ICRA
A MOODY'S INVESTORS SERVICE COMPANY

ECONOMIC OUTLOOK AND MACRO TRENDS

GDP expansion in Q1 FY2022 pegged at 20.0%; spread of delta variant renews uncertainty

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Abbreviations

ADR: American Depository Receipt
AE: Advance Estimates
BE: Budget Estimates
BPCL: Bharat Petroleum Corporation Limited
BoP: Balance of Payments
CEA: Central Electricity Authority
CEIC: Census and Economic Information Center
CGA: Controller General of Accounts
CGST: Central Goods and Services Tax
CIL: Coal India Limited
CMIE: Centre for Monitoring Indian Economy
CNY: Chinese Yuan
CP: Commercial Paper
CPI: Consumer Price Index
CTD: Central Tax Devolution
CWC: Central Water Commission
DBTL: Direct Benefit Transfer for LPG subsidy
DIPAM: Department of Investment and Public Asset Management
DoT: Department of Telecommunications
ECB: External Commercial Borrowing
EM: Emerging Markets
FAO: Food and Agriculture Organization
FCI: Food Corporation of India
FCNR (B): Foreign Currency Non-Resident (Bond)
FDI: Foreign Direct Investment
FII: Foreign Institutional Investor
FOMC: Federal Open Market Committee
FPI: Foreign Portfolio Investors
FRL: Full Reservoir Level
FRP: Financial, Real Estate and Professional Services
FX: Foreign Exchange
GDP: Gross Domestic Product
GFCE: Government Final Consumption Expenditure
GFCF: Gross Fixed Capital Formation
GoI: Government of India
GSAP – Government Securities Acquisition Programme
G-Sec: Government Securities
GST: Goods and Services Tax
GUR: Gross Under Recoveries
GVA: Gross Value Added
IGST: Integrated Goods and Services Tax
IIP: Index of Industrial Production
IMD: Indian Meteorological Department
IMF: International Monetary Fund
INR: Indian National Rupee
IPO: Initial Public Offering
ITeS: Information Technology Enabled Services
JPC: Joint Plant Committee
LPA: Long Period Average
LPG: Liquefied Petroleum Gas
MGNREGS: Mahatma Gandhi National Rural Employment Guarantee Scheme
MoM: Month-on-Month
MPC: Monetary Policy Committee
MSP: Minimum Support Price
NBFC: Non-Banking Finance Companies
NMP: National Monetisation Pipeline
NR(E)RA: Non-Resident (External) Rupee Account
NRI: Non-Resident Indians
NRO: Non-Resident Ordinary
NSO: National Statistical Office
NSSF: National Small Savings Scheme
NMDC LTD: National Mineral Development Corporation Limited
OBICUS: Order Books, Inventories and Capacity Utilisation Survey
OFS: Offer for Sale
OMCs: Oil Marketing Companies
OMO: Open Market Operation
OPEC: Organization of the Petroleum Exporting Countries
PE: Provisional Estimates
PFCE: Private Final Consumption Expenditure
PLI: Production Linked Incentive
POL: Petroleum Oil and Lubricants
PPAC: Petroleum Planning and Analysis Cell
PMGKY: Pradhan Mantri Garib Kalyan Yojana
PMGKAY: Pradhan Mantri Garib Kalyan Ann Yojana
QE: Quantitative Easing
RBI: Reserve Bank of India
RDB: Rupee Denominated Bonds
RE: Revised Estimates
REER: Real Effective Exchange Rate
SDL: State Development Loans
SGB: Sovereign Gold Bonds
SGST: States Goods and Services Tax
SEBI: Securities and Exchange Board of India
THTCS: Trade, Hotels, Transport, Communication and Services
TLTRO: Targeted Long Term Repo Operations
US$: United States Dollar
VRR: Voluntary Retention Route
VRRR: Variable Rate Reverse Repo
WMA: Ways and Means Advances
WPI: Wholesale Price Index
YoY: Year-on-Year
YTD: Year to Date

OVERVIEW

YoY expansion in India's GDP and GVA is projected at 20% and 17%, respectively, in Q1 FY2022, in real terms

Baseline GDP forecast maintained at 8.5% for FY2022; step-up in vaccine administration could provide a back-ended upside

CPI inflation projected to average 5.5-5.7% in FY2022; MPC likely to embark on policy normalisation once domestic demand strengthens and starts dominating inflationary pressures

GoI's fiscal deficit for FY2022 estimated at Rs. 16.0 trillion (7.0% of GDP), overshooting the budgeted amount of Rs. 15.1 trillion

Current account balance to revert to a deficit of 0.7% of GDP in FY2022

Healthy Central and state Government capital spending, robust merchandise exports and resilient demand from the farm sector, as well as the muted base of last year's nationwide lockdown are expected to boost the year-on-year (YoY) growth of the GDP and gross value added (GVA) at basic prices (at constant 2011-12 prices) to 20.0% and 17.0%, respectively, in Q1 FY2022, concealing the impact of the second wave of Covid-19. While globally, the spread of the Delta variant has renewed uncertainty about the sustainability of demand and arrested the rise in commodity prices, we maintain our baseline expectation that the Indian GDP will grow by 8.5% in FY2022. We project the average CPI inflation for FY2022 to veer alarmingly close to the upper threshold of the MPC's medium term target range of 2-6%. In our view, policy normalisation will start in February 2022 with a change in the stance of the Monetary Policy to neutral from accommodative. Reflecting on improved economic activity and higher average commodity prices, we expect the current account to revert to a deficit of US$20-25 billion or 0.7% of GDP in FY2022, from the surplus of US$24 billion in FY2021 (0.9% of GDP). We estimate the GoI's fiscal deficit at Rs. 16.0 trillion or 7.0% of GDP in FY2022, overshooting the budgeted amount of Rs. 15.1 trillion.

ICRA's Macroeconomic Projections	FY2021	ICRA's FY2022 Projections
GDP Growth (at constant 2011-12 prices)	-7.3%	8.5%
GVA Growth (at constant 2011-12 prices)	-6.2%	7.3%
CPI Inflation (average)	6.2%	5.5-5.7%
WPI Inflation (average)	1.3%	9.2%
Current Account Balance	Surplus of US$24 billion	Deficit of US$20-25 billion
INR	74.2/US$	73.7-75.5/US$
G-sec Yields	6.2%	6.35% by the end of Q2 FY2022
GoI's Fiscal Deficit	Rs. 18.2 trillion; 9.2% of GDP	Rs. 16.0 trillion; 7.0% of GDP
Repo rate	Repo rate cut by 40 bps in May 2020	Hike in the repo rate of 25 bps each in the April 2022 and June 2022 reviews
Monetary Policy Stance	Accommodative	Stance change to neutral in the Feb 2022 policy review

EXECUTIVE SUMMARY

YoY real GDP expansion forecast at deceptively high 20.0% in Q1 FY2022: Following the second wave of Covid-19 and the restrictions in place during much of April-May 2021, we have pared our estimates of the GDP and GVA growth for Q1 FY2022. We now project the GVA growth in Q1 FY2022 at 17.0%, led by healthy exports, Government capital spending and resilient farm sector demand. Given the sharp rise in the indirect taxes, we anticipate that the NSO may peg the GDP expansion at a relatively higher 20% for Q1 FY2022. Nevertheless, the double-digit expansion expected in YoY terms in Q1 FY2022 is deceptively high, as it benefits inordinately from last year's contracted base. We forecast the GVA and the GDP to have shrunk by around 9% each in Q1 FY2022, relative to the pre-Covid level of Q1 FY2020, highlighting the tangible distress being experienced by economic agents in the less formal and contact-intensive sectors.

Real GDP to grow by 8.5% in FY2022; acceleration in vaccine administration could provide a back-ended upside: With the easing of the state-wise restrictions, especially across the southern states, the roots of the economic recovery deepened in July 2021, as evidenced by a slew of high frequency indicators. Globally, the spread of the Delta variant has renewed uncertainty about the sustainability of demand and arrested the rise in commodity prices. We expect the Indian GDP to grow by 8.5% in FY2022, with faster vaccine coverage to provide a back-ended upside, affording a 9.5% expansion this year. However, vaccination coverage in India remains relatively low at 32% of adults. To administer the second Covid-19 vaccine shots to 50% of the adults by December 2021, average daily doses need to be scaled up to 6.3 million from the current 5.1 million.

CPI Inflation projected at 5.5-5.7% in FY2022, closer to the MPC's upper limit of medium-term target range: The CPI inflation is expected to remain sticky in the range of 5-6% during Q2-Q4 FY2022, and average 5.5-5.7% in FY2022. We anticipate that the MPC will embark on policy normalisation once domestic demand strengthens and starts dominating inflationary pressures, in place of supply-side issues. We foresee a change in the stance to neutral from accommodative in the February 2022 Policy review, followed by a hike in the repo rate of 25 bps each in the April 2022 and June 2022 meetings. Once the lift-off starts, we believe that the MPC will stagger rate increases over a period of time, instead of immediately trying to push real interest rates back into the positive territory.

Current account balance to revert to a deficit of 0.7% of GDP in FY2022: In the base case, ICRA expects merchandise exports and imports to rise by ~38% and ~43%, respectively, in FY2022 to ~US$405-410 billion, and US$565-570 billion, respectively. As a result, the merchandise trade deficit is expected to widen to ~US$157-162 billion in FY2022. While the Government's PLI scheme will help in enhancing exports in some sectors, a spike in cases resulting from the Delta plus variant poses a substantial risk to our forecasts. The global economic recovery is expected to boost the secondary income by 6-7% and the services trade surplus by ~8% in FY2022, whereas the outflow of primary income may remain flattish, relative to FY2021. ICRA expects India's current account balance to revert to a deficit of US$20-25 billion (-0.7% of GDP) in FY2022, from the surplus of US$24.0 billion (+0.9% of GDP) in FY2021.

GoI's fiscal deficit to overshoot FY2022 BE: As per our estimates, the FY2022 BE for gross tax revenues of Rs. 22.2 trillion can be achieved, even with a 4% contraction in the remainder of FY2022, which appears unlikely despite the lingering uncertainty on the growth front. Moreover, the transfer of surplus by the RBI in FY2022 has been higher than budgeted by ~Rs. 0.5 trillion. Additionally, modest inflows may be garnered under the newly announced NMP. This provides a cushion to absorb the net cash outgo of Rs. 236.7 billion under the First Supplementary Demand for grants and the anticipated step up in fertiliser subsidy for the rabi season of Rs. 100-150 billion. However, with low receipts so far, it is likely that the disinvestment target of Rs. 1.75 trillion will be missed by a considerable margin, causing the GoI's fiscal deficit to overshoot the FY2022 BE. Moreover, if other major fiscal stimulus measures are announced, and the outlay for vaccine procurement is raised above the budgeted Rs. 350 billion, it could cause the fiscal deficit to widen. At present, we estimate the GoI's fiscal deficit for FY2022 at Rs. 16.0 trillion or 7.0% of GDP, overshooting the budgeted amount of Rs. 15.1 trillion.

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ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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