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Contents

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View from the top

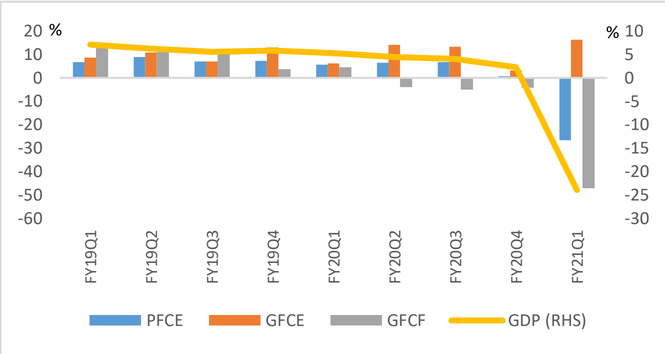
The Q1 FY21 GDP data revealed severe contraction in the manufacturing, construction and trade, hotels and other services sectors which recorded the worst ever decline of 39.3%, 50.3%, 47% respectively. Without the agriculture sector clocking a higher growth of 3.4%, the GDP would have staged a further decline during the period of nation-wide strict lockdown. The concern is that the final growth data is likely to be worse than the current print, when the estimates of the informal sector activity will be included. This also means that the slowdown in these employment intensive sectors must have had a stronger impact on the obliteration of existing and new jobs in these sectors. As the pandemic is yet to peak, activity in high-contact services sectors such as hotels and restaurants, wholesale markets and recreational activities like movie theatres will continue to remain subdued impacting job intake in these sectors.

Concerns have increased as downward pressure on the growth estimates for FY21 have gone up. The recovery now is expected to be albeit gradual as rising infections pose constraints towards full-fledged re-opening of the economy. Even if the recovery takes the form of a V-shape, the level of GDP will matter. Post Q1 FY21, the economic indicators throw a mixed picture. While the agriculture activity, index of industrial production, railway freights, road transport and exports point to some stabilization of economic activity, some of the segments are yet to pick up. Production of cement and petroleum refinery products contracted more in July than in June. The recent pick-up in some sectors such as automobiles cannot considered as a leading indicator of recovery, as of now, as it reflects pent-up demand which might fade away sooner. Credit growth has not picked up comparatively. After increasing in July, bank credit growth has tapered off in August 2020 and is the lowest since June 2017. The sectoral credit data which comes with a lag shows that the credit to the micro & small and medium industries continued to decline in June with credit to medium industries registering more than 9% decline. With the credit guarantee scheme in place for the small and medium (SMEs) firms, credit off-take was expected to strengthen. Priority sector credit growth also remained muted with loans to the manufacturing and education loans recording a decline.

With the government planning to infuse Rs 200 bn in public sector banks, banks are likely to start lending more. High probability of default plays a role in the risk aversion of banks. The RBI's Financial Stability Report has estimated that non-performing assets of all Scheduled Commercial Banks (SCBs) would rise from 8.5% of total as of end-March 2020, to 14.7% of total at end-March 2021, in a very severe scenario. This would see five banks fail or require emergency recapitalisation and/or rescues, in the central bank's analysis. In fact, loan losses were expected to be realised after the moratorium expires. As per RBI's report, around 50% of total customers of SCB's have availed the RBI's loan moratorium which amounts to 50% of total outstanding loans as on 30th April. By end-August, non-food credit around was Rs 102 tn. Assuming 50% of the loans go under moratorium and a 10% of those loans default it would add to around Rs 5 trillion to the existing bad loans. However, the RBI has allowed banks a one-time restructuring of debt of borrowers facing stress owing to the pandemic, provided they were not in default till March 1, 2020. While this will prevent the increase in the number of NPLs recognized in the banking system, the banking system will have to bear the burden of recovering the bad loans and increase in credit costs during the next two years. This could be aggravated by the defaults that are likely to materialise in the NBFC sector as defaults in the NBFC sector would block the funds lent by the banking sector to NBFCs. As on 19th June 2020, the bank lending to NBFCs was around Rs 8 tn.

While majority of the economic activity has restarted with 'Unlock 4' since September 1st, the steady rise in caseloads and the spillover effects of the strict lockdown measures will continue to undermine the growth impulses during the subsequent quarters of the year. Constrained government finances, contraction investment activity, probable defaults both at firm and consumer level and bankruptcies will continue to be a drag on growth.

Government Final Consumption Expenditure helped GDP from subsiding further

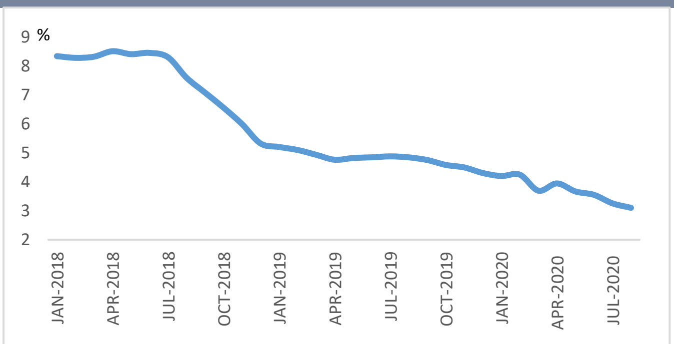


Source: MOSPI

Real Sector

- In Q1 FY21, real Gross Value Added (GVA) contracted by 22.8% (y-o-y) with all the components contracting except Agriculture which grew by 3.4% (y-o-y).
- Gross Domestic Product (GDP) contracted by to 23.9% (y-o-y) in Q1 FY21, lowest since the beginning of the new series. Government Final Consumption Expenditure increased by 16.4% (y-o-y), compared to a growth of 6.2% (y-o-y) in the comparable period last year.
- The pace of contraction in Index of Industrial Production (IIP) fell to 10.4% (y-o-y) in Jul 20 compared to a contraction of 57.3% (y-o-y) in Apr 20. Consumer non-durables grew by 6.7% (y-o-y) in Jul 20 compared to a contraction of 48.1% (y-o-y) in Apr 20.
- Output of the Eight Core industries contracted by 9.6% (y-o-y) in Jul 20 compared to a contraction of 37.9% (y-o-y) during Apr 20. Pace of contraction for coal production declined to 5.7% (y-o-y) in Jul 20 compared to a contraction of 15.5 (y-o-y) in Apr 20.
- Pace of contraction for growth in domestic sales of passenger vehicles declined to 2.1% (y-o-y) in Aug 20 compared to a contraction of 13.8% (y-o-y) in Jul 20.

Consistently falling housing inflation

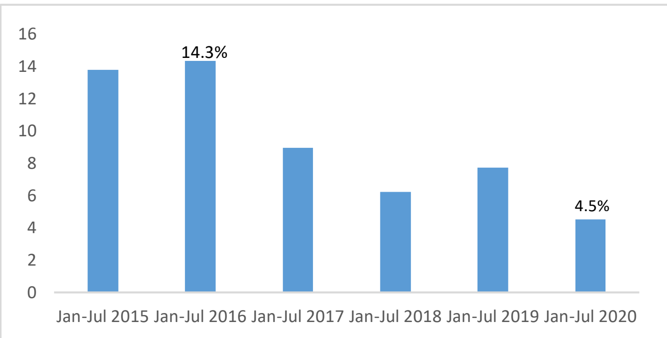


Source: MOSPI

Price Scenario

- Retail inflation increased by 6.7% (y-o-y) in Aug 20 compared to 3.3% (y-o-y) in Aug 20.
- Inflation Food and beverages softened to 1.7% (y-o-y) in Aug 20 compared to 2.9% (y-o-y) in Aug 19. Vegetable inflation contracted by 10.5% (y-o-y) in Aug 20, lowest since Feb 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.
- Wholesale food inflation (WPI) rose by 0.2% (y-o-y) in Aug 20 after contracting for 3-straight months. Inflation in Minerals grew by 4.9% (y-o-y) in Aug 20 compared to a contraction of 7.8%(y-o-y) in Jul 20.
- Wholesale Food Articles inflation softened to 3.8% (y-o-y) in Aug 20 compared to 4.1% (y-o-y) in Jul 20 with inflation in cereals contracting by 1.8% (y-o-y) in Aug 20 lowest in almost 3 years.

Bank Credit to Deposit Ratio is falling since September 2019

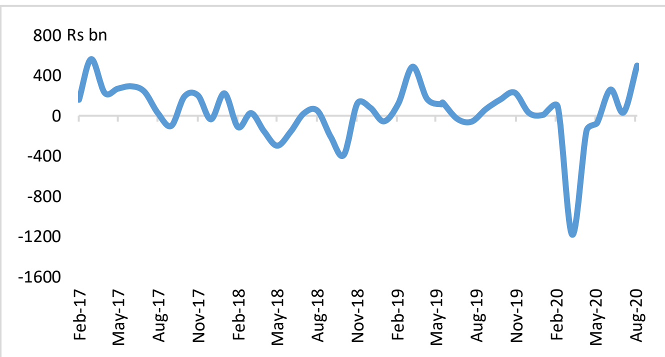


Source: RBI

Money & Finance

- Bank credit to industries grew by 0.8% (y-o-y) in Jul 20 compared to a growth of 2.3% (y-o-y) in Jun 20. Bank credit to mining and quarry industry jumped to 7.6% (y-o-y) in Jul 20, 15-months high.
- Growth in bank credit to large enterprises grew by 1.4% (y-o-y) in Jul 20 compared to a growth of 3.7% (y-o-y) in Jun 20. Bank credit to micro and small enterprises contracted by 1.9% (y-o-y) in Jul 20 compared to a contraction of 3.7% (y-o-y) in Jun 20.
- Personal loans grew by 11.2% (y-o-y) in Jul 20 compared to 17% (y-o-y) in Jul 19. Credit card outstanding jumped to 7.9% (y-o-y) in Jul 20 compared to 2.8% (y-o-y) in Jun 20.
- Investment to Deposit ratio increased to 30.74 in Aug 20 from 28.02 in Aug 19.
- Average 10-yr G-Sec yield stood at 6.01% in Aug 20 compared to 5.8% in Jul 20. 15-91 days treasury yield stood at 3.2% in Aug 20 after falling to the lowest levels of 5.5% in Aug 19.

FII's highest in three years



Source: CMIE

External Sector

- Merchandise trade deficit stood at US$ 6.77 bn in Aug 20, after recording a surplus of US$ 0.79 bn in in Jun 20. Merchandise exports declined by 12.8% (y-o-y) to US$ 22.7 bn in Aug 20 and imports contracted by 26 % (y-o-y) to US$ 29.5 bn.
- Oil imports contracted by 41.5% (y-o-y) to US$ 6.4 bn in Aug 20 from US$ 10.9 bn in Aug 19.
- 36-currency nominal effective exchange rate index declined to 71 during the period of Apr-Aug 20 compared to 75.4 during the same period last year.
- External Commercial Borrowings (ECB) declined by 56.9% (y-o-y) in Jul 20 and stood at US$ 2.15 bn.
- Exports of gems & jewellery commodities reduced to US$ 5.9 bn during Apr-Aug 20 from US$ 15.6 bn during the corresponding period last year indicating a contraction of 61.9% (y-o-y).

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Dun & Bradstreet's Macro Economic Forecasts			
Variables	Forecast	Latest Period	D&B's Comments
I.I.P Growth	(-) 4% - (-) 3% Aug-20	(-) 10.4% Jul-20	With 'Unlock 4.0' from September, the pace of contraction in the Index of Industrial Production (IIP) is expected to reduce further. The pent-up demand and re-start of small businesses and street vendors along with medium and large firms is likely to drive demand for industrial goods. The index is expected to rebound to the positive territory from the month of October
Inflation W.P. I	0.7% - 0.9% Sep-20	0.16% Aug-20	Inflationary pressures continued to prevail in the month of September as the pent-up demand is expected to keep the prices elevated. Even as inflation for food articles has abated under the Consumer Price Index (CPI), certain categories of food articles such as pulses, vegetables, egg, meat and fish products under Wholesale Price Index (WPI) continue to be high
Inflation C.P.I (Combined)	6.3% - 6.5% Sep-20	6.69% Aug-20	
15-91 days T-Bills	3.1% - 3.2% Sep-20	3.24% Aug-20	The Reserve Bank of India (RBI) announced several measures including special open market operation and measures to reduce the cost of funds for the banks to keep the yields from inching up sharply, as this would hinder monetary policy transmission. Also, the RBI's indication on its intent to take necessary measures to keep yields low is expected to prevent further rise in the bond yields across the curve, even as inflation and government borrowing remains high
10-year G-Sec Yield	6% - 6.15% Sep-20	6.01% Aug-20	
Bank Credit	4.5% - 5.5% Sep-20	5.5% Aug-20	
Exchange Rate INR v/s US$	73.2 - 73.4 Sep-20	74.87 Aug-20	Foreign Institutional Investment (FII) inflows, RBI's measures to infuse liquidity in the system, hopes of a vaccine and increase in the forex levels will cause rupee to appreciate in September from the levels recorded in August
All figures are monthly average			

Sectoral Impact and Recovery

The table below illustrates the impact of COVID-19 on various sectors and their pace of recovery:

COVID -19 Impact	Sectors		Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Recovery Period
Moderate	Food Products		-15	-22	-18	-2	-5		Short term
	Pharmaceuticals & other		-16	-19	2	31	23		
High	Media & Entertainment		-31	-77	-47	-21	-19		Medium term
	Banking		6.7	7.3	6.8	6.7			Long term
Severe	Automotive		-34	-99	-86	-51	-29		Long term
	Logistics	Aviation: Passenger	-38	-100	-98	-85	-84		Medium term
		Aviation: Cargo	-33	-93	-83	-48	-41		
		Road: Tanker freight rates	4.5	4.4	6.1	6.3	6.0	7.4	
		Rail: Revenue Earning Freight Traffic	-14	-35	-21	-8	-5	4	
	Infrastructure/ construction goods	Cement	-25	-85	-41	-19	-11		Long term
	Metals	Base metals	-19	-71	-40	-21	-11		Medium term
	Electronics	Consumer- TV sets and Mobile instrument	-26		-81	-23	-17		Long term
		Industrial- Computer, electronic and optical products	-43	-93	-68	-24	-24		
	Gems & Jewellery	Exports	-37	-99	-66	-46	-46		Long term
		Imports	-54	-98	-87	-71	-22		
	Textiles		-17	-91	-68	-52	-15		Long term
	Retail & Wholesale	Consumer durables	-37	-96	-69	-34	-24		Short term
		Consumer non-durables	-20	-48	-11	14	7		
	Livestock		-17	-87	-87	-37	-43	-3	Short-term

Source: MOSPI and CMIE

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