ICRA

A MOODY'S INVESTORS SERVICE COMPANY

ECONOMIC OUTLOOK AND MACRO TRENDS

India's real GDP growth likely to have moderated to 3.5% in Q4 FY2022; expect GDP to grow by 7.2% in FY2023

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

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

Tiasha Chakraborty
+91 124 4545 848
tiasha.chakraborty@icraindia.com

Rahul Agrawal
+91 22 6169 3353
rahul.agrawal@icraindia.com

Aarzoo Pahwa
+91 124 4545 835
aarzoo.pahwa@icraindia.com

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ABBREVIATIONS

AE: Advance Estimates
AIAHL: Air India Asset Holding Ltd.
ATF: Aviation Turbine Fuel
BE: Budget Estimates
BMTPC: Building Materials and Technology Promotion Council
BPS: Basis Points
BoP: Balance of Payments
CAD: Current Account Deficit
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
CRR: Cash Reserve Ratio
CSI: Current Situation Index
CTD: Central Tax Devolution
CWC: Central Water Commission
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
GTR: Gross Tax Revenue
GVA: Gross Value Added
HUDCO: Housing and Urban Development Corporation Ltd.
IGST: Integrated Goods and Services Tax
IIP: Index of Industrial Production
IMD: Indian Meteorological Department
IMF: International Monetary Fund
IPCL: Indian Petrochemicals Corporation Ltd
IPO: Initial Public Offering
JPC: Joint Plant Committee
LAF: Liquidity Adjustment Facility
LIC: Life Insurance Corporation
LPA: Long Period Average
LPG: Liquefied Petroleum Gas
MEP: Monthly Expenditure Plan
MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act
MoM: Month-on-Month
MoRTH: Ministry of Road Transport and Highways
MPC: Monetary Policy Committee
MSF: Marginal Standing Facility
NBFC: Non-Banking Finance Companies
NDTL: Net Demand and Time Liabilities
NFSA: National Food Security Act
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
OPEC: Organisation of Petroleum Exporting Countries
OM: Office Memorandum
OMCs: Oil Marketing Companies
OMO: Open Market Operation
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
PMAY: Pradhan Mantri Awas Yojana
PMGKY: Pradhan Mantri Garib Kalyan Yojana
PMGKAY: Pradhan Mantri Gareeb Kalyan Ann Yojana
QEP: Quarterly Expenditure Plan
RBI: Reserve Bank of India
RDB: Rupee Denominated Bonds
RE: Revised Estimates
REER: Real Effective Exchange Rate
RIC: Road and Infrastructure Cess Exported Products
SDL: State Development Loans
SDF: Standing Deposit Facility
SEBI: Securities and Exchange Board of India
SGB: Sovereign Gold Bonds
SGST: States Goods and Services Tax
THTCS: Trade, Hotels, Transport, Communication and Services related to broadcasting
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

OVERVIEW

ICRA maintains its estimate of real GDP growth for FY2023 at 7.2%

The rise in oil and commodity prices have heightened macrostability risks; we expect a deterioration in the CAD (to 2.7% of GDP) and CPI inflation (to 6.5%) and a mild overshooting in the fiscal deficit (to 6.5% of GDP as against the BE of 6.4% of GDP) in FY2023

Our base case pencils in repo rate hikes of 40 bps in the June 2022 review and 35 bps each in the Aug 2022 and Sep 2022 reviews followed by a pause

The fiscal year 2023 has begun on a sombre note, in the backdrop of global challenges such as the Russia-Ukraine conflict, the surge in crude oil and commodity prices and renewed lockdowns in China. However, the high frequency data for India for April 2022 and early-May 2022 suggests that the aforementioned factors have not dented volume growth so far. Nevertheless, business margins are likely to be compressed, amidst an incomplete pass-through of input price pressures, while higher inflation would constrain demand growth, both of which would dampen the expansion in value added in FY2023. We maintain our estimate of real GDP growth for FY2023 at 7.2% at the current juncture, amidst expectations of slowing external demand, a gradual increase in capacity utilisation levels through the year, and a recovery in contact-intensive services. The rise in oil and commodity prices have also heightened macro stability risks for the Indian economy; we expect a deterioration in the CAD (to 2.7% of GDP) and the CPI inflation (to 6.5%) and a mild overshooting in the GoI's fiscal deficit (to 6.5% of GDP as against the BE of 6.4% of GDP) on account of a larger-than-budgeted subsidy burden in FY2023. The recent excise duty cut on fuels has mitigated some upside risks to the CPI inflation projection and has distinctly lowered the probability of highly front-loaded rate hikes. We foresee the MPC to hike the repo rate by 40 bps in the June 2022 review and 35 bps each in the August 2022 and September 2022 reviews, followed by a pause to assess the robustness of growth.

ICRA's Macroeconomic Projections	FY2022	FY2023
GDP Growth (in real terms)	8.5%	7.2%
GVA Growth (in real terms)	7.8%	7.0%
CPI Inflation (average)	5.5%	6.5%
WPI Inflation (average)	13.0%	9.5%
Current Account Balance	Deficit of US$41.5-43.5 billion; 1.3% of GDP	Deficit of US$95-100 billion; 2.7% of GDP
GoI's Fiscal Deficit	In line with the RE of Rs. 15.9 trillion; modest upside to tax revenues and undershooting of capex can offset a potential missing of disinvestment target	Rs. 17.6 trillion (6.5% of GDP) in FY2023, slightly higher than 6.4% of GDP indicated in FY2023 BE
G-sec Yields	10-year G-sec yield to trade with an upward bias, due to rising inflationary pressures and a large borrowing programme for FY2023; overall, it is likely to be capped at 8.0% in CY2022	
Repo rate	40 bps rate hikes in Jun-22 and 35 bps rate hikes in Aug-22 and Sep-22 policies each, respectively, followed by a pause	
INR	75-79/US$ in H1 FY2023	

EXECUTIVE SUMMARY

Real GDP growth to moderate to 3.5% YoY in Q4 FY2022 but print well above pre-Covid levels: ICRA expects the YoY growth in GDP to have moderated to 3.5% in Q4 FY2022 from 5.4% in Q3 FY2022 on account of the impact of higher commodity prices on margins, decline in wheat yields and the hiccups in the recovery of the contact-intensive services attributable to the third wave of Covid-19 in India, as well as the high base. We expect both agriculture and industry to post a sub-1% GVA growth in Q4 FY2022, whereas services growth is expected to print at around 5.4% in that quarter. Encouragingly, relative to the corresponding pre-Covid quarter of FY2019, growth in GDP is expected to remain healthy in Q4 FY2022 at 8.6%, as against 9.4% in Q3 FY2022. We forecast the YoY expansion in real GDP at 8.5% in FY2022 (as against the NSO's projection of 8.9%), exceeding the FY2020 levels by a muted 1.3%.

Real GDP to rise by 7.2% in FY2023: This fiscal year has begun on a sombre note, in the backdrop of global challenges such as the Russia-Ukraine conflict, the surge in crude oil and commodity prices and renewed lockdowns in China. However, the high frequency data for India for April 2022 and early-May 2022 suggests that the aforementioned factors have not dented volume growth so far. Nevertheless, business margins are likely to be compressed, amidst an incomplete pass-through of input price pressures, while higher inflation would constrain demand growth, although the excise duty cuts on petrol and diesel are likely to provide some respite to consumers in the second half of the quarter. Based on the early data for the first half of the quarter, ICRA expects GDP growth to improve to ~12-13% in Q1 FY2023, aided by a low base. We maintain our estimate of real GDP growth for FY2023 at 7.2% at the current juncture, amidst expectations of elevated inflation levels constraining household budgets in the low-to-mid income segments, compression in business margins, slowing external demand and lower rabi output impacting rural farm sentiment. However, a recovery in demand for contact-intensive services, better income visibility for households dependent on the same and a back-ended pick-up in private capex will support the recovery, although it will be uneven.

CPI Inflation to surge to 6.5% in FY2023: ICRA expects CPI inflation to average at 6.5% in FY2023 (as against the MPC's projection of 5.7% indicated in the Apr 2022 meeting), a rise from 5.5% in FY2022, with the broad basing of inflationary pressures, as seen in the recent inflation prints, imparting stickiness to the inflation trajectory in the near term. The May 2022 excise duty cut on petrol and diesel has mitigated some upside risks to the CPI inflation projection and has distinctly lowered the probability of highly front-loaded rate hikes. We foresee the MPC to hike the repo rate by a further 40 bps in the June 2022 review and 35 bps each in the Aug 2022 and Sep 2022 reviews, followed by a pause to assess the robustness of growth. As of now, we see the terminal repo rate in the current rate hike cycle at 5.5%. We believe that overtightening is not warranted under the current circumstances as inflation is being fuelled by global supply side factors and it may needlessly sacrifice domestic growth and sentiment.

Current account deficit to widen to 2.7% of GDP in FY2023: India's merchandise exports are expected to rise by ~9% in FY2023, with expectations of a sharp slowdown in world trade volumes, being partly offset by higher commodity prices during the duration of the Russia-Ukraine conflict. Merchandise imports, on the other hand, are set to expand by a faster ~16% in FY2023, as domestic demand growth is likely to outpace external demand. Accordingly, we expect the trade deficit to widen to an all-time high of US$250-255 billion in FY2023, with a higher net oil imports accounting for most of the increase. As a result, the CAD is expected to deteriorate to ~US$95-100 billion in FY2023 from ~US$41.5-43.5 billion in FY2022. The deterioration in the CAD, monetary policy tightening across the globe and the risk aversion towards EM assets are expected to impart a depreciating bias to the INR. However, large forex reserves, narrower inflation differentials and the likely stemming of FII debt outflows would contain the further depreciation from the recent record low. We expect the INR to trade between 75.0-79.0/US$ in the remainder of H1 FY2023.

Fiscal deficit target of 6.4% of GDP for FY2023 to be overshot mildly: In the Union Budget 2022-23, the GoI had pencilled in a fiscal deficit of Rs. 16.6 trillion (6.4% of GDP) for FY2023. There are several risks to the fiscal target emanating from the revenue loss to the Centre on account of the recently announced excise duty cut, lower-than-budgeted transfer of the RBI's surplus and the need for additional spending on food, fertilizer and LPG subsidies through the year. However, a part of this would be offset by higher taxes on account of a low growth embedded in the FY2023 BE for taxes. While we expect the GoI's fiscal deficit in FY2023 to overshoot the BE of Rs. 16.6 trillion by Rs. 1.0 trillion, a higher nominal GDP vis-à-vis the BE is likely to aid in containing the expected fiscal deficit to 6.5% of GDP, only slightly higher than the 6.4% of GDP indicated in the Union Budget.

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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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- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- 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