ICRA
A MOODY'S INVESTORS SERVICE COMPANY

ECONOMIC OUTLOOK AND MACRO TRENDS

Real GDP likely rose by 7.9% in Q2 FY2022, narrowly trailing pre-Covid level

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Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Yash Panjrath
+91 124 4545 399
yash.panjrath@icraindia.com

Aarzoo Pahwa
+91 124 4545 873
aarzoo.pahwa@icraindia.com

Tiasha Chakraborty
+91 124 4545 300
tiasha.chakraborty@icraindia.com

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ABBREVIATIONS

AE: Advance Estimates
ATF: Aviation Turbine Fuel
BE: Budget Estimates
BEML: Bharat Earth Movers Limited
BPCL: Bharat Petroleum Corporation Limited
BPS: Basis Points
BoP: Balance of Payments
CEA: Central Electricity Authority
CEL: Central Electronics Limited
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
DAP: Di-ammonium Phosphate
DBTL: Direct Benefit Transfer for LPG subsidy
DIPAM: Department of Investment and Public Asset Management
ECB: External Commercial Borrowing
EM: Emerging Markets
FAO: Food and Agriculture Organization
FCNR: Foreign Currency Non-Resident
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
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
IPO: Initial Public Offering
ITeS: Information Technology Enabled Services
JPC: Joint Plant Committee
LIC: Life Insurance Corporation
LPA: Long Period Average
LPG: Liquefied Petroleum Gas
MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act
MoM: Month-on-Month
MoRTH: Ministry of Road Transport and Highways
MPC: Monetary Policy Committee
MSP: Minimum Support Price
NBFC: Non-Banking Finance Companies
NH: National Highway
NINL: Neelachal Ispat Nigam Limited
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
OBICUS: Order Books, Inventories and Capacity Utilisation Survey
OFS: Offer for Sale
OM: Office Memorandum
OMCs: Oil Marketing Companies
OMO: Open Market Operation
P&K: Phosphatic and Potassic
PADOS: Public Administration, Defence and Other Services
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 Gareeb Kalyan Ann Yojana
QE: Quantitative Easing
RBI: Reserve Bank of India
RDB: Rupee Denominated Bonds
RE: Revised Estimates
REER: Real Effective Exchange Rate
RIL: Reliance Industries Limited
RoDTEP: Remission of Duties and Taxes on Exported Products
SDL: State Development Loans
SEBI: Securities and Exchange Board of India
SGB: Sovereign Gold Bonds
SGST: States Goods and Services Tax
SIAM: Society of Indian Automobile Manufacturers
THTCS: Trade, Hotels, Transport, Communication and Services related to broadcasting
TLTRO: Targeted Long-Term Repo Operations
VAT: Value Added Tax
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
TLTRO: Targeted Long-Term Repo Operations
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OVERVIEW

Normalising base to moderate YoY GDP expansion to 7.9% in Q2 FY2022 from 20.1% in Q1 FY2022; Q2 FY2022 GDP to print a shade below the Q2 FY2020 level

CPI inflation projected to average 5.5% in FY2022, despite cuts in fuel taxes

GoI's fiscal deficit could touch Rs. 15.8-16.0 trillion (6.9-7.0% of GDP) in FY2022, if neither BPCL nor LIC disinvestment inflows are realised

Current account balance to revert to a deficit of 1.0% of GDP in FY2022

After the second wave of Covid-19 subsided, and rising vaccine coverage boosted confidence, economic activity gathered pace in Q2 FY2022 amidst a pickup in government spending, robust exports and a resilient farm sector. ICRA projects the YoY real GDP growth (at constant 2011-12 prices) in that quarter at 7.9%, with the absolute level narrowly trailing the Q2 FY2020 GDP, dragged by the lagged revival in the contact-intensive sectors. While the data for October 2021 is healthy, the holidays in early November 2021 are obscuring signals about the durability of the demand revival. Additionally, even as Covid-19 cases in India remain low, the impact of the resurgence of infections in Europe and the new variant discovered in Africa warrant caution. Therefore, we are maintaining our forecast of a 9.0% expansion in real GDP in FY2022. Despite the recent fuel tax cuts, the CPI inflation is expected to average 5.5% in FY2022, higher than the forecast of 5.3% made by the MPC in its October 2021 review. We continue to expect policy normalisation to start in February 2022, with a change in the stance of the Monetary Policy to neutral from accommodative. Following the surge in imports, we expect the current account to revert to a deficit of US$30-35 billion or 1.0% of GDP in FY2022. If disinvestment missed its ambitious target, we estimate the GoI's fiscal deficit at Rs. 15.8-16.0 trillion or 6.9-7.0% 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%	9.0%
GVA Growth (at constant 2011-12 prices)	-6.2%	8.6%
CPI Inflation (average)	6.2%	5.5%
WPI Inflation (average)	1.3%	11.2%
Current Account Balance	Surplus of US$24 billion	Deficit of US$30-35 billion
INR	74.2/US$	73.5-75.5/US$ in Q3 FY2022
G-sec Yields	6.2%	6.3-6.45% in the remainder of Q3 FY2022 6.4-6.7% in Q4 FY2022
GoI's Fiscal Deficit	Rs. 18.2 trillion; 9.2% of GDP	Rs. 15.8-16.0 trillion (6.9-7.0% of GDP)
Repo rate	Repo rate cut by 40 bps in May 2020	Hike in the repo rate of 25 bps each in the Apr 2022 and Jun 2022 reviews
Monetary Policy Stance	Accommodative	Stance change to neutral in the Feb 2022 policy review; to be accompanied by 15 bps reverse repo rate hike by the RBI

EXECUTIVE SUMMARY

Real GDP in Q2 FY2022 to expand by 7.9% YoY; print a shade below Q2 FY2020 level: Economic activity in Q2 FY2022 was supported by a pick-up in industrial and service sector volumes after the second wave of Covid-19 subsided and rising vaccine coverage revived confidence. Additionally, healthy Central and state Government spending, robust merchandise exports and continuing demand from the farm sector supported economic activity in that quarter. Nevertheless, the YoY expansion in real GDP and GVA is projected to moderate to 7.9% and 7.4%, respectively, in Q2 FY2022 (-7.4% and -7.3%, resp., in Q2 FY2021) from 20.1% and 18.8%, respectively, in Q1 FY2022 (-24.4% and -22.4%, resp., in Q1 FY2021), on a normalising base. However, compared to the respective pre-Covid quarters, the performance of GDP and GVA is expected to improve substantially in Q2 FY2022 (-0.1% and -0.4%, resp., relative to Q2 FY2020) as opposed to Q1 FY2022 (-9.2% and -7.8%, resp., relative to Q1 FY2020). Accordingly, Q2 FY2022 GDP is likely to narrowly trail the Q2 FY2020 level, with a lagged revival in the contact-intensive sectors.

Real GDP and GVA expansion maintained at 9.0% and 8.6%, respectively, for FY2022: The high frequency indicators were healthy in Oct 2021, and the festive season trends are broadly positive. We also anticipate a brisk pace of Central and state government spending in H2 FY2022, following improved revenue visibility. However, the early data for Nov 2021 is dull, with the holidays in the first fortnight obscuring whether pent-up demand has flagged post the festive season. We have lowered our estimate of the coverage of adults having received their first and second Covid-19 vaccine shots to ~90% and ~60%, respectively, by end-Dec 2021. While rising vaccine coverage and fuel tax cuts will boost confidence and re-invigorate demand, more sectors are likely to see producers passing through higher input and logistics costs, which will contain the demand recovery in H2 FY2022. Even as Covid-19 cases in India remain low, the impact of the resurgence of infections in Europe and the new variant discovered in Africa warrant caution, especially whether the available vaccines will offer protection against the latter. We continue to estimate the YoY growth in real GDP and GVA at basic prices in FY2022 at 9.0% and 8.6%, respectively, with real GDP in H2 FY2022 exceeding the pre-Covid level of H2 FY2020.

CPI Inflation projected at 5.5% in FY2022, higher than the MPC's Oct 2021 forecast: As the base effect wears off, and the pressures related to coal, metals and logistics costs come to the fore, the CPI inflation is likely to rise to an uncomfortable 5.5-6% in Dec-Mar FY2022. Nevertheless, we expect the MPC to remain growth-supportive until demand-side pressures start dominating the inflation outlook. We expect a status quo in the Dec 2021 policy review, amidst a shift in the tone to signal an upcoming change in the monetary policy stance to neutral in the Feb 2022 policy review. We expect this to be accompanied by a 15 bps hike in the reverse repo rate by the RBI in Feb 2022. Subsequently, we expect hikes of 25 bps each in the repo and reverse repo rates each in the Apr 2022 and Jun 2022 reviews, followed by a likely pause to reassess the durability of growth revival as monetary policy is normalised.

Current account balance to revert to a deficit of US$30-35 billion in FY2022: ICRA expects merchandise exports and imports to rise by ~39% and ~48%, respectively, in FY2022 to ~US$410-415 billion, and US$585-590 billion, respectively. However, rapid spread of Delta variant in Europe, recent surge in container freight rates, intermittent Covid-19 restrictions and supply side capacity constraints could moderate the exports outlook. The merchandise trade deficit is expected to widen to ~US$172-177 billion in FY2022 from US$102.2 billion in FY2021. The global economic recovery is likely to boost the services trade surplus by ~12% in FY2022 and secondary income by 8%, whereas the outflow of primary income may remain flattish, relative to FY2021. Following the sharp revival in imports in recent months, ICRA expects India's current account balance to revert to a deficit of around US$30-35 billion or around 1.0% of GDP in FY2022, from the surplus of US$24.0 billion (+0.9% of GDP) in FY2021.

Considerable shortfall in disinvestment target may overshoot the GoI's fiscal deficit in FY2022, relative to the BE: Considering the likely revenue foregone from the excise and customs duty relief, the gross tax revenues of the GoI are likely to exceed the FY2022 BE by a significant Rs. 1.8 trillion, of which around Rs. 600 billion would be shared with the states. Adding the higher than budgeted surplus transfer by the RBI to the extra net tax revenues, we expect the GoI's net revenue receipts to exceed the FY2022 BE by Rs. 1.7 trillion. Moreover, we estimate the total expenditure to overshoot the FY2022 BE by Rs. 1.3-1.5 trillion, based on the net outgo related to First Supplementary Demand for Grants, recent enhancement in food subsidy outgo towards the PMGKAY, increase in fertilizer subsidy for the rabi season, and the likely enhancement in the allocation for the MGNREGA and the new export benefit RoDTEP scheme. If the proceeds of the BPCL disinvestment and LIC IPO are both not realised in the current fiscal, the fiscal deficit may print at Rs. 15.8-16.0 trillion (6.9-7.0% of GDP), exceeding the FY2022 BE 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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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: Jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: Communications@icraindia.com
Tel: +91 124 4545 860

Registered Office

B-710, Statesman House 148,
Barakhamba Road
New Delhi-110001
Tel: +91 11 23357940-45

Corporate Office

Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon - 122 002
Tel: +91-124-4545300

Ahmedabad

1809-1811, Shapath V,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

Bengaluru 1

'The Millenia', Tower B Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

4th Floor, 'Shoban'
6-3-927/A&B. Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

No. 7-1-58, 301, 3rd Floor, 'Concourse',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 1194

Email: Info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.Icraresearch.in