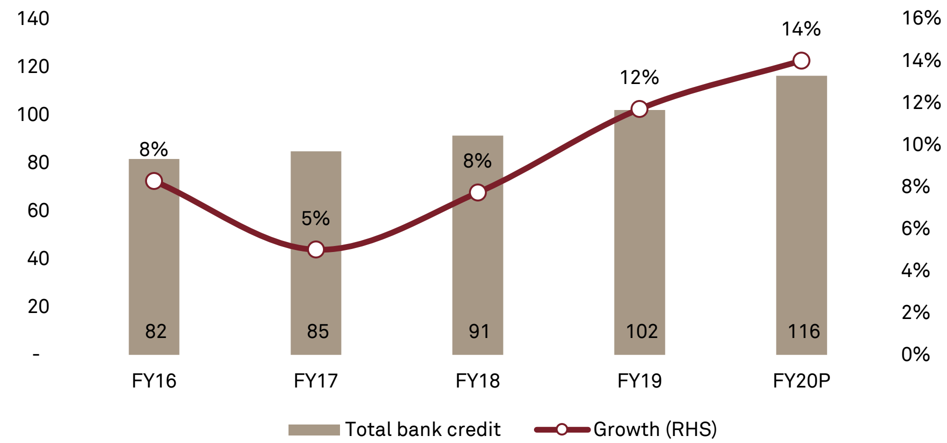
From a segmental perspective, retail credit growth is expected to spurt to ~19% in fiscal 2020 compared with 16% in the previous fiscal. Within the retail segment, secured loans are growing steadily, whereas unsecured loan products such as credit cards and personal loans are showing strong traction.

At the other end, corporate sector loan growth, which saw a revival in fiscal 2019 to 13.1% from 4.9% in fiscal 2018, is expected to stay at similar levels. Growth in MSME loans slowed in fiscal 2019 to 6.7%, but is expected to touch 9% this fiscal.

For PSBs, growth will be supported by the recapitalisation of Rs 2.1 lakh crore received from the government in the past two years as well as the Rs 70,000 crore announced recently. But the PSBs, which continue to face lending constraints due to the prompt corrective action invoked by the RBI and inadequate capital buffer, are likely to grow much slower.

Private banks, however, will continue to grow much faster than the rate of growth in systemic credit, supported by strong balance sheets and significant presence in the retail segment.

Driven by retail



Note: P = Projected; 1 crore = 100 lakh = 10 million
Source: RBI, CRISIL estimates

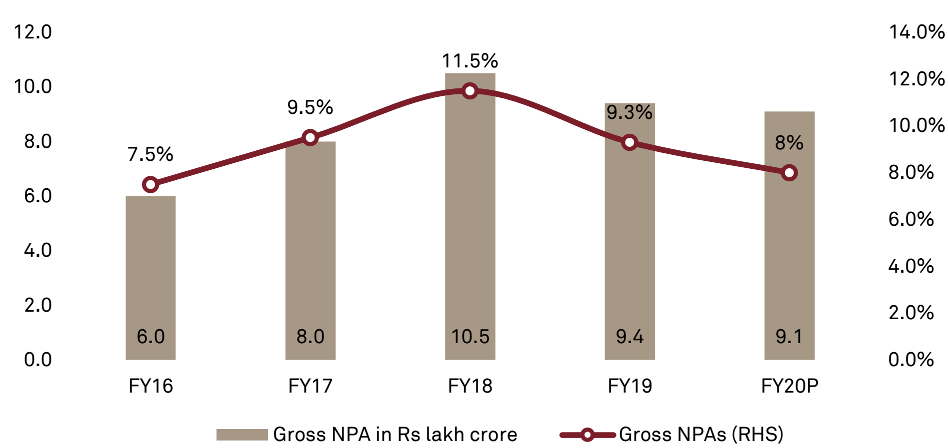
GNPAs trending down after tripling in fiscals 2015 to 2018

Bank NPAs are expected to shrink 350 bps over two years to ~8% by March 2020. That compares with the peak of 11.5% in March 2018 and 9.3% in March 2019.

This will be driven by reduction in fresh accretions to NPA as well as stepped-up recoveries from existing NPA accounts. Resolution of large NPA accounts, especially under the IBC, will particularly help, assuming that bulk of the cases pending in the NCLT will be resolved, with higher recovery rates and faster resolution times than seen so far.

A pick-up in credit growth will help, too.

A picture of sanguinity



Note: P = Projected
Source: CRISIL estimates

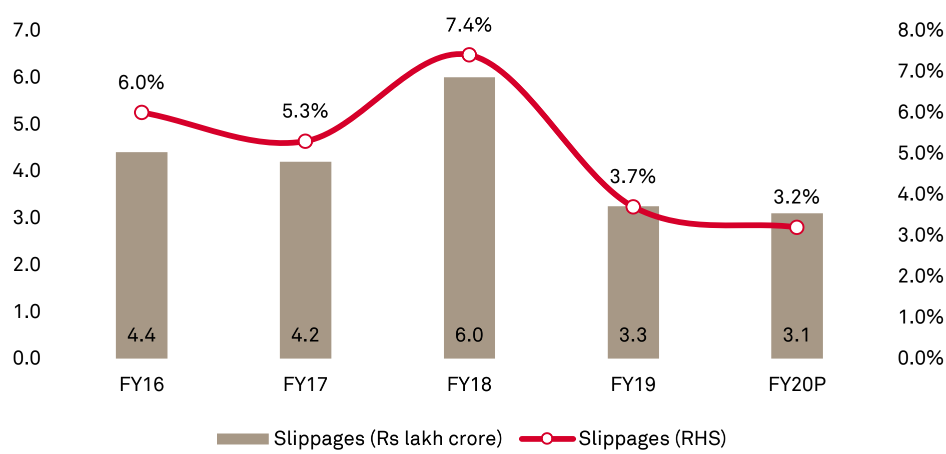
NPA accretion nearly halved in fiscal 2019, will fall further

Slippages have been on the wane since last fiscal, with the rate of accretion of fresh NPAs halving in fiscal 2019 to 3.7% compared with 7.4% the previous fiscal.

This is expected to drop further to ~3.2% in fiscal 2020. Banks have already recognised ~Rs 17 lakh crore of stressed loans as NPAs since fiscal 2016, led by accelerated NPA recognition following the Reserve Bank of India's stringent norms and asset quality reviews.

The estimates for fiscal 2020 also factor in slippages from the stress being witnessed in a few large corporate and financial sector entities.

On the descent



Note: P = Projected
Source: CRISIL estimates

Corporate NPAs to shrink, but SME and retail NPAs among monitorables

A substantial reduction in NPA levels is expected in corporate loan accounts, riding on resolution of some large NPA accounts under NCLT-1 and NCLT-2 fructifying by the end of this fiscal.

Trends in corporate credit quality at an aggregate level are also supportive. CRISIL's credit ratio, or the number of upgrades to downgrades, increased to 1.81 in the second half of fiscal 2019 compared with 1.67 in fiscal 2018.

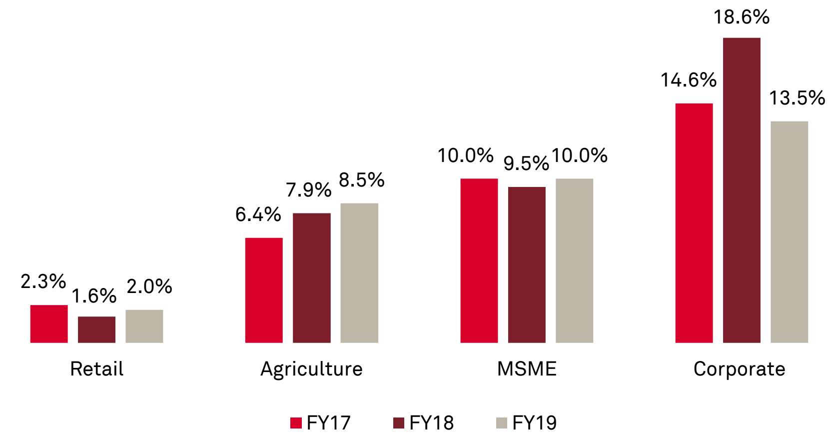
The credit ratio is expected to moderate going forward – though it will remain above 1 – given steady economic growth and benign interest rates.

Although delinquencies have inched up marginally in the retail segment and portfolios are yet to fully season, given strong growth in the past few years, the granular nature of these loans should ensure diversification and support against material deterioration going forward.

Also, given the RBI's stance on restructuring of loans to SMEs till the end of fiscal 2020, NPAs in this segment would be controlled till then.

Hence, seasoning of retail portfolio and performance of the SME portfolio post the restructuring period will be key monitorables.

IBC-led recoveries and lower slippages cull corporate NPAs



Source: CRISIL estimates

For non-banks, growth will remain subdued over the medium term

The challenges faced by non-banks in access to funding following the credit cliff event in September 2018 and recent defaults by some large non-banks has only increased the risk aversion of lenders and investors.

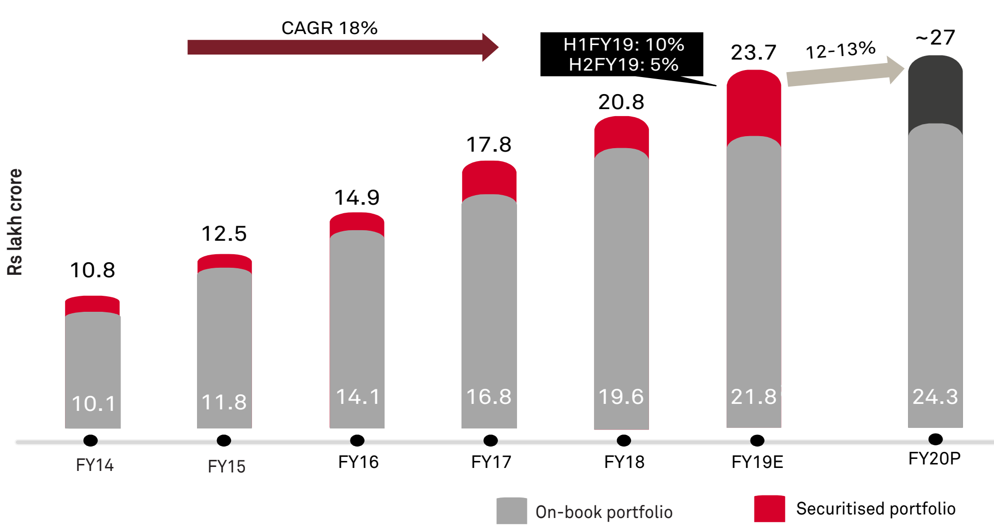
A clear differentiation is visible between groups of non-banks. At an overall level, players with a strong parentage are still getting funds, while those without any parentage continue to face challenges.

Bifurcating this further, wholesale NBFCs without strong parentage are the worst hit. Home loan- and retail-focused non-banks are relatively better off.

With all of this, growth in the second half of fiscal 2019 was around half of what was seen in the first half. But given the strong growth in the first half, growth in overall non-bank credit in fiscal 2019 was still at ~15%, with assets under management reaching Rs 23.7 lakh crore.

Growth is expected to be remain subdued at least in the first half of fiscal 2020, with overall assets under management growth for the year estimated at 12-13%. With securitisation expected to sustain as a preferred funding mode, the on-balance growth of non-banks is expected to be lower.

Growth in non-bank AUM to remain subdued



Note: Chart does not factor in the impact of corporate restructuring events; E = Estimated; P = Projected
Source : CRISIL estimates

Retail segments better placed on growth and asset quality

Growth and asset quality are expected to be different across asset classes.

The unsecured loans and gold loans businesses are unlikely to witness any material impact.

In traditional retail asset classes such as vehicle finance and home loans, while there could be some moderation because of intensifying competition from banks, these segments are expected to grow and aid growth for the overall non-banks space going forward.

However, wholesale segments, especially real estate finance, are expected to be impacted the most. This is reflected in curtailed disbursements to this segment. With incremental funding toward real estate dropping, asset quality concerns have elevated.

Loan against property (LAP) is also a segment where delinquencies have already been rising over the past three years. This trend is expected to continue.

	Growth		Asset quality
	FY19	Medium term impact	Medium-term impact
Home loans	16%		
Vehicle finance	18%		
Unsecured loans	30%		
Gold loans	8%		
Infrastructure finance	9%		
LAP	13%		
Structured & real estate	11%		

High impact | Medium impact | No impact

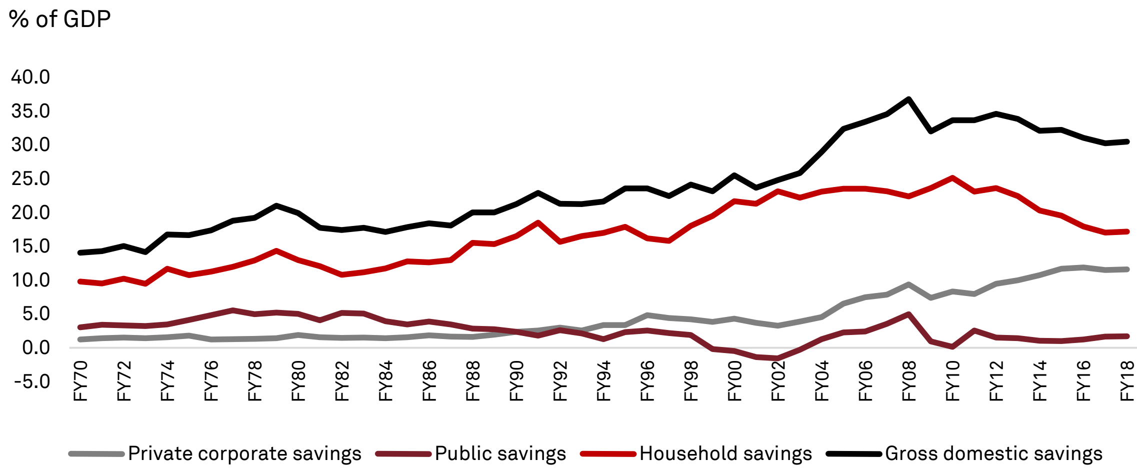
Note: Unsecured lending includes personal loans, consumer durable loans and unsecured business loans and two-wheeler finance (excluded from vehicle finance for the purpose of this asessment)
Source: Company reports, CRISIL estimates

Annexures

Annexure 1

Higher investment needs are chasing lower savings

Households have turned profligate, slowing down overall savings



Low savings can hurt the investment-growth cycle. For a fast-growing economy like India, investment generally outpaces domestic savings, and the gap is funded by foreign savings that shows up as current account deficit. Maintaining adequate domestic savings is, therefore, an important cornerstone of sound macroeconomic management. That is particularly true, given the challenging global environment of today.

Worryingly, India's savings rate has declined sharply in recent years. Savings rate, or the proportion of gross domestic savings in GDP peaked at 36.8% of GDP in fiscal 2008 and has since trended down, recording 30.5% in fiscal 2018 (latest available data). While India's savings rate has yo-yoed in the past, the magnitude and length of decline this time around is unprecedented.

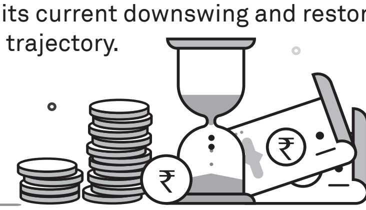
The disaggregated picture (see chart above) shows households – the largest savers in the economy – have also dragged down overall savings rate most. Ipso facto, their consumption has risen. Given a youthful population (about 70% of the working age population in India falls in the 20-40 years category), households are becoming consumption-centric and leverage-happy. Their financial liabilities are on the rise, as evidenced in retail credit, which, at 17% growth annually, is the fastest-growing loans segment in the past five fiscals.

Physical savings (largely, real estate) of households declined from 15.9% in fiscal 2012 to 10.3% in fiscal 2018. Financial savings declined, too, from 7.4% to 6.6%. And that's a major source of concern because households are traditionally the net supplier of funds to the private corporate and public sectors. Put another way, the excess of household savings over their investment is used to fund the saving-investment gap of the other two sectors. At present, the level of financial savings is just about enough to finance the combined fiscal deficit of the Centre and the states.

A continuation of this trend will shrink the pool of savings available for private investments – or result in a crowding out.

The re-elected NDA government's resolve to push growth up is evident. And with a softer monetary policy stance, investments are likely to increase in the future. But if savings do not rise commensurately, India's current account deficit could come under stress.

Clearly, it is time to reignite the virtuous cycle of high savings, investment, and growth, if the economy has to be pulled out of its current downswing and restored on the high growth trajectory.



Annexure 2

Why India badly needs a good monsoon year

With 14% share in GDP, agriculture is not the primary driver of economic growth in India, but its role had assumed greater significance this fiscal because the other engines of growth – consumption and investment demand, and exports – are weak.

Rainfall this year – both in timeliness and distribution – has so far disproved predictions. The onset of rains was delayed, and the catch-up (up to July) has been slow. Some key crop producing areas are reeling under the shortfall, and coupled with weak irrigation, could see more stress.

And that's probably the last thing rural folks want this year. Normal rains and healthy distribution is critical this year, because the past two seasons saw not only below-normal rains (95% of long period average in 2017 and 91% in 2018), but skewed distribution, too. In 2017, the temporal dimension was affected as rains weakened in August. In 2018, regional rains were skewed, with 33% sub-divisions facing deficiency. So, another year of inadequate monsoon will decrease the efficacy of India's irrigation ecosystem and could impact crops and farmers adversely.

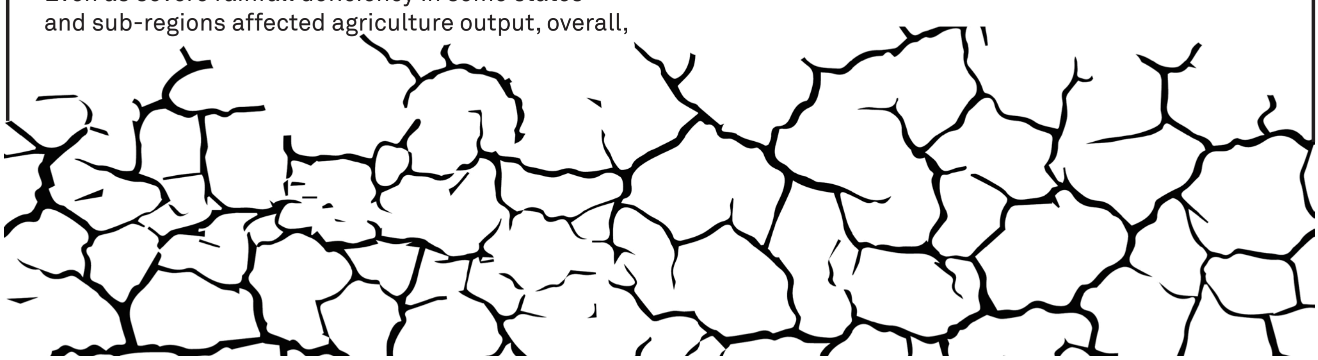
Between fiscals 2017 and 2019, the steepest declines in nominal growth in agriculture – a proxy for farm prices – were in Madhya Pradesh, Maharashtra, Odisha, Bihar, Telangana, Punjab, and Karnataka. These states bore the brunt as their real gross value added (GVA) growth also declined, indicating overall loss of income.

Even as severe rainfall deficiency in some states and sub-regions affected agriculture output, overall, there was a supply glut causing crop prices to fall rapidly, and hurting farm incomes. Higher minimum support prices (MSPs), too, provided little relief because procurement at those prices was either delayed or low.

Rain deficit scenario: A rise in farm prices could recoup some farm income losses, but will feed mildly into headline inflation. As for food grains, buffer stocks will continue to be a cushion, while for pulses and oilseeds, currently low international prices and appreciating rupee will facilitate higher imports.

Between fiscals 2017 and 2019, growth in real GVA of agriculture rose at an average 4.7%, or twice as fast as the preceding three fiscals. This culled food prices. Despite higher real growth, for the same period, nominal growth in agriculture GVA fell to 7.6% from 11.4%, indicating a fall in farm prices and, therefore, farmer margins. Naturally, food inflation mirrored this, sliding to 2.1% on average, from 7.8% in the preceding three fiscals.

Pertinently, the past three fiscals have seen the price effect overtaking the output effect in determining farm income. The situation is made worse by a sharp rise in input costs. Therefore, if rains are inadequate this year and hurt output, the consequent rise in food prices could offset some of the income loss of farmers. But that could also push headline inflation above the RBI's medium term target of 4%.



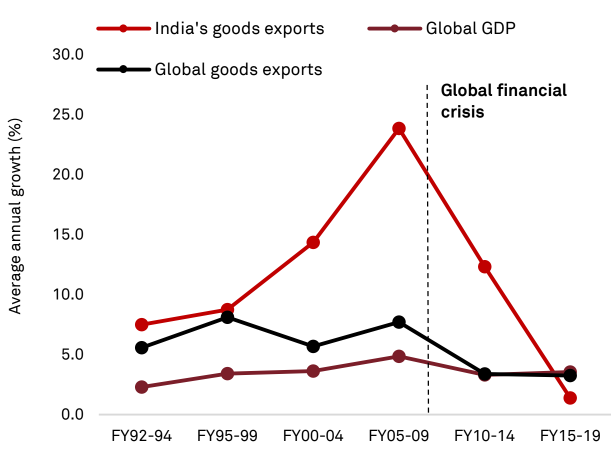
Annexure 3

The opportunity in every crisis

In a closely knit world, there's no escaping repercussions of global developments on the domestic economy. In India, the high export growth post 1991 liberalisation played a major role in propping up GDP growth. Since the 2008 global financial crisis, export growth too slowed in line with global growth. Noticeably, in the past five years, India's export slowdown has been steeper than the global average. That could be attributed to declining competitiveness relative to peers such as Vietnam and Bangladesh. Appreciating rupee, demonetisation, and glitches in GST implementation have also played a role in paring India's export competitiveness.

Reviving competitiveness has become more crucial now than ever. Just as the global economy was emerging from the woods, the winds of protectionism started to batter global trade and investment. This is hampering a nascent recovery in global growth. The International Monetary Fund expects global GDP to grow 3.6% over the next five years, same as in the preceding five years. Moreover, the downside risks to growth remain significant, given that US-thrust trade tensions continue.

Global trade is literally down, but new pathways could be exploited for India



Source: Ministry of Commerce, IMF, CRISIL

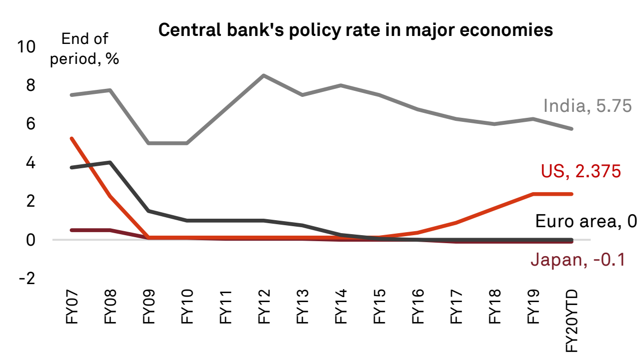
However, rising trade tensions between the US and China have opened the doors for other countries to substitute for the export goods impacted by tariffs. India has already seen some gains from China. Its exports to China grew in tariff-hit products such as cotton, organic chemicals, and petroleum products. However, in the largest traded items between the US and China - such as electrical machinery and equipment, and mechanical appliances -- India still lacks competitiveness to scale up to required trade volumes. Attracting foreign investment in these sectors can help India improve its competitiveness.

The US-China war has also sped the shift of production bases out of China and restructuring of supply chains, paving the way for India to plug into new networks. India must be proactive in reaping this opportunity by taking steps to improve competitiveness, attract investment, and ink new trade agreements.

A third positive spinoff of the global slowdown is the benign financial conditions. Slowing global growth has meant major advanced economies have shelved policy normalisation plans. The US, the only major advanced economy to have raised policy rates post the global financial crisis, has paused doing so, in the light of rising risks to growth from the trade wars. S&P Global expects one rate cut by the US Federal Reserve this year. Other major central banks have been unable to even start raising rates. The European Central Bank (ECB) is expected to continue with monetary policy easing. S&P Global expects the ECB resume net asset purchases of €15 billion from October 2019. Bank of Japan is also expected to continue with monetary support.

This means, external financial conditions will remain conducive for attracting capital flows and investment.

Easing on the cards?



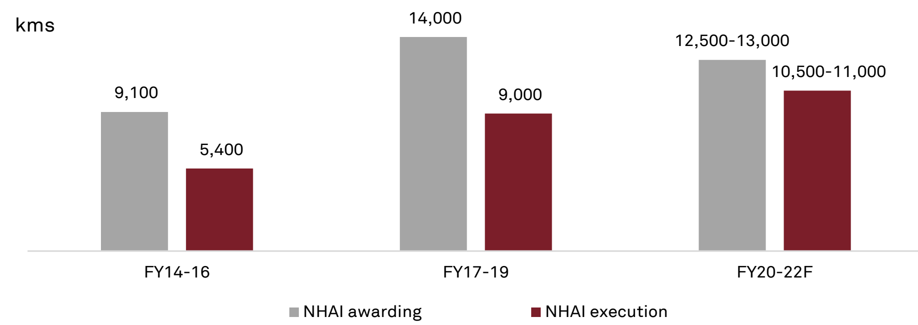
Note: Data as on July 30, 2019
Source: Bank of International Settlements

Annexure 4

Borrowings, budgetary support to determine execution pace of roads

NHAI and the Ministry of Road Transport and Highways account for nearly half of India's road investments. State road departments account for a little over 40% and rural roads 7-8%. In the absence of new public-private partnership (PPP) models, the high share of public investments would restrict growth in national highways, while a drop in budget allocation would lead to a 14% decline in investments in rural roads over the next three fiscals versus the previous three fiscals. State roads, however, are expected to see a 40% increase in spending over the next three years.

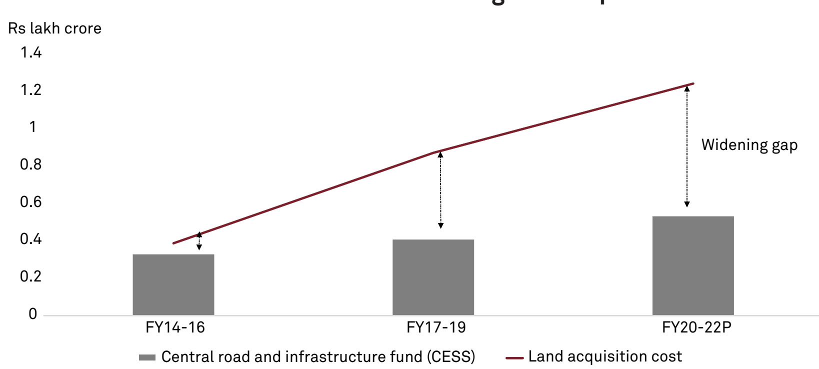
Awarding to drop for NHAI; execution growth plateaus



F: Forecast
Source: NHAI, CRISIL Research

- NHAI would now focus on completing under-construction projects, as awarding moderates
- Around 60% of NHAI awarding in fiscal 2019 is estimated to be under engineering, procurement and construction (EPC) and the rest under the hybrid annuity model (HAM). An analysis of 30 companies executing HAM projects indicates the current cumulative networth would suffice their contribution in HAM projects up to fiscal 2021
- At present, leverage for top 30 companies participating in PPP projects is ~3x. Beyond fiscal 2021, companies would either sell assets or raise equity to bid for new projects, given that the entry of new players has been limited in the past few years

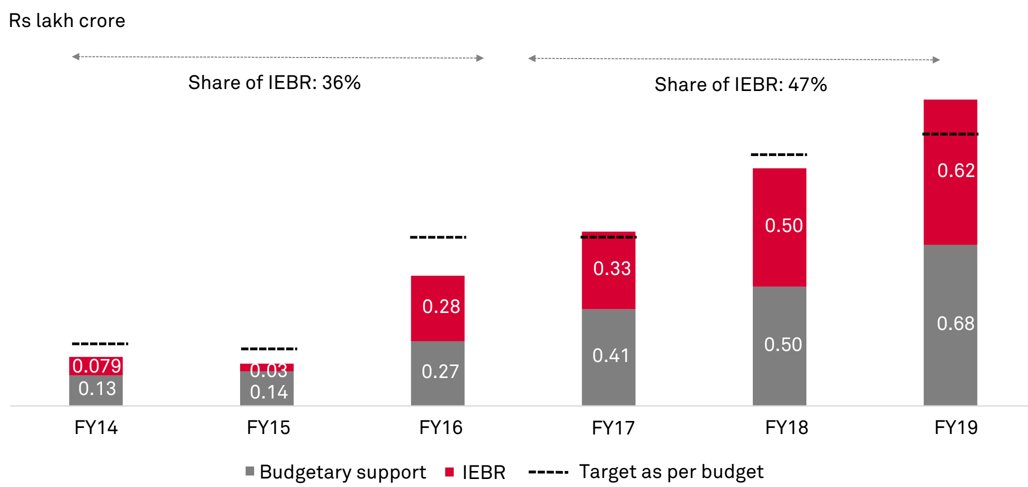
Cess funds insufficient to meet NHAI's rising land acquisition costs



P: Projected
Source: NHAI, Union budget, CRISIL Research

- Land acquisition costs have risen a significant 2.3x from Rs 39,000 crore over fiscals 2014 to 2016 to Rs 87,000 crore over fiscals 2017 to 2019. The allocated cess fund under Central Road and Infrastructure Fund is insufficient to meet the rising land acquisition cost of NHAI
- The allocation of cess funds to NHAI has been largely static, while land cost has more than doubled during fiscals 2017 to 2019 versus fiscals 2014 to 2016

Rising proportion of IEBR signifies higher public debt



IEBR: Internal and extra-budgetary resources
Source: Union budget

- NHAI's borrowing has quadrupled over fiscals 2016 to 2019. Nearly 64% of the total expenditure by NHAI in fiscal 2018 was funded by borrowings, compared with 38% in fiscal 2014
- NHAI's borrowing stands at Rs 1.8 lakh crore in fiscal 2019. Either higher borrowing or additional budgetary allocation would be needed to achieve execution numbers over the next three fiscals
- Toll-operate-transfer asset sales, contingent liabilities, arbitration accrual, and land acquisition would remain key monitorables for the entity

State roads to aid growth, as six of nine to sustain higher spending

	Roads & bridges capex past 3-yr CAGR	Roads & bridges capex next 3-yr CAGR	% share in total capex past 3-yr avg	Fiscal deficit FY20BE
Uttar Pradesh	-3%	9-11%	22%	3.0% ⇩
Tamil Nadu	9%	11-13%	29%	2.6% ⇩
Maharashtra	22%	10-12%	21%	2.1% ⇧
Karnataka	15%	8-10%	24%	2.7% ⇔
Odisha	1%	9-11%	33%	3.0% ⇧
Bihar	6%	4-6%	18%	2.8% ⇩
Madhya Pradesh	28%	20-22%	20%	3.3% ⇩
Rajasthan	19%	18-20%	18%	3.2% ⇩
Chhattisgarh	20%	25-27%	42%	3.0% ⇧

Worse than the all-India average
In line with the all-India average
Better than the all-India average

⇧ Fiscal deficit as % of GDP increased from fiscal 2017
⇩ Fiscal deficit as % of GDP declined from fiscal 2017

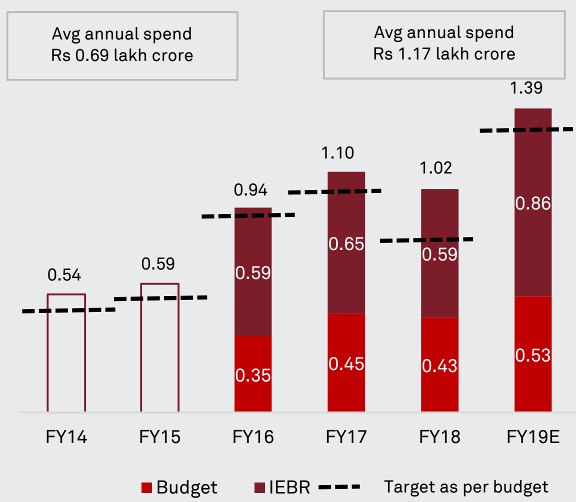
BE: Budget estimates
Note: The top nine states considered account for ~70% of states' expenditure on roads and bridges
Source: State government budget, CRISIL Research

Annexure 5

Railways: LIC and bilateral agencies will continue to aid growth

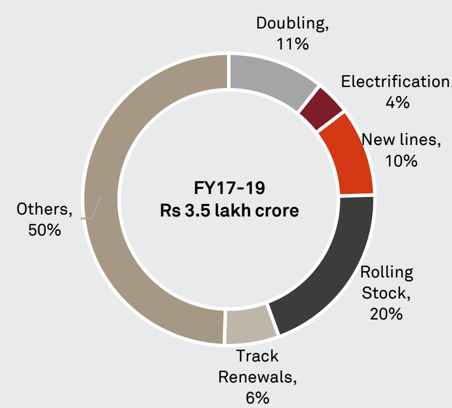
The story of higher IEBR support is no different for railways than roads. Life Insurance Corporation of India World Bank and Japan International Cooperation Agency have been the key partners for railways. However, both allocations and IEBR extensions have improved at a healthy pace, leading to healthy growth and achievement of targets. Dedicated freight corridor spending accounted for nearly 7% of total capex as of fiscal 2018 for railways.

Railways' annual capex up 1.7x over FY17-19 versus FY14-16



E = Estimated
Source: Union budget

Locomotives, wagons, new lines and doubling account for nearly 40% of spending



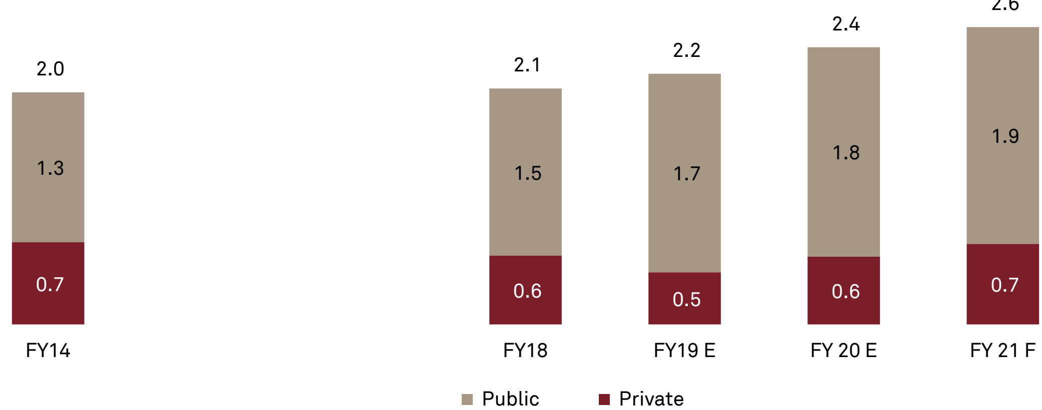
Source: Union budget

Annexure 6

Power: growth to be driven by public spends

(Rs lakh crore)

Total investments in power (including renewables)

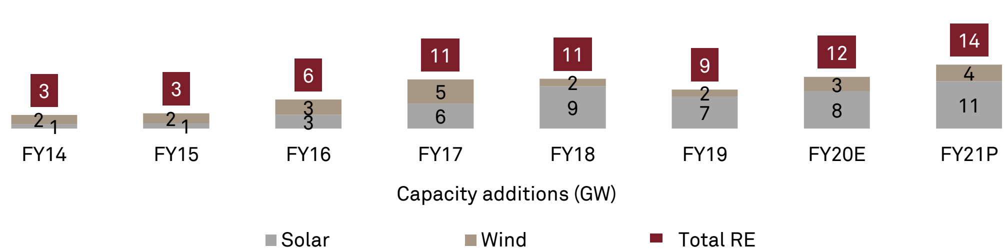


E = Estimated; F = Forecast
Source: Union budget, CRISIL Research

- Growth in power sector investments is expected to be driven by renewable generation capacity addition and T&D segments, as slowdown in conventional capacity additions on the generation side, especially from the private sector, will slow down overall investments
- Investments in the private generation sector (conventional power) are expected to decline on account of lack of fresh power purchase agreements, driven by weak financial health of distribution companies (discoms) and issues related to domestic coal availability
- However, we expect investments in T&D to pick up led by the government's thrust on improving infrastructure and financial support from central schemes such as DDUGJY and Integrated Power Development Schemes in distribution, inter-regional as well as intra-regional transmission projects and renewable energy-related transmission projects such as green energy corridors
- Revival of investments in the private generation sector will depend on structural changes towards improving financial health of discoms as demand growth will remain healthy, driven by the government's massive electrification drive - 'Power for All'

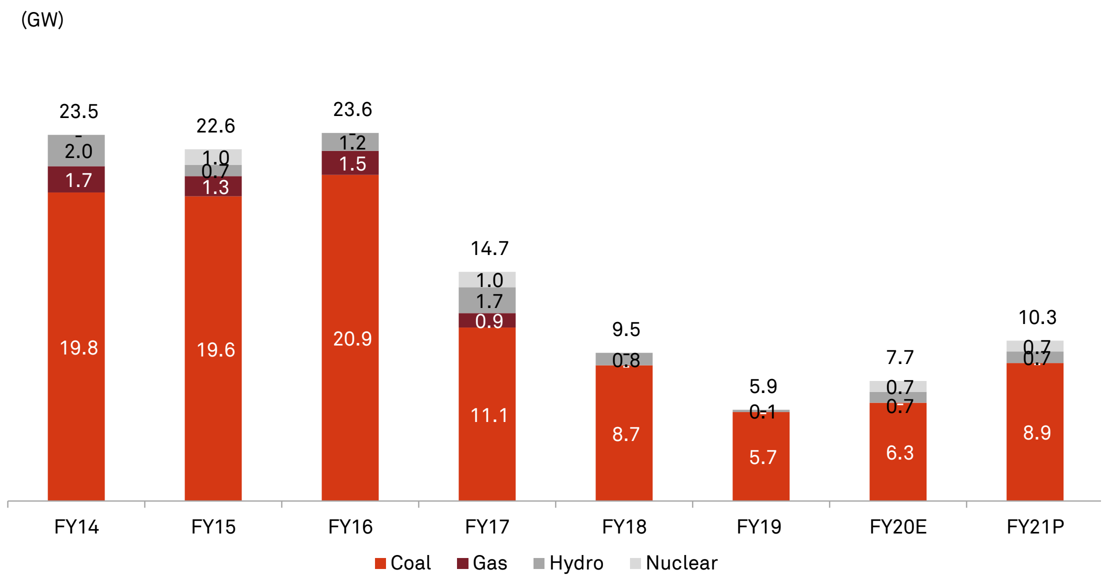
Trend in capacity addition

GW



E = Estimated; P = Projected
Source: Industry, CRISIL Research

Conventional capacity additions



E = Estimated; P = Projected
Source: Industry, CRISIL Research

- Renewable generation capacity is expected to increase at a robust pace, especially solar, over the next five years (fiscals 2019 to 2024) with installed capacity for solar growing at a CAGR of 23% over the period

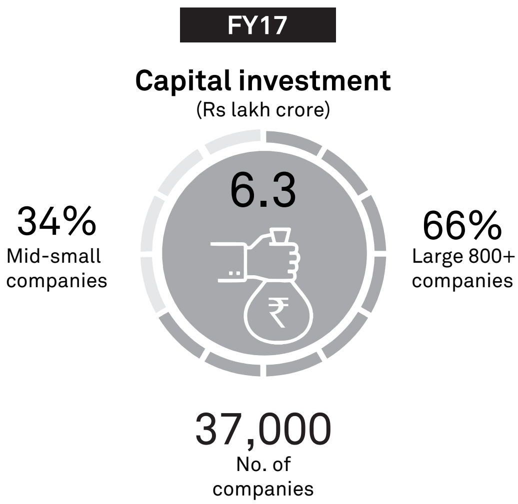
- In contrast, conventional capacity addition growth is expected to be slower, driven by decline in investments from the private sector. The central sector will continue to drive capacity addition growth on the conventional side

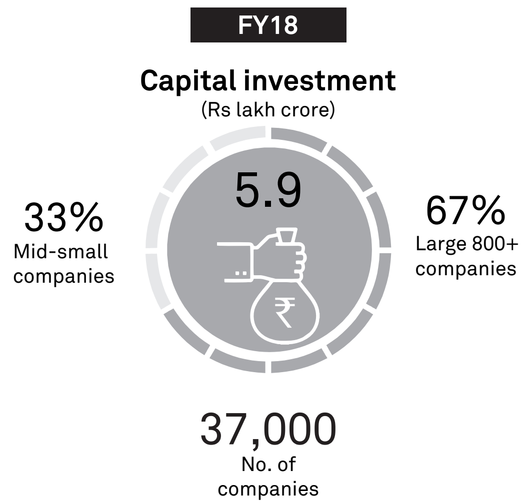
- Growth in renewable capacity will be driven by several factors, key being the government's focus and falling cost of capital (module prices for solar), which has made cost of renewable generation more competitive / even lower than that of conventional power

- However, to sustain the growth momentum in renewable capacity addition, certain key risks that have emerged over the past two fiscals - regulatory uncertainty (arbitrary cancellations and renegotiations), additional taxation (safeguard duty, higher GST rate), and lack of adequate infrastructure in parts (transmission connectivity, land parcels) - need to be addressed

Annexure 7

Large 800+ listed companies constitute two-thirds of capital investment mix for 37,000+ companies



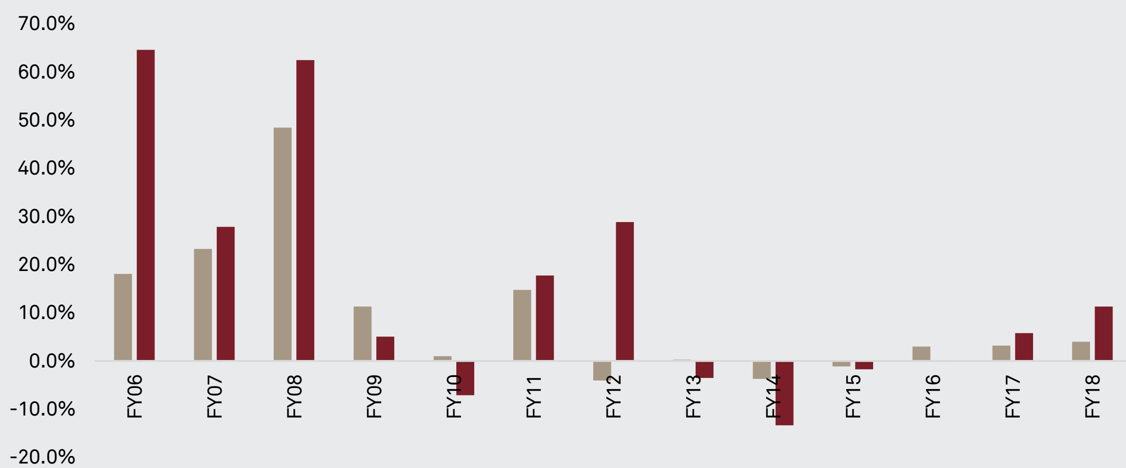


Source: CRISIL Research, Quantix

Annexure 8

Capital goods and imports trend lower, led by a weak capital investment cycle

The slowdown in private capex is also reflected in the capital goods industry. Domestic production and imports, which grew at a robust 52% and 30% between fiscals 2005 and 2008, respectively, moderated significantly after fiscal 2010.



Note: Domestic production of capital goods based on the Index of Industrial Production. Imports are only for machine tools, machinery, transport equipment and project goods
Source: Database of Indian Economy-RBI

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