

D&B ECONOMY OBSERVE

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Recent developments indicate that the assessment of risks and opportunities to India's growth prospects needs a more cautious approach. Currently, emergence of a 2nd wave, persistent inflationary pressures, volatility in industrial production, emerging risk from rising global commodity and bond yields and resurgence of asset quality stress in the banking system in FY22 pose challenges to India's pace of recovery.

India's growth for FY21 has been revised downwards even before we witnessed the recent spurt in COVID-19 cases. During early Jan 2021, Gross Domestic Product (GDP) for FY21 was projected to be -7.7%, a month later, it was revised to -8.0, 30 basis points lower than the earlier estimate. While GDP for FY21 was revised downwards, GDP for FY22 was revised upwards. The IMF revised it to 11.5% in Jan 2021 from 8.8% projected in Oct 2020. The OECD projection comes in at a higher 12.6% (the highest among G20 countries) from 7.9% projected in Dec 2020.

All these estimates have been coined when COVID-19 cases were slowing down, new cases in Feb 2021 (avg of ~12,000) were considerably lower than reported in Nov 2020 (avg of ~ 42,600) and India started a strong vaccination drive. India now faces a risk from the 2nd wave. As on Mar 2021, new COVID-19 cases rose to the July 2020 levels (7 days cumulative data). Maharashtra, which contributes to around 15% of GDP is at the threshold of experiencing a 2nd wave with almost 50% of restrictions being re-imposed. Other states which have witnessed a spike in COVID cases, have also imposed various forms of restrictions. There is an urgent need for inoculating those section of the population who have joined the workforce and are fully operating their business or the migrant labour who have returned back to the urban centres. Concerns remain heightened over disruptions to businesses and supply chain from the restrictions imposed to curb the possibility of a 2nd wave. This poses an imminent risk to the growth projection of India.

Headline inflation remained above the upper threshold level of the central bank's target for eight consecutive months to November 2020 and the recent surge in global crude oil and industrial input prices are also rekindling cost push inflationary pressures. India's core inflation remains stubbornly high and persistent, recording close to 6% for 8 consecutive months to Feb 2021, even as headline inflation moderated during Dec 2020 (4.6%) and Jan 2021 (4.1%).

India's industrial production is yet to record a stable growth. The mining sector continues to grow negatively since Mar 20 (except for Sep 2020). Majority of the 22 manufacturing sub-sectors are not out of the woods yet; after the festive month of October, around 14 to 18 manufacturing sub-sectors grew negatively till Jan 2021. Consumption demand, although improved remains weak, also evident from the consumer confidence on spending in the RBI's survey data. As global oil and commodity prices remain high and volatile and global bond yields harden, emerging markets like India could face volatility in capital outflows, pressuring domestic yields and raising government borrowing costs thus adding to fiscal strains. A larger concern is on the resurgence of asset quality stress in the banking system in FY22 which could intensify as the various regulatory forbearances are withdrawn. It is yet to be seen how recapitalization of Rs 200 bn and proposed 'bad bank' could cushion this emerging risk to the banking sector.

While both the government and the RBI are proactively trying to address the challenges discussed above, we feel that the foremost challenge to estimating growth forecasts is the availability of reliable data on the informal sector; the one that the pandemic has disrupted the most. To conclude, it is the growth in FY23 that will tell us the strength of India's resilience to the pandemic.

Dun & Bradstreet's Macro Economic Forecasts

Variables	Forecast	Latest Period	D&B's Comments
I.I.P Growth	2% - 2.5% Feb-21	(-) 1.6% Jan-21	Dun & Bradstreet expects growth in industrial production to remain low over the near to medium term. Broad-based recovery of the manufacturing sector has not taken place. Demand is yet to normalize and amidst low capacity utilization, private sector investment is likely to gain traction only in the second half of the next fiscal year. The recent surge in the COVID-19 cases and the restrictions imposed by several states will impose further uncertainty and hurdles to the pace of revival of industrial production
Inflation W.P. I	5.75% - 6% Mar-21	4.17% Feb-21	Dun & Bradstreet expects both headline and Wholesale Price Inflation (WPI) to increase and remain elevated in the near term. The rout in global crude oil, commodity and food prices are expected to feed into the inflation dynamics of India through various channels. The Reserve Bank of India (RBI) thus, has a difficult task of managing the inflation pressures while preventing a rise in borrowing cost to the government. Despite the upward inflationary pressures, Dun & Bradstreet expects the RBI to keep the policy rate unchanged in the April 2021 Monetary Policy meeting
Inflation C.P.I (Combined)	5.7% - 5.9% Mar-21	5.03% Feb-21	
15-91 days T-Bills	3.1% - 3.2% Mar-21	3.26% Feb-21	Dun & Bradstreet expects short term yields in March 2021 to remain largely unchanged from the February 2021 level and long-term yields to increase in the month of March 2021. The RBI's January 2021 announcement to restore normal liquidity management operations will act as a signal, prompting the market to adjust and align the low short-term rates towards the repo rate. The long-term bond yields are expected to be driven higher by the rise in US 10-year treasury yields, high government borrowing, outflow of Foreign Institutional Investors (FIIs) from the debt markets and elevated inflationary pressures
10-year G-Sec Yield	6.2% - 6.3% Mar-21	6.2% Feb-21	
Bank Credit	6% - 6.5% Mar-21	6.63% Feb-21	
Exchange Rate INR v/s US\$	72.8 - 73 Mar-21	72.8 Feb-21	The year-end importers' demand for dollar and external debt repayments will exert pressure on the rupee towards end-March 2021. The rupee will also face depreciating pressures from rise in oil prices, outflow of FIIs from the debt market and the uncertainty imposed by the rising COVID-19 cases

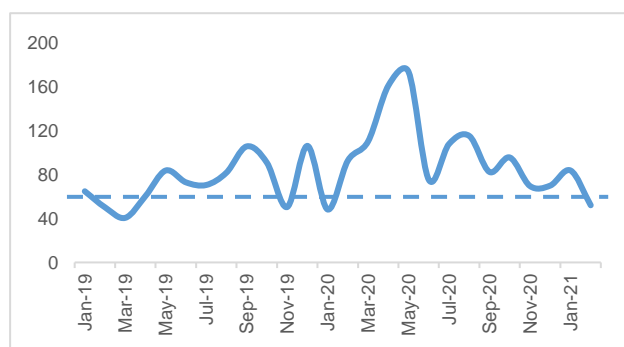
All figures are monthly average

Real Sector

- Gross Value Added (GVA) increased to 1% (y-o-y) in Q3 FY21, after contracting for 2 quarters because of strong performance of electricity, construction and agriculture sector.
- According to government estimates, GDP for FY21 is expected to contract by 8% (y-o-y).
- Pace of contraction in Government Final Consumption Expenditure (GFCF) fell steeply and stood at (-)1.1% (y-o-y) in Q3FY21 compared to (-)24% in Q2FY21.
- Growth in Index of Industrial Production (IIP) remains volatile since Sep 20. IIP contracted by 1.6% (y-o-y) in Jan 21 compared to a growth of 1.6% (y-o-y) in Dec 20. IIP contracted by 11.1% (y-o-y) cumulatively in 2020.
- Mining sector continues to contract since Mar 20 and stood at (-)7% (y-o-y) in 2020. Manufacturing sector contracted by 12.7% (y-o-y) in 2020.
- Sharp contraction was seen in consumer durables and consumer non-durables which stood at (-)0.1% (y-o-y) and (-)7.1% (y-o-y) in Jan 21 respectively compared to 5.5% (y-o-y) and 1.2% (y-o-y) respectively in Dec 20.



India Economic Policy Uncertainty Index have fallen below the 2-year average



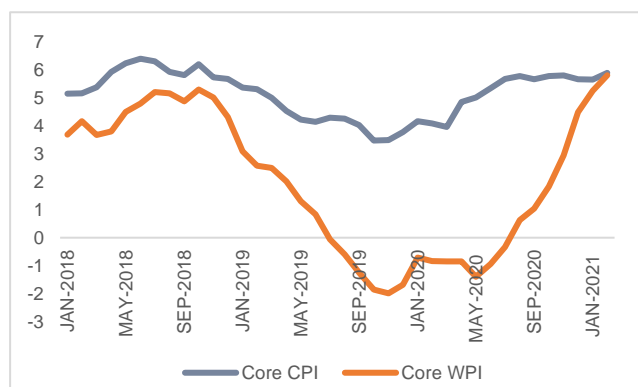
Source: Policyuncertainty.com

- Government has been achieving the GST target since Oct 20. However, cumulative GST revenue collection during the period Apr-Feb FY21 stands at Rs 10,129 bn lower than Rs 11,245 bn during the same period last financial year.
- Conventional electricity generation grew by 0.08% (y-o-y) during Feb 21, lowest in 6 months. Renewable electricity generation grew by 7.6% (y-o-y) in Jan 21, lowest in 4 months.
- Growth in production of passenger vehicles have been robust since Sep 20 except a decline in Jan. The production increased by 12.9% (y-o-y) in Feb 21.

Price Scenario

- CPI inflation increased by 100 bps on the back of rise in food inflation and services inflation. CPI inflation rose to 5.03% (y-o-y) in Feb 21 from an 18-month low of 4.06% (y-o-y) in Jan 21.
- Food and beverage inflation grew by 4.3% (y-o-y) in Feb 21 compared to 2.7% (y-o-y) in Jan 21. Inflation in oil and fats grew by 20.8% (y-o-y) in Feb 21 (highest in 2011-12 series), inflation in fruits grew by 6.3% (y-o-y) in Feb 21 (highest since Aug 18), inflation in vegetable prices contracted by 6.3% (y-o-y) in Feb 21 compared to (-)15.8% in Jan 21.
- Clothing and Footwear prices increased to 4.2% (y-o-y) in Feb 21, highest since Oct 18.
- Inflation in health services grew by 6.3% (y-o-y) in Feb 21, highest since Oct 19.
- Inflation in rural areas rose by 6.7% (y-o-y) in Aug 20 compared to 2.3% (y-o-y) during the same month last year. Inflation in urban areas increased to 6.8% (y-o-y) in Aug 20 compared to 4.5% (y-o-y) in Aug 19.
- As per the quarterly data, rural inflation grew by 5.9% (y-o-y) and urban inflation grew by 6.4% (y-o-y) in Q3 FY21, both lowest in 4 quarters. However, the increase in inflation has been sharper in urban areas compared to the rural areas.

Converging WPI & CPI Core inflation touched the same levels for the first time in the 2011-12 series



Source: MOSPI, Office of Economic Adviser

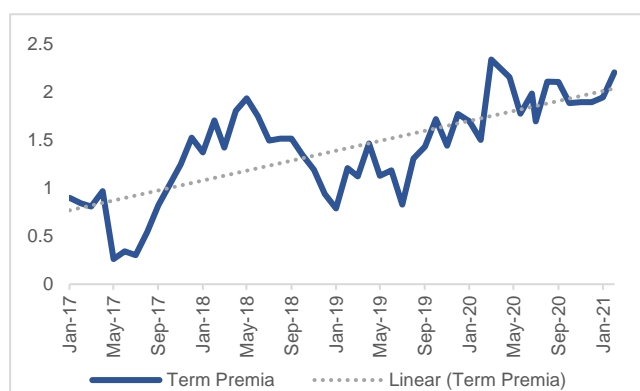
- WPI inflation rose to 4.2% (y-o-y) in Feb 21, highest since Dec 18. The increase in WPI is due to a sharp rise in the inflation in manufacturing segment which grew by 5.9% (y-o-y) (highest in 2011-12 series) and inflation in minerals which grew by 16.7% (y-o-y) compared to 2.3% (y-o-y) in Jan 21.
- Inflation in manufactured food products (0.65%), textiles (0.32%) and chemical and chemical products (0.4%) are the highest contributors to the inflation in the manufacturing segment.
- Inflation in fuel and power grew by 0.3% (y-o-y) in Feb 21, after contracting for 11 straight months on the back of rising crude oil prices.

Money & Finance

- Bank credit to industries continued to decline for 4-straight months and stood at (-)1.3% (y-o-y) during Jan 21.
- Growth in bank credit to services sector grew at 8.4% (y-o-y) in Jan 21, lowest since April 20. Bank credit to computer software contracted for the first time since Feb 20 and stood at (-)0.23% (y-o-y) in Jan 21.
- Bank credit to personal loans grew by 9.1% (y-o-y) in Jan 21, lowest in 10 years. Despite the falling interest rates on housing loans, growth in bank credit to housing sector is the lowest in 10 years and stood at 7.68% (y-o-y) in Jan 21.
- The Weighted Average Call Rate (WACR) has been trading below the reverse repo since Sep 2020, reflecting the surplus liquidity in the system.
- RBI's intervention to stabilize the rupee amid rising capital inflows has increased significantly and stood at US\$ 28.3 bn in Nov 20, compared to an outflow of US\$ 1.2 bn in Jan 20.



Upward sloping term premia



Source: RBI

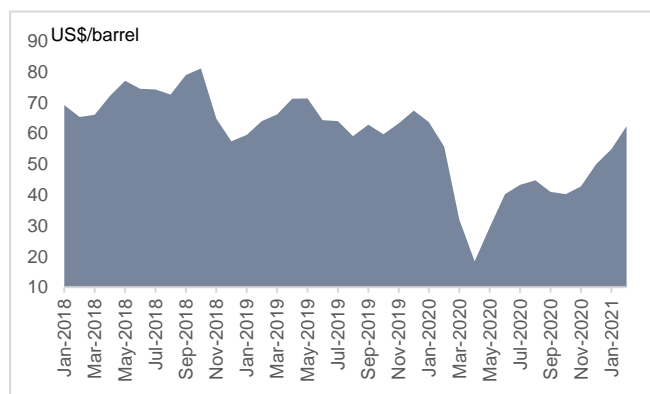
- 10 yr G-Sec yield hardened to 6.2% in Feb 21, highest since May 20.
- Credit spread between 10-yr G-Sec and 10-yr AAA Corporate bond has narrowed to 0.8% in Feb 21, compared to 1.6% in May 20, as the bond yields continue to harden.
- Aggregate deposits have increased to 12.1% during Feb 21 compared to 7.9% (y-o-y) in Mar 20. Since Jul 20, the average aggregate deposit rate has been 11.1% (y-o-y), compared to an average of 9.7% (y-o-y) during the period Jan-Jun 20.
- BSE Sensex touched 49,747 in Mar 21, highest ever.
- Incremental investment to deposit ratio stood at 52.3 on Feb 26, 2021, lowest since Apr 10, 2020.

External Sector

- Merchandise trade deficit narrowed to US\$ 12.6 bn in Feb 21 compared to US\$ 15.4 bn during Dec 20.
- Non-oil exports continued to grow for 6-straight months and stood at 3.7% (y-o-y) in Feb 21. Non-oil imports continued to expand for 3-straight months and stood at 16.3% (y-o-y) in Feb 21, posting double-digit growth for three consecutive months.
- Import of gold and silver increased by 114.7% (y-o-y) in Feb 21 and stood at US\$ 5.3bn compared to a contraction of 10.8% (y-o-y) during the same month last year.
- India's foreign exchange reserves became fourth largest in the world surpassing Russia. China has the largest reserves, followed by Japan and Switzerland. Reserves stood at US\$ 580 bn as on 5th Mar 21.



Brent crude oil prices rising near to the levels seen in 2018



Source: EIA

- Net FII investments stood at Rs 240 bn during Feb 21 compared to Rs 89 bn during Feb 20. Strong inflow in equity markets have been driving up the FII investments which stood at Rs 549.2 bn in 2021 with a net outflow in debt market of Rs 180.6 bn.
- One month inter-bank forward premia on US dollar stood at 4.2% during Dec 20, highest since Jul 19.
- Index of 40-currency NEER remains undervalued and stood at 94.2 during the Feb 21 compared to 97.6 during the comparable month last year.
- Rupee touched 100.8 per pound in Feb 21, highest since Oct 15. Rupee appreciated to 72.76 per US\$ in Feb 21, highest, value recorded since Mar 20.

Please send your feedback to Dr Arun Singh, Global Chief Economist.

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