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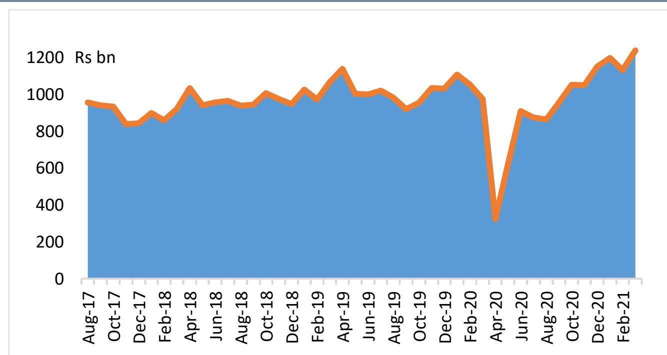
India is confronted with a much intense and a severe 2nd wave of the coronavirus. India now accounts for close to 50% of the daily reported global COVID-19 cases (27 April), the highest share recorded by any country. The sporadic event of lockdown, strict guidelines and restrictions have reemerged across many states. It appears that the 2nd wave has rolled back the growth prospects for FY22 and derailed the nascent recovery witnessed during Q4 FY21. We have thus, revised downwards the estimates for GDP growth from 11.5% to 9.1% for FY22. The risk from high global commodity prices, rise in asset quality stress in the banking system and debt burden has further added to the downside risks to growth. To begin with, the pressure on public health infrastructure and household healthcare expenses to deal with the pandemic have significantly mounted.

Headwinds are thus intensifying as with the spike in COVID cases, several states might have to consider further restrictions. As restrictions on social distancing increases, consumer demand, especially, in the urban centres would be severely curtailed, in turn impacting the already subdued manufacturing sector. With the rise in cases, the health care expenses are accelerating which will further dent the consumption expenditure. The out-of-pocket health expenditure of India is huge given that the density for life insurance at US$ 58 is a significant low compared to global level of US$ 379.

The impact of the current measures would largely and directly impact the services sector, especially the high-contact services sector in Q1 FY21. The impact is not small. The impact of localized lockdowns and social distancing measures on the very high-contact services sectors could wipe out the gains we have achieved during the previous two quarters. However, what is unclear is how seriously the construction sector will be affected by restrictions and unavailability of migrant labour as another exodus of migrant workers could take place if the cases continue to rise and the existing measures prolong past April 2021.

The stricter the restrictions and the longer the period of enforcement the larger the impact will be on the economy. In that context, the government might have to consider a stimulus package, initially curated only for the directly impacted segments of the economy, given the already strained public finances and high debt burden. The vaccination rate also needs to pick up dramatically. The key to revival of the economy would be a dramatic pick-up in the vaccination rate, further stimulus measures and improvement in global growth besides, strict enforcement of restriction mesaures.

GST collections continued to rise, recording the highest in March

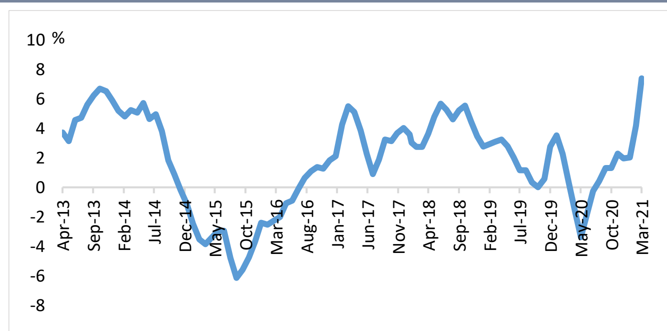


Source: PIB

Real Sector

- Growth in Index of Industrial Production (IIP) continued to contract for 2-straight months and stood at (-)3.6% (y-o-y) in Feb 21.
- Mining sector continues to contract since Mar 20 and stood at 5.5% (y-o-y) in Feb 21. Manufacturing sector contracted by 3.7% (y-o-y) in Feb 21 compared to a growth of 2.6% (y-o-y) in Dec 20.
- Sharp contraction was seen in infrastructure goods and intermediate goods which stood at (-)4.7% (y-o-y) and (-)5.6% (y-o-y) in Feb 21 respectively compared to 3.9% (y-o-y) and 0.6% (y-o-y) respectively in Jan 20.
- Growth in all the sectors in the Eight Core indices are contracting, for the first time in 11-months and stood at (-)4.6% (y-o-y) in Feb 21, majorly due to a sharp contraction in production of petroleum and refinery products which stood at (-)10.9% (y-o-y) in Feb 21 compared to (-)2.6% (y-o-y) in Jan 21.
- India's indirect tax revenue collection grew by 12% (y-o-y) to Rs 10.7 tn in FY21, representing ,108% of the revised estimates of Rs 9.89 tn.

WPI Inflation at an all-time high

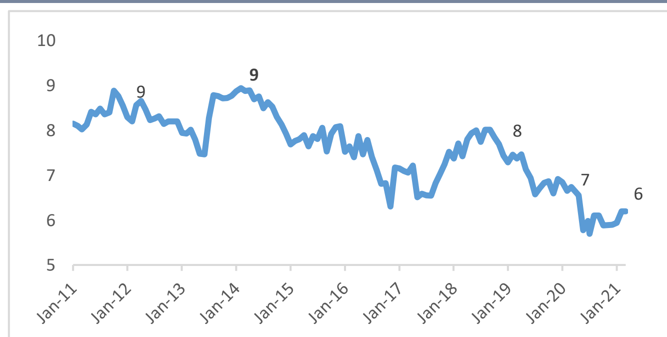


Source: MOSPI, Office of Economic Advisor

Price Scenario

- WPI inflation increased to 7.4% (y-o-y) in Mar 21, highest in new series 2011-12. The increase in WPI is due to a sharp rise in the inflation in non-food articles, which grew by 11.9% (y-o-y), highest since Jul 13 and inflation in crude petroleum & natural gas which grew by 32.2% (y-o-y) after contracting for 13 months.
- Annual CPI inflation increased by 6.2% (y-o-y) in FY21, highest in 7-years, with H1 at 6.7% (y-o-y) and H2 at 5.6% (y-o-y). Retail inflation in Mar 21 grew by 5.5% (y-o-y) compared to 5.8% (y-o-y) a year ago.
- Momentum in CPI inflation is led by the rise in Fuel and Light inflation which grew by 4.5% (y-o-y) in Mar 21, 12-months high, due to rapid increase in prices of LPG, Kerosene, Charcoal and Diesel.
- Food and beverage inflation grew by 5.2% (y-o-y) in Mar 21 compared to 4.3% (y-o-y) in Feb 21. Inflation in oil and fats grew by 24.9% (y-o-y) in Mar 21 (highest in 2011-12 series), inflation in fruits grew by 7.9% (y-o-y) in Mar 21 (highest since Jul 18).

Shift in dynamics of 10-yr G-Sec yields

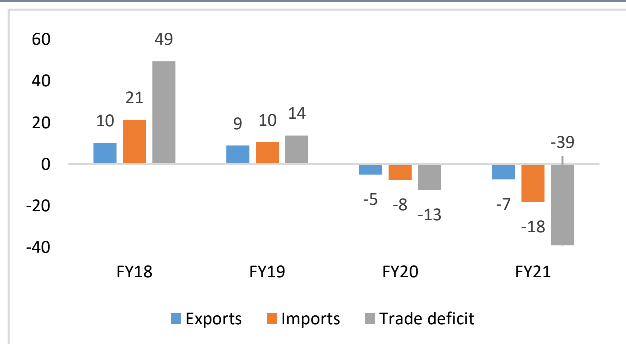


Source: BSE

Money & Finance

- During the 1st MPC meeting for FY22, the members decided to keep the repo rate unchanged and decided to continue with the accommodative stance.
- Pace of contraction in bank credit to industries declined to 0.24% (y-o-y) in Feb 21 compared to a contraction of 1.3% (y-o-y) during the last month. Growth in bank credit to beverages industry recorded a spike of 7% (y-o-y) in Feb 21, highest in 9 months. Bank credit to construction sector continued to contract for 2nd straight month and stood at (-)6.6% (y-o-y) in Feb 21.
- Bank credit to medium enterprises grew by 21% (y-o-y) in Feb 21, highest since Jan 11. Bank credit to services sector grew by 9.3% (y-o-y) in Feb 21, compared to 6.9% (y-o-y) in Feb 20. Loans against consumer durables grew by 11.5% (y-o-y) in Feb 21, lowest since Aug 19.
- 10-yr AAA Corporate bond yields have increased to 7.1% in Mar 21 compared to 6.5% in Oct 20.

India's foreign trade deteriorated severely during FY21



Source: EIA

External Sector

- Merchandise trade deficit narrowed to US$ 97.9 bn in FY21 compared to US$ 160.4 bn during FY20. Exports grew by 60% (y-o-y) in Mar 21 compared to a contraction of 34.3% in Mar 20. Imports grew by 53.7% (y-o-y) in Feb 21 compared to (-) 28% in Mar 20.
- Foreign exchange reserves increased to US$ 579 bn during Mar 21 from US$ 475 bn in Mar 20 and thus import cover increased from 6.6 months in Mar 20 to 8.4 months during Mar 21.
- FIIs rose to 6-year high in FY21 and stood at US$ 36.2 tn compared to an outflow of US$ 5.5 tn in FY20. Debt market saw net outflow in FPI and stood at US$ 2.2 tn and the equity market recorded strong inflow of US$ 37 tn during FY21.
- Rupee has depreciated to Rs 74.2 per US$ in FY21 as against Rs 70.9 per US$ during FY20.
- Brent crude oil price increased to US$ 65.4 per barrel in Mar 21, highest since Jan 20.

Dun & Bradstreet's Macro Economic Forecasts			
Variables	Forecast	Latest Period	D&B's Comments
I.I.P Growth	10% - 12% Mar-21	-3.6% Feb-21	Dun & Bradstreet expects industrial activity to have improved in March 2021 as compared to February 2021 as economic activity had gathered pace by then. The all-time high Goods and Services Tax (GST) collections in March 2021 indicated the uptick in consumer demand and higher transactions conducted by businesses. The rise in demand for passenger vehicles and two wheelers along with increase in prices also reflected the recovery in the consumer demand. Improving global growth prospects have similarly led to buoyancy in the industrial activity through high export demand
Inflation W.P. I **Inflation C.P.I (Combined)**	9.3% - 9.5% Apr-21 4.1% - 4.3% Apr-21	7.39% Mar-21 5.52% Mar-21	Dun & Bradstreet expects wholesale inflation to remain elevated and inch higher in April 2021 from the March 2021 levels largely due to the low base effect. The restriction on people movement is expected to generate hoarding tendencies and fuel inflationary pressures. The uncertainty posed by the rapid rise in cases will lead to an increase in the cost of various services including logistics. Supply side pressures to inflation will emanate from the quantitative easing as the Reserve Bank of India (RBI) will buy one trillion rupees of government bond in the first quarter of FY22, the elevated international commodity prices and the localized lockdowns. The expected depreciation in rupee is also likely to feed into inflation. However, better agricultural output and lower demand for non-essential and recreational services in the coming months should offset some of the price pressures
15-91 days T-Bills **10-year G-Sec Yield** **Bank Credit**	3.2% - 3.3% Apr-21 6.18% - 6.2% Apr-21 6.7% - 7% Apr-21	3.28% Mar-21 6.19% Mar-21 5.6% Mar-21	Dun & Bradstreet expects long term bond yields to moderate from the March 2021 levels and remain range bound in April 2021 as the RBI will buy government bonds worth one trillion rupees in the three months up to June 2021 under the G-sec acquisition programme or G-SAP 1.0. This will offset the upward pressures to long term yields from high inflation, government borrowing and the rise in US 10-year treasury yields. While the open market purchases by the RBI is likely to support the long end of the curve, the RBI's decision to increase the tenure of variable rate reverse repo auction operations is expected to put some pressure on the short-term yields
Exchange Rate INR v/s US$	74.5 – 74.8 Apr-21	72.8 Mar-21	Dun & Bradstreet expects rupee to depreciate from the levels witnessed in March 2021. The RBI's decision to infuse one trillion rupees in the market to buy government bonds during the quarter ending June 2021 is likely to exert significant downward pressure on rupee. The elevated global commodity prices and expected rise in US bond yields will add to the rupee depreciation pressures
All figures are monthly average			

Transition from LIBOR-What does it hold for Indian Financial Markets

Of the myriad risks that pose a threat to India's growth prospects for FY22, the risk from the financial sector could be formidable. Tackling the stressed assets is not the only challenge that the financial sector has to bear. The London Inter Bank Offer Rate (LIBOR), the widely used benchmark rate to price a range of global financial instruments for nearly five decades cease to exist by end December 2021. It was initially announced in 2017.

Many countries where LIBOR is the benchmark for the domestic interbank interest rate or forms one component of the local interest rate benchmarks have identified the benchmark risk-free alternate reference rates (ARR) to LIBOR while many are still to launch. Thus, as the deadline approaches, the financial institutions across the world have begun the process of unlinking the financial products from LIBOR, re-evaluating their pricing and rewriting the contracts. The task is daunting. While globally more than US$ 350 - 400 trillion (broad estimates) worth of financial contracts were linked to LIBOR, India's exposure to LIBOR is more than US$ 350 trillion as on March 2020 (excluding the data for LIBOR-referenced assets and liabilities of the government). In India, with less than three quarters to end 2021, an alternative domestic benchmark rate i.e. an alternative for Mumbai Interbank Forward Offer Rate (MIFOR) which is derived from USD LIBOR is yet to be developed. Moreover, India still has to notify a cut-off date, beyond which no new contracts can be entered using LIBOR. The Indian financial sector thus faces various risks arising from the transition from LIBOR. The tasks underlying with the regulators, the banking system, the financial sector entities and their clients are enormous.

transition challenge. If adequate fallback clauses which cater to such contracts aren't already in place, it could disrupt the financial system. For countries which are LIBOR takers such as India, the fallback clauses for each contract will have to be customized for the domestic market and depending on the selection of the ARR, include the country specific practices as well.

Risk from tough legacy contracts and tax, legal and liquidity risk: To insert the fallback clauses, each contract will have to be renegotiated. In the derivative markets, the International Swaps and Derivatives Association (ISDA) have made the adoption of fallbacks mechanism more standardized, whereas the cash market contracts, including loan contracts remain at risk. Such contracts become difficult to negotiate ('tough legacy' contracts) as they are typically customized and have non-standardized features. Renegotiation of contracts will lead one of the parties to lose as the spreads between term LIBOR and term ARR could vary. The renegotiated contracts may have changes in the fair value creating risk from associated tax liabilities. Both counterparties will have to agree on the renewed terms and huge costs might have to be incurred for changing contractual terms which will also involve legal and conduct risks. As rates for all tenors, except the short term will not be available immediately, alternative risk-free rate benchmarks would pose refinancing challenges due to lack of liquidity. In fact, development of liquidity in contracts that reference ARRs will continue to remain a challenge till adequate new contracts are available to impart liquidity.

Across major countries such as US, UK, Europe and Japan transition to alternative rates has begun

Countries	USA	UK	EU	Switzerland	Japan	Hong Kong	Canada
LIBOR Rate	USD LIBOR	GBP LIBOR	EURIBOR and EUR LIBOR	CHF LIBOR	TIBOR, JPY LIBOR and Euroyen TIBOR	HIBOR	CDOR
ARR	Secured Overnight Financing Rate (SOFR)	Sterling Overnight Interbank Average Rate (SONIA)	Euro Short Term Rate (ESTR)	Swiss Average Rate Overnight (SARON)	Tokyo Overnight Average Rate (TONAR)	Hong Kong Interbank Offered Rate (HONIA)	CORRA
Secured	Yes	No	No	Yes	No	No	Yes
Tenor	Overnight	Overnight	Overnight	Overnight	Overnight	Overnight	Overnight
Implementation	Apr-18	Apr-18	Oct-19	Feb-20	A pre-existing rate adopted in Nov 2019	A pre-existing rate	Jun-20

Source: Various research reports

The key differences between LIBOR and the other alternative risk-free reference rates makes the transition riskier. LIBOR is a forward-looking benchmark rate, dependent on expert judgment, are bank-to-bank lending rates which are unsecured, has a term structure as it has seven varying rates on terms of one day to one year and has a credit-risk component because it represents the average cost of borrowing by a bank. Whereas alternative risk-free reference rates are backward looking rates, calculated on actual overnight transactions that take place outside market hours, are secured and usually collateralized.

The key risks that arises from LIBOR transition

Risk of adoption: The process to reform the benchmark rates and adopting alternative reference rates are at various stages globally. This would mean, unlike LIBOR, the benchmark rates will differ across geographies and the different period of transition will pose risk of adoption for firms and their clients who operate in different countries.

Dealing with fallback clauses: Dealing with contracts referencing LIBORs that will continue beyond December 2021 will be a critical

Transitional risks: Challenges would also emanate from adequate risk assessment, changing and upgrading the system infrastructure, existing processes and policies and products modifications. Limited awareness of the 3rd parties on the new reference rate poses risks such as asset and liability management and legal risk arising from implementing the new contracts and new products, operational risk arising from transition, valuation risk arising from derived and implied term-structure for the new ARR besides others.

The challenges faced by financial institutions, corporations, private equity firms hedge funds in India are similar to those faced by other countries. The tasks underlying with the regulators, the banking system and the other financial sector entities are enormous given that they have to operate in a difficult situation posed by the severe onslaught of the 2nd wave of COVID. Nonetheless, the Indian banks have started testing the transactions on the secured overnight financing rate (SOFR), but the COVID scenario might postpone the transition date well beyond the stipulated deadline.