MACRO PULSE REPORT

May 2022

Contents

From the desk of the Chief Analytical Officer

Our **seventeenth** edition of **Acuité Macro Pulse (May-2022)** is out in the public domain which has a **special report on the corporate performance** over the two year pandemic period of FY20-22.

There are some interesting takeaways from this report that I wanted to talk about before we go to the current economic landscape. We looked at the data of 1370 listed companies that have published their financial results for FY22 and we analysed their performance over the last two years that had been disrupted by the prolonged pandemic. What we see is a tale of resilience and recovery in the Indian corporate sector which also includes some of the MSMEs. The revenue CAGR has been healthy notwithstanding the pandemic and importantly, there has been a significant jump in the profitability levels. While the uptick in the margins had been supported by a supporting framework with low commodity prices and rock bottom interest rates that have already started to reverse, we note that the corporate sector has been fairly prudent in debt intake which has translated to a moderate decline in the average leverage levels. Our study also reveals that private sector capital expenditure have been in a steady, if not in a big bang mode with 56% of listed companies in our sample having incurred moderate to large capital expenditure over this period. We don't see signs of any material credit stress in the listed MSME businesses as only 8% of these companies had a leverage of over 1.5 times as on Mar-22.

It is, therefore, fair to say that corporate India has passed the pandemic test with distinction however, with some grace marks given to the weaker businesses. The strong recovery in corporate sector is reflected in the GDP growth of 8.7% in FY22 which can be considered to be fairly healthy, given the Omicron threat in the last quarter. While the high frequency indicators highlight a moderate momentum in economic recovery in Q1FY23 particularly driven by the pent up demand in contact intensive sectors, the economic headwinds have got stronger.

The ongoing inflationary threat has been buoyed by the continuing geo-political risks which shows no signs of abatement. Crude oil at USD 120 pb is surely not good news for the Indian economy though RBI and the government have started to act in tandem to cool down the overheated commodity markets. As regards RBI's monetary stance, it supported the growth momentum as long as it could and now clearly, it has pushed the button on rate hikes and already increased the benchmark repo rate by 90 bps. We believe that the repo rate is set to be between 5.5%-6.0% by end of FY23, given the forecasts on the headline inflation in the next two quarters. This will obviously imply that borrowing costs of the corporate sector will increase by 150-200 bps through the current fiscal.

What, however, is of larger concern at this stage is the high volatility in the global capital markets triggered by a sharp tightening in the monetary policies of advanced economies. This continues to lead to high and sustained FII capital outflows, adding to the rupee depreciation pressures that have already been created by a higher trade and current account deficit. Let's wait and watch how the Indian economy and the Indian corporate sector fare in the post pandemic test!

Suman Chowdhury
Chief Analytical Officer

Growth

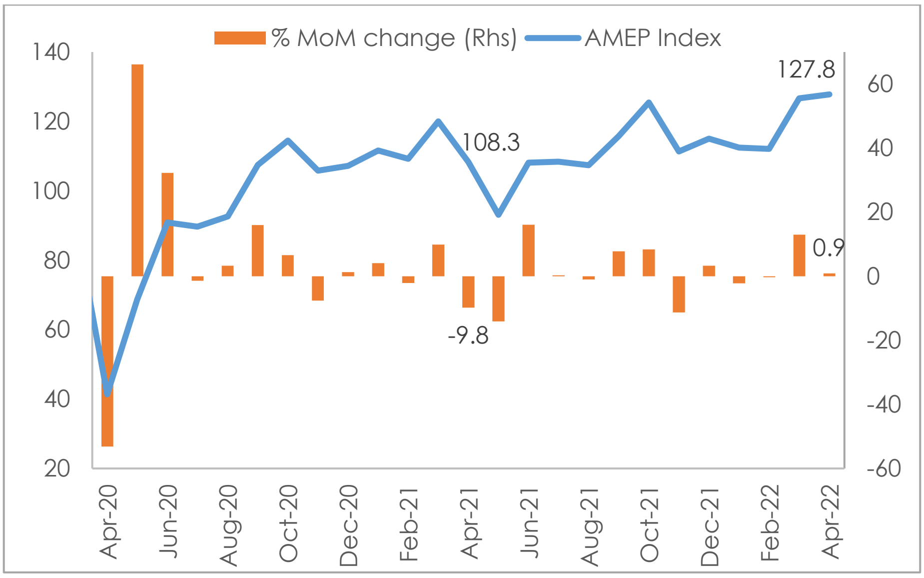
Growing downside risks

KEY TAKEAWAYS

- India Q4 FY22 GDP growth decelerated to 4.1% YoY from 5.4% in Q3, partly on account of the third pandemic wave, moderating the GDP growth to 8.7% in FY22, which still is the highest in current series and reflects a healthy recovery from the pandemic disruption.
- The domestic macroeconomic conditions consolidated their recent strength in Apr-22, as economic activity continued to normalize further despite the recent uptick in Covid infections in some states.
- With nearly 70% of the population fully vaccinated, contact-intensive services are leading the recovery amidst complete opening up of the economy.
- Among the broad spate of incremental lead indicators, most continued to display strength for months of Mar-22 and Apr-22.
- As such, we expect FY23 GDP growth estimate at 7.5% with steady support from government's thrust on infrastructure segment along with prospects of normal monsoon and robust vaccination coverage which is likely to provide some support to overall growth momentum.
- Nevertheless, geopolitics led surge in commodity prices, pass-through to domestic prices, slowdown in global growth, prolonged supply disruptions are downside risks likely to make a dent on growth momentum, in addition to financial market volatility from global monetary policy tightening now firmly underway.

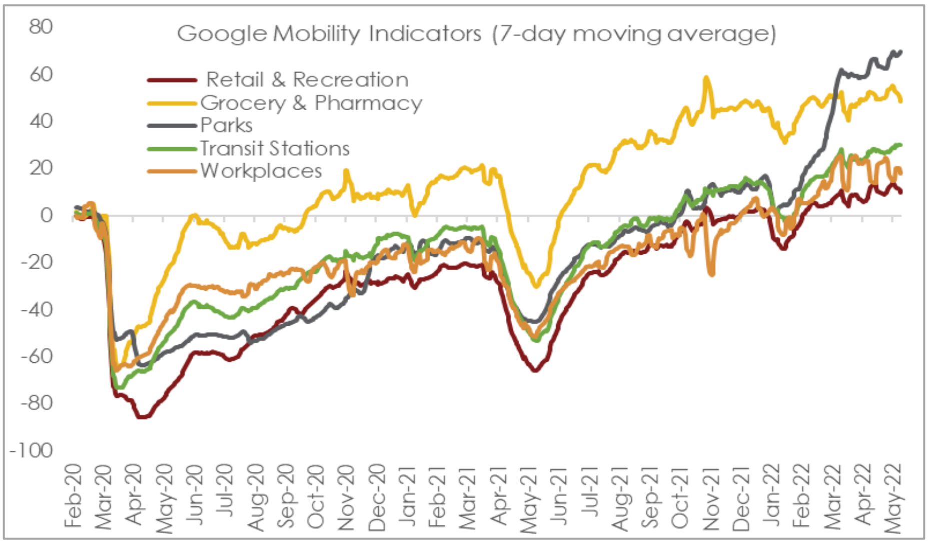
India's GDP growth in Q4 FY22 decelerated to 4.1% YoY from 5.4% in Q3, taking the GDP growth from -6.6% in FY21 to 8.7% in FY22, the highest in current series. Nevertheless, domestic macroeconomic conditions consolidated their recent strength in Mar-Apr-22, amid continued normalization in economic activities particularly in the services sector and strong vaccination coverage (73% of India's total population is now fully vaccinated). Among the broad spectrum of lead indicators, most continued to display incremental strength for months of Mar-22 and Apr-22. This was clearly captured in our inhouse proprietary AMEP (Acuité Macroeconomic Performance) index which registered its post-pandemic record high level in the month of Mar-22 (126.6) and Apr-22 (127.8).

Chart 1: AMEP index surges to record high levels in Mar-Apr-22



Having said so, geopolitics led surge in commodity prices, pass-through to domestic inflation, slowdown in global growth, prolonged supply disruptions are downside risks likely to make a dent on growth momentum, in addition to financial market volatility stemming from global monetary policy tightening now firmly underway.

Chart 2: Google mobility continues to scale new highs



Recent data releases: A granular look at recovery

- IIP growth rose marginally in Mar-22 to 1.9%YoY from 1.5% in Feb-22 (revised lower by 20 bps) to fare slightly better than market consensus pegged at 1.7%. Over the last 5 months, annualised IIP growth has remained in a slow albeit steady range of 1.0-1.9%, to average at 1.4%. Notwithstanding the subdued headline growth, sequentially IIP posted a strong expansion of 12.5%MoM in Mar-22, in line with year-end seasonality.
- Headline PMI manufacturing index remained broadly unchanged at 54.5 in May-22 from 54.7 in Apr-22, led by output and new orders.
- PMI services index rebounded strongly to an 11-year high of 58.9 in May-22 from 57.9 in Apr-22 driven by a rise in incoming new orders amidst improving demand.
- GST in May-22 continued to record a robust collection coming at 1.4 lakh Cr, capturing sales for Apr-22, improved economic activity as well as better tax compliance.
- Merchandise exports moderated to USD 37.2 bn in May-22, lower than USD 40.2 bn in Apr-22 reflecting the moderating global growth prospects.
- NONG (Non-oil-non-gold) imports, a key indicator of domestic demand, moderated sequentially to USD 36.1 bn in May-22 from USD 38.2 bn in Apr-22.

Outlook

Heading into FY23, the pace of domestic growth recovery could come under threat given the growing headwinds from:

- The sharp rally in commodity prices and inputs costs for the industrial sector in the aftermath of the ongoing Russia-Ukraine war. This is likely to dent producer margins as pass-through to consumers is likely to remain inelastic amidst downside risks to growth. The geopolitical crisis is also likely to prolong supply bottlenecks and act as an added dampener for the sector.
- The updraft in CPI inflation over Mar-22 and Apr-22 has triggered a faster than envisaged monetary policy normalisation by the RBI. Earlier this month, RBI in an off-cycle meeting hiked the repo rate by 40 bps to 4.40% and in the last policy meeting in Jun-22, another 50 bps hike has taken place. Following the move, several scheduled commercial banks have adjusted upwards their MCLR rates in the range of 10-35 bps.
- The run-up in global commodity prices accompanied by tightening of financial conditions, along with Covid related uncertainties and slowdown induced in China, is likely to weigh on global economic activity. IMF expects global GDP growth to slow down by 80 bps to 3.6% in 2022 vs. its Jan-22 estimate, with a sharper deceleration of 100 bps on world trade volumes to 5.0%. This is likely to weigh on domestic export-oriented industries.
- Despite palpable downside to growth prospects, the elevated and rising inflation has hastened the pace of monetary policy normalisation in major

advanced economies could induce financial market volatility with spill overs on emerging markets including India.

- While the pandemic has been under control since the third wave in Jan-22, there has been a perceptible rise in fresh infections since early Jun-22. A likelihood of a fourth wave can't be ruled out though it's not likely to be as intense as the previous waves, given the high vaccination coverage.

As such, while **we attach a moderate downside risk** to our FY23 GDP growth estimate at 7.5%, growth is likely to find support from the capex focused government spending, expectation of a normal Southwest monsoon, complete opening up of the economy post the Omicron wave with more than 70% of population fully vaccinated.

- Indian Meteorological Department (IMD) expects Southwest monsoon to be normal pegged at 99% of LPA with a margin error of +/-5% in 2022, with Government setting the food grain production target of 328 mn tonnes for 2022-23 (3.8% higher vs. last year).
- Improvement in manufacturing capacity utilization to 72.4% in Q3 FY22 (higher than its pre pandemic level of 68.6% in Q3 FY20) corroborates the gradual easing of domestic supply side constraints and bodes well for future activity.
- Amidst these evolving dynamics and as the economy emerges out of the pandemic, services sector is likely to play a dominant role in FY23 GDP growth vis-à-vis manufacturing sector.

Inflation

The great flare up

KEY TAKEAWAYS

- Inflation metrics scaled to new highs at the start of FY23.While CPI inflation soared to a near 8-year high of 7.79%YoY, WPI inflation accelerated to a fresh record high of 15.08% YoY in the current series with price pressures being fairly broad-based, capturing the war dynamics.
- The opening up of the economy, strong pick-up in retail mobility and vaccination attaining critical mass is hastening the pass-through of elevated input prices.
- The sharp bump up in prices in last two months will shift the anticipated inflation trajectory upwards for FY23.
- Keeping in mind the upside risks and assuming price of Brent to average at USD 100 pb in FY23(in the base case), we now project CPI inflation in FY23 to average at 6.5% with some upside risk amid recent spike in crude oil prices.

Inflation metrics scaled to new highs at the start of FY23. While CPI inflation soared to a near 8-year high and WPI inflation accelerated to a fresh record high in the current series. Both metrics beat market expectations with price pressures being fairly broad-based, capturing the war dynamics.

To be specific :

- CPI inflation accelerated to 7.79% YoY in Apr-22 from 6.95% in Mar-22 (Market consensus: 7.4-7.5%) marking the fourth consecutive month of CPI inflation remaining above the 6.0% policy tolerance threshold.
- WPI inflation accelerated to 15.08% in Apr-22 from 14.55% in Mar-22, to remain in double-digits for the thirteenth consecutive month.

Key highlights: CPI inflation

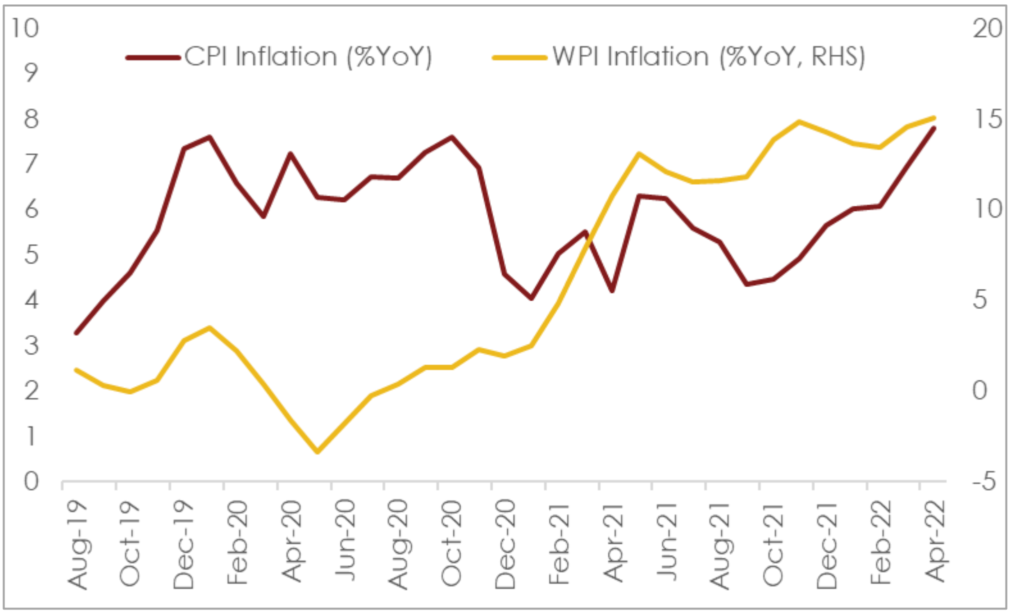
- Sequential momentum rose to 1.43% MoM in Apr-22, the highest in last 11-months, led by broad-based price pressures.
- The upside was led by the Food and Beverages index that saw a strong sequential momentum of 1.43% MoM. Incremental price pressures were led by Fruits (+9.52%), Oils & Fats (+2.52%), Spices (+2.14%), Cereals (+1.06%), and Milk & Milk Products (+1.05%). With this, annualized food inflation soared to a 17-month high of 8.10% from 7.47% in Mar-22. This partly reflects the impact of adverse summer seasonality, exacerbated by (i) elevated commodity prices impacting agricultural inputs, and (ii) second order effect of the ongoing conflict between Russia and Ukraine on items like wheat and edible oil.
- Fuel and Light index rose sharply by 3.11% MoM. This is the highest sequential jump in nearly 11-years. Incremental price pressures during the month were led by Kerosene (+20.05%), Diesel (+10.05%), LPG (+4.06%), and Electricity (+1.62%).
- Core (i.e., CPI ex indices of Food & Beverages, Fuel and Light, and petrol and diesel in Miscellaneous) inflation momentum quickened to an 11-month high of 0.83% MoM from 0.60% in Mar-22, pushing the annualized rate of inflation to 6.5%, the highest in the new series.
  - Annualized inflation in Clothing & Footwear category touched a series high of 9.85% in Apr-22. This captures the impact of earlier hike in GST rate along with strong pickup in retail mobility in the post Omicron phase.
  - Miscellaneous inflation too rose to a near 10-year high of 8.03% YoY, led primarily by higher prices for Transport & Communication (capturing petrol and diesel prices), along with moderate push from Personal Care & Effect (reflecting elevated price of precious metals), Household Goods & Services, and Recreation & Amusement (which reflects impact of pent-up demand and pass-through of input prices as services opened up post the Omicron wave).

Key highlights: WPI inflation

- Sequential momentum remained strong at 2.08% MoM, though eased marginally from 2.41% in Mar-22. While momentum in fuel eased considerably, it was offset by the rise in primary goods, of which food led the upside.

- Food prices rose by 3.61%MoM, led by Fruits (19.6%) and vegetables (4.5%) predominantly amidst the onset of summer seasonality and soaring temperatures.
- Fuel prices rose by 2.79% MoM, with strong upward sequential adjustments seen in price of Kerosene (25.8%), LPG (12.6%), Furnace oil (14.7%) and ATF (12.6%). Compared to last month's 6.22%MoM jump, sequential momentum eased in Apr-22 owing to latent price pressures on electricity prices not getting fully captured.
- Within manufacturing, strong price pressures were seen in sub-sectors of Basic metals, Paper & paper products, and Fabricated metal products.

Chart 1: CPI and WPI inflation accelerated further in Apr-22



Outlook

CPI inflation has made rapid strides in the last two months. While the directional move was anticipated, the accompanying strong momentum has been a surprise to market participants as well as the RBI.

The sharp bump up in prices in last two months will shift the anticipated inflation trajectory upwards for FY23. In this context, we note that:

- The Russia-Ukraine conflict is not showing any signs of cooling off. In fact, on the margin, the geopolitical environment seems to have deteriorated amidst unrelenting posturing by the two sides. This has raised the pressure on commodity prices incrementally. For India, although retail fuel prices have remained unchanged since the first week of Apr-22, the spillovers effect is nevertheless gaining momentum.
    - Wholesale fuel prices continue to capture the upside in international crude oil prices

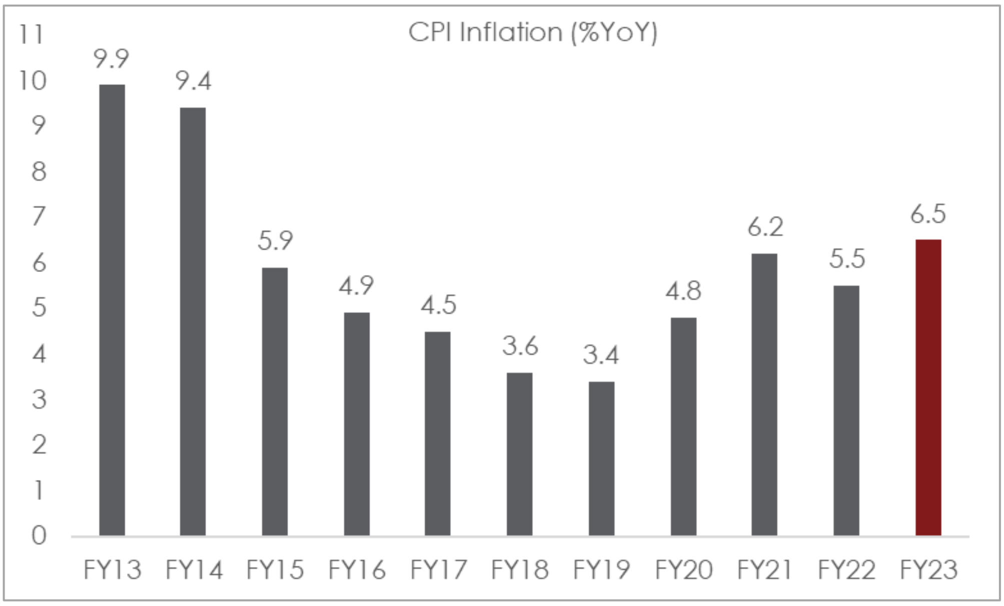
- The opening up of the economy, strong pick-up in retail mobility (to its highest post pandemic levels currently), and vaccination attaining critical mass (with over 64% of the total population having achieved two doses) is hastening the pass-through of elevated input prices. This is likely to provide stickiness to core inflation at around 6% levels.

Some respite on inflation will come from the recent announcement of a reduction in excise duty on petrol and diesel by Rs 8 and Rs 6 respectively. As per our estimates, it is likely to directly lower CPI inflation by 25-30 bps. In addition, while difficult to quantify, the reduction in customs and import duties announced by the Government on a range of raw materials used in steel and plastic industries, will offer some respite to producers. Further, the domestic wheat export ban announced earlier by the government along with reversal of export ban on edible oils by Indonesia will help to moderate the food price pressures in FY23.

There can also be some respite from the likelihood of a normal monsoon outturn. As per the IMD, the upcoming south-west monsoon season could see normal rainfall at 99% of the long period average. Early onset of monsoon if accompanied by a normal distribution could potentially help douse some of the seasonal pressure on food prices. Nevertheless, food inflation could continue to face pressures from global factors, esp. ones impacting agricultural inputs, which in turn could potentially manifest in higher announcement of MSP by the government.

Considering these factors and assuming crude oil price to average at USD 100 pb in the base case scenario, we expect CPI inflation for FY23 to average at 6.5%, with some upside risk stemming from the recent spike in crude oil price. That said, we do acknowledge risks to our forecast to stem from extreme volatility in commodity prices particularly crude oil which is currently hovering at USD 120+ pb.

Chart 2: For FY23, we expect CPI inflation to avg. at 6.5%



Government Finances

Fiscal uncertainty clouds FY23 outlook

KEY TAKEAWAYS

- India's central government fiscal position for FY22 slightly improved coming in at 6.7% of the GDP, modestly lower as compared to the revised estimate of 6.9%.
- The gains largely accrued from higher tax & non-tax realization which more than off-set the shortfall recorded in the disinvestment target and higher than budgeted revenue expenditure.
- In addition, to strong windfall in revenues, the nominal GDP growth of 19.5% in FY22 as against the revised estimate of 17.2%, has also provided a denominator support of 0.1% of GDP.
- Going forward in the current year, despite buffers from the recently concluded LIC IPO (garnering Rs 205 bn on revised valuation) along with the likelihood of higher than budgeted tax revenue collections, we now see the possibility of fiscal slippage risks, aggregating to 0.3%-0.4% of GDP from the budgeted 6.4% of GDP for FY23, given the higher subsidy burden and the fiscal measures taken to cool down retail fuel prices among others.

India's central government fiscal position for FY22 slightly improved coming in at 6.7% of the GDP, lower not only as compared to the revised estimate of 6.9% but also lower than the initial budgeted estimate of 6.8%. The gains largely accrued from higher tax & non-tax realization which more than off-set the shortfall recorded in the disinvestment target and higher than budgeted revenue expenditure. In addition, to strong windfall in revenues, the nominal GDP growth of 19.5% in FY22 as against the revised estimate of 17.2%, has provided a denominator support of 0.1% of GDP.

Receipts: Robust tax and non-tax revenue collection buoys overall receipts

Barring the large one-off tax revenue sharing with states in Feb-22, total receipts have been buoyed by healthy tax as well as non-tax revenue accretion in FY22. For FY22, gross tax revenue collection clocked a growth of 33.7% YoY compared to just of 0.7% seen in the corresponding period in FY21. It's not just the annualized growth that looks better (which is strongly aided by a favourable statistical base), the FY22 gross tax revenue achieved 107.6% of the full year RE. While strong momentum in tax collection is broad based, it is being powered by robust growth in collections of corporate tax, customs, and income tax.

Non-tax revenue too stood at 110.9% of the RE. The key reason for robust performance under this category stems from a significantly higher than budgeted dividend from the RBI. Collection under non-tax revenue has also been boosted in Mar-22 with key telecom companies prepaying their spectrum fee, taking advantage of the current low interest rate regime.

Meanwhile, non-debt capital receipts stood at just 39.2% of the RE primarily on the back of lower disinvestment receipts. The government closed FY22 with a disinvestment revenue of only Rs 135 bn. This is significantly lower vis-à-vis the downwardly revised estimate of Rs 780 bn due to deferral of LIC IPO from Mar-22 to the early part of FY23.

Higher subsidies push up revenue expenditure, capex gap narrows considerably

The total expenditure met the government's target primarily due to revenue expenditure which more than offset a marginal decline in the capital spending in FY22. On the revenue front, bulk of growth in the expenditure was driven primarily by interest payments and subsidies. After remaining muted, with disbursal of capital expenditure trailing at just 80.5% of RE during Apr-Feb FY22, government's capex increased significantly to INR 1076 bn in Mar-22 from INR 434 bn in Feb-22.

Outlook

For FY23, we now see congregation of fiscal slippage risks despite buffers from the recently concluded LIC IPO (garnering Rs 205 bn on revised valuation) along with the likelihood of higher than budgeted tax revenue collections. The slippage risks are gaining momentum on back of the latest fiscal measures announced by the government as follows:

- **Excise duty on petrol and diesel has been reduced by Rs. 8 per litre and Rs. 6 per litre respectively** further to the cuts effected in Nov-21, bringing down the taxes to their respective pre-Covid levels. From the fiscal perspective, a cut in excise duty on petroleum products is expected to have a revenue implication of around Rs. 850 bn over the remainder of FY23 which will be entirely borne by the Central Government.

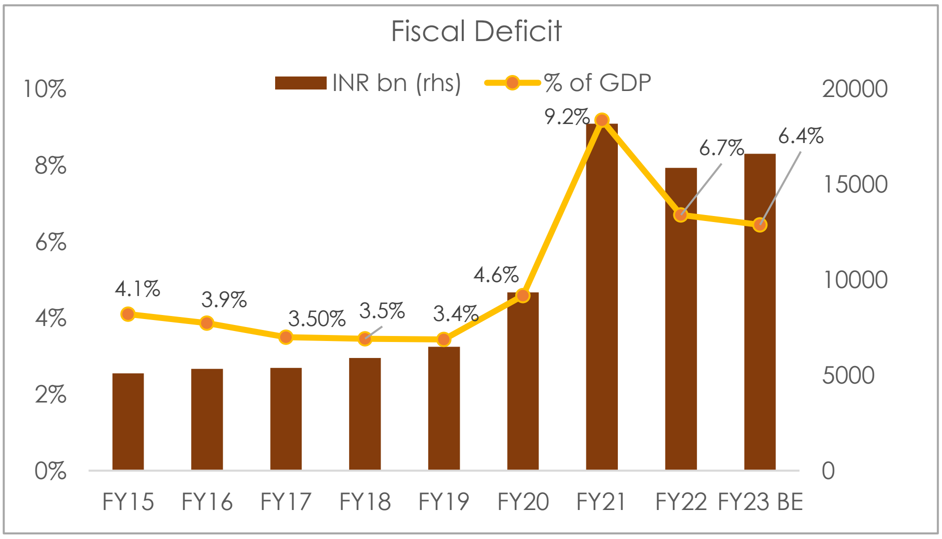
- **Fertilizer subsidy has been increased by Rs. 1.1 tn** doubling it to Rs. 2.15 tn from the budgeted level for FY23, to insulate farmers from the spike in the global prices of DAP (Di-ammonium Phosphate) and MoP (Muriate of Potash) in the last one year.
- **LPG subsidy of Rs. 200 per gas cylinder (up to 12 cylinders)** to be provided to over 90 mn beneficiaries under PM Ujjwala Yojna. This is expected to have a revenue implication of around Rs. 61 bn a year on the exchequer.
- **Custom duty on the import of certain industrial raw materials like coking coal, ferronickel and coke and food commodities like edible oil** has been cut from 2.5%/5.0% to nil.

Overall, the fiscal slippage of these measures announced by the government is estimated at around Rs. 2 tn. Apart from the aforementioned set of measures, the government had earlier decided to extend PM Garib Kalyan Anna Yojana by 6-months till Sep-22 which involves an additional outlay of Rs. 800 bn. Moreover, a likely deferment of the big-ticket BPCL divestment due to subdued interest by the bidders amidst volatile market conditions along with lower than budgeted dividend/surplus RBI dividend of Rs. 303 bn (vs. FY23 budget estimate of Rs 650-700 bn) will put pressure on government's budgeted fiscal arithmetic.

Table1: Key drivers of fiscal deficit

Fiscal Variables	% of RE	INR bn	
	FY22	Actual	Revised Estimate
Revenue Receipts	104.3	21684.3	20789.4
Net Tax	103.1	18203.8	17651.4
Non-Tax	110.9	3480.4	3137.9
Non-Debt Capital Receipts	39.2	392.1	999.8
Total Receipts	101.3	22076.3	21789.1
Revenue Expenditure	101.1	32013.73	31672.89
Capital Expenditure	98.4	5927.98	6027.11
Total Expenditure	100.6	37941.71	37700.00
Fiscal Deficit	**99.7**	**15865.37**	**15910.9**

Chart 2: Fiscal consolidation likely to take time



Rates

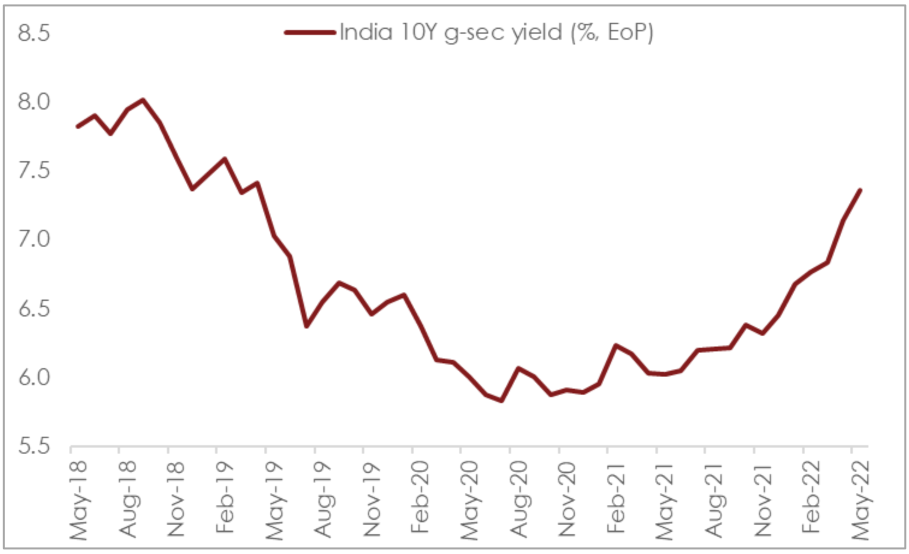
The monetary policy shocker

KEY TAKEAWAYS

- After closing the month of May-22 at 7.4%, India's 10Y g-sec yield has hardened to an over 3-year high of 7.5%.
- The turn in global monetary policy has gathered steam amidst hardening of inflationary risks, with US Fed leading the pack in normalizing interest rates aggressively.
- Amid rise in inflationary pressures, RBI has been frontloading the post-pandemic policy normalization cycle by increasing the repo rate in an unscheduled policy meeting by 40 bps accompanied by a 50 bps increase in the CRR in May-22.
- Further, the RBI has also raised repo rate by an additional 50 bps to 4.9%. Consequently, the standing deposit facility (SDF) rate also stands adjusted to 4.65%; and the marginal standing facility (MSF) rate to 5.15%.
- Overall, with the MPC now appearing to be decisive in addressing inflation risks, we expect the RBI to raise repo rates by a cumulative 150-200 bps in FY23, taking it higher than the pre-pandemic level of 5.15%.

India's 10Y g-sec yield has been climbing up for the past six months. After closing the month of May-22 at 7.4%, the 10Y g-sec yield has hardened further to an over 3-year high of 7.5% currently in Jun-22.

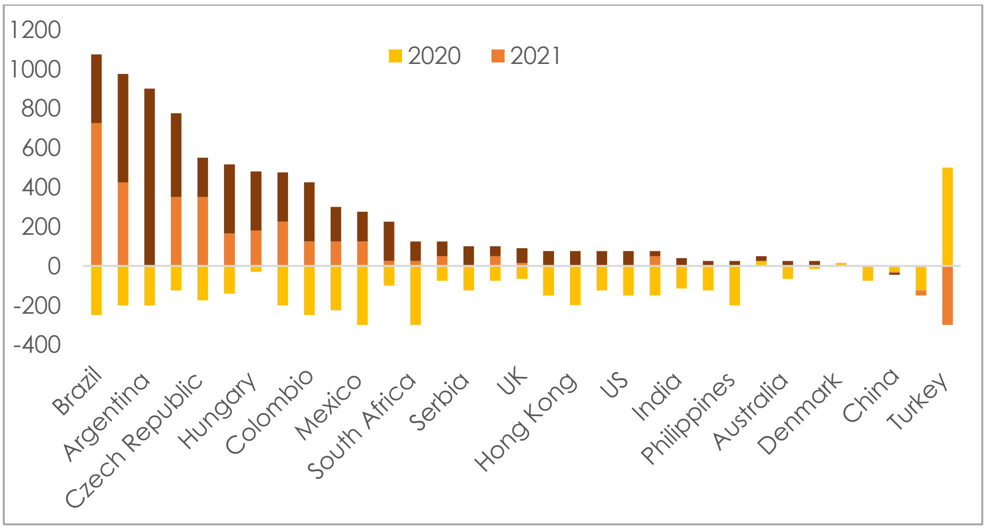
Chart 1: 10Y g-sec yield moves up to an over 3-year high level



Normalization of global monetary policy powers ahead

The turn in global monetary policy has gathered steam amidst hardening of inflationary risks. Central banks across many countries continue to scale back pandemic era extraordinary monetary accommodation. Among developed countries, the US Fed, and the BoE (with 75 bps hike each in 2022 so far) have initiated their monetary policy normalization with an aim to emphatically start addressing inflation risks. Meanwhile, several EM central banks appear to be ahead in terms of policy normalization, prompted by concerns on inflation and financial market stability.

Chart 2: Global monetary policy normalization gathers steam in 2022



- Among key central banks tracked by the BIS who effected rate action in the pandemic period, as of May-22: i) 15 have their monetary policy rate below their pre pandemic levels (with median at 75 bps below pre pandemic level), ii) 1 has its monetary policy rate at its pre pandemic level, and iii) 18 have their monetary policy rate above their pre pandemic levels (with median at 225 bps above pre pandemic level).

Domestic monetary policy normalization playing a catch up

Against the backdrop of accentuated inflationary pressures, the RBI, in line with our expectations, frontloaded its policy normalization path by hiking the repo rate by 50 bps taking it to 4.9%. Consequently, the standing deposit facility (SDF) rate also stands adjusted to 4.65%; and the marginal standing facility (MSF) rate to 5.15%. Clearly, RBI is gradually moving away from its accommodative stance to a more neutral approach with MPC clearly stating that it would now "remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth".

Since the April-22 policy meeting, RBI has clearly shifted its focus on inflation management by doubling down on its efforts to address increasing price pressures with the aim of pulling down CPI inflation within its target range (2%-6%) while also fostering macroeconomic stability. However, we believe mild downside surprises to growth (if any) is unlikely to sway the MPC from its inflation objective as of now.

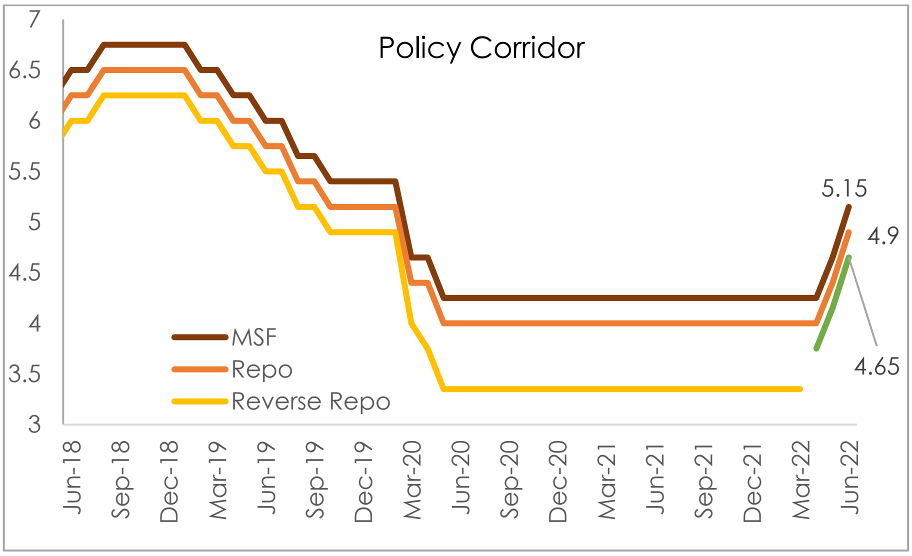
RBI has acknowledged the serious and persistent nature of the current inflation trajectory through its revised CPI forecasts which is projected to persist above the upper tolerance threshold of 6% in the first three quarters of FY23. With an expectation of normal monsoon and assumption of crude oil price averaging at USD 105 pb in FY23, it now expects inflation in FY23 to be sharply higher at 6.7% in FY23 from 5.5% in FY22.

As per our inflation model, in the base case assumption, headline CPI inflation is likely to average at 6.5% in FY23. This forecast factors in the government measures including the domestic wheat export ban along with reversal of export ban on edible oils by Indonesia and prospects of a normal monsoon that will help in moderating the food price pressures in FY23. It also anticipates further duty cuts by both the central and the state governments to moderate the impact of increased commodity prices like crude oil. However, we do acknowledge risks to our estimate to stem from the unusually high degree of volatility in global commodity prices especially crude oil prices which are currently hovering close to USD 120+ pb.

With the MPC clearly decisive in addressing inflation risks, we expect the RBI to raise repo rates by a cumulative 150-200 bps in FY23 taking the repo rate in the range of 5.5%-6.0% in FY23, well above the pre-pandemic level of 5.15%. Additionally, we also expect the central bank to rely on various monetary tools to support yields and ensure an orderly completion of government's record high borrowing program in FY23. From bond yields perspective, we now see 10Y g-sec yield moving higher towards 7.75-

8.00% range before the end of FY23 (our previous call of 7.25% with upside risk got breached right after the surprise rate hike in May-22).

Chart 3: The tide has turned on rates, cumulative 90 bps repo rise within a month



Rupee

Pressure intensifies

KEY TAKEAWAYS

- The Indian rupee has weakened for five straight months culminating into a depreciation of 4.4% in 2022 so far.
- The dollar is likely to continue deriving support from aggressive pricing in of monetary policy normalization in the US along with geopolitical led risk aversion.
- The combination of elevated global commodity prices, sequential improvement in domestic growth, and gradually increasing vaccination coverage is resulting in widening of trade and current account deficit for India.
- Portfolio outflow continues to persist for the eighth consecutive month with markets aligning to US monetary policy normalization and spike in commodity prices amidst ongoing geopolitical conflict between Russia and Ukraine.
- We expect India's current account deficit to widen to more than USD 90 bn in FY23 from an estimated level of USD 47 bn in FY22 amid persistent rise in crude oil price which has again risen to USD 120+ pb.
- While anticipated BoP deficit would weigh on INR in FY23, comfortable reserve cover and carry support would prevent excessive weakness.
- We expect rupee to depreciate moderately and project USDINR pair to touch 79 levels before Mar-23.

The Indian rupee has weakened for five straight months culminating into a depreciation of 4.4% in 2022 with levels currently hovering at 77.8 against the USD.

Chart 1: INR is currently trading close to its weakest levels

Notwithstanding the rupee depreciation seen already this year, global and domestic factors continue to point towards the likelihood of further moderate weakness.

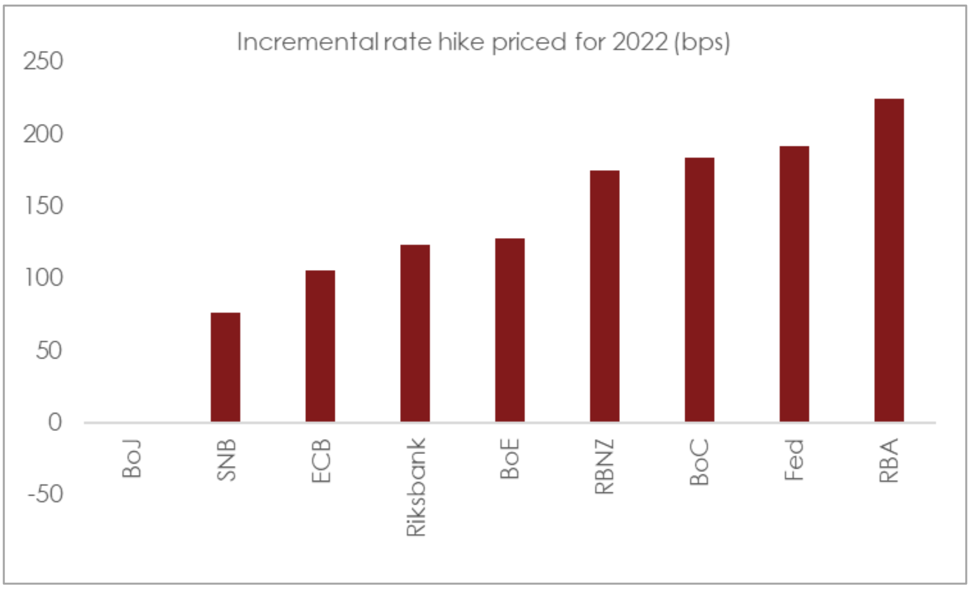
On the global front, dollar supportive environment continues to persist.

- High inflation is not just prompting the US Fed to start scaling back exceptional monetary policy accommodation provided since the onset of the pandemic in Mar-20, but it has also imparted policy aggression and urgency to tame inflation by projecting fed funds rate above the neutral rate by the end of 2023. The turn in US monetary policy cycle is critical as:
    - The Fed is poised to emerge as one of the most hawkish DM central banks in 2022. In its last policy review in May-22, the FOMC shrugged off the unanticipated contraction in Q1 2022 GDP data while acknowledging that "ongoing increases" will be required with Chair Powell appearing to be in support of a series of 50 bps rate hikes. As per the fed funds futures market, in the remaining months of 2022, the FOMC is projected to deliver cumulative of 192 bps hike. Since this will put the policy rate above its pre pandemic levels of 1.625%, the entire interest rate accommodation provided post COVID would then stand to get neutralized.
    - In line with market expectation, the Fed also announced the beginning of quantitative tightening to further address inflation risks. QT will commence from Jun-22 at a pace of USD 47.5 bn per month (USD 30 bn USTs and USD 17.5 bn Agency MBS) before getting to a "max" of USD 95 bn in Sep-22 (USD 60 bn USTs and USD 35 bn Agency MBS).

- The unwinding of the Fed balance sheet will reinforce the message of monetary policy normalization and would provide a supplementary tailwind to the USD.

- The ongoing geopolitical crisis between Russia and Ukraine has also cast its shadow on European currencies like the EUR, GBP, CHF, and SEK (comprising ~77% share in the DXY Index), which have weakened by 0.8-11.2% since the start of the conflict. Europe's greater economic linkage with Russia-Ukraine vis-à-vis US is acting as a supplementary source of dollar strength in the current environment.
  - Having said so, this leg of support is unlikely to have a long-lasting impact on the USD as inflation concerns have caught up in case of European nations

Chart 2: US Fed is likely to be one among the most aggressive in scaling back pandemic era monetary accommodation



On the domestic front, the BoP comfort is expected to peter out completely amidst the commodity price shock from the ongoing conflict between Russia and Ukraine.

- Assuming an average price of Brent oil at USD 100 pb levels, as the base case, we project current account deficit to widen to more than USD 90 bn in FY23 from an estimated level of USD 47 bn in FY22. The expectation of widening of current account deficit not just rests upon the likelihood of elevated global commodity prices, but is contingent upon the following factors:
  - Unlocking of the economy post the Omicron wave has begun to revive pent-up demand.
  - Improving vaccination cover (~70% of the population has so far received two doses) will limit future COVID led disruptions and aid organic recovery.
  - While PLIs would start accreting to export buoyancy in a gradual manner from FY23 onwards, we also need to be cognizant of continued

disruption due to COVID (of late there is resurgence in infections in South Korea, Vietnam, Japan, China, Germany, etc.).

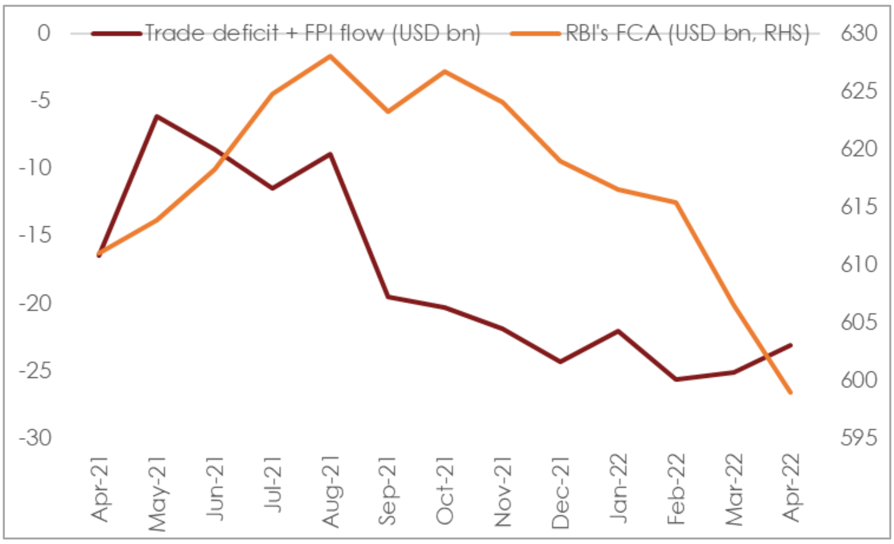
- The pressure on trade deficit is increasing at a time when portfolio outflows have remained persistent since Oct-21. In the last eight months, Indian markets have seen a cumulative portfolio outflow of over USD 28 bn. Elevated domestic equity valuations, surge in global commodity prices on account of geopolitical conflict, aggressive normalization of US monetary policy, and lack of any commitment from the FY23 Union Budget with respect to India's inclusion in global bond indices could keep portfolio flows subdued in the near term.
- As such, we expect FY23 BoP to register a moderate deficit to the tune of USD 8 bn. However, there could now be risk of further widening of the BoP deficit if non portfolio flows also moderate (we note that FDI inflow moderated to a 3-year low of USD 39.3 bn in FY22 while ECBs could moderate amidst tightening of global financial conditions).

While reserve buffer and rupee's carry appeal remain supportive, there has been some let up in both in the last one month:

- India's FX Reserves (including net forward reserves) appears comfortable at ~13 months of import cover and provides the first line of defense against excessive volatility, it is slowly moderating amidst widening of current account deficit and persistent portfolio outflows.
- After remaining above 600 bps (highest in over two decades) for six consecutive months, India's long term (10Y) sovereign real yield spread vis-à-vis the US has moderated to 471 bps in Apr-22 on the back of sharp rise in domestic inflation.

We continue to expect further mild depreciation in rupee in FY23, with a move in USDINR towards 79 levels (vs. our earlier call of 78) before Mar-23.

Chart 3: India's foreign currency reserves have been moderating amidst widening of trade deficit and ongoing portfolio outflows



Global Overview

The going gets tough

KEY TAKEAWAYS

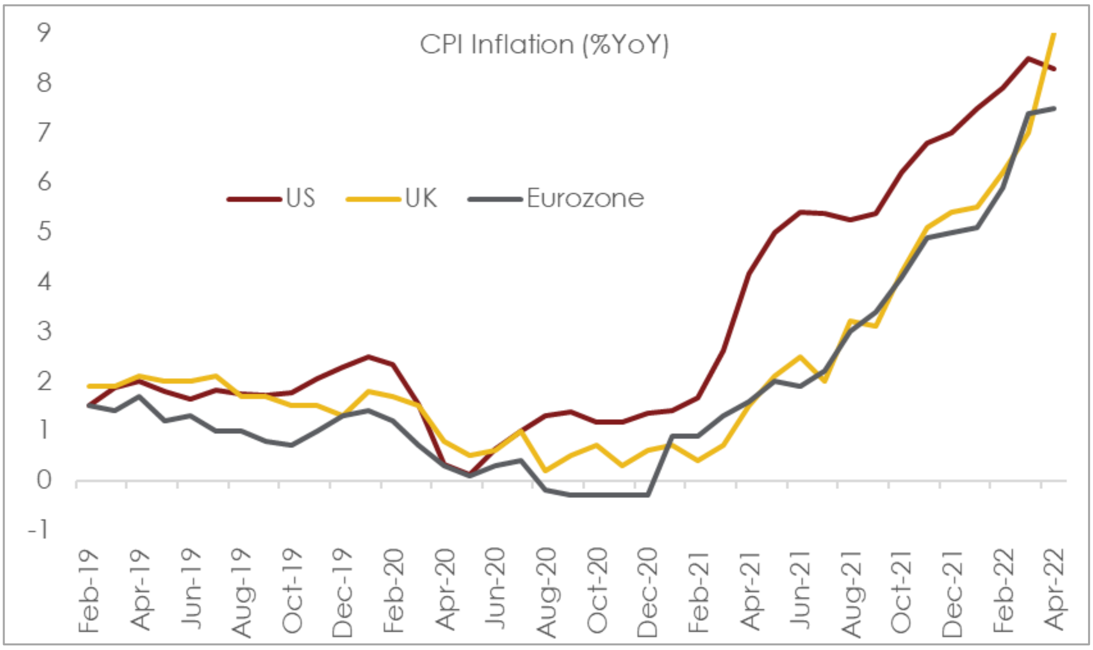
- The global economy continues to grapple with the effects of the Russia-Ukraine crisis, now running in its fourth month.
- The conflict has upended the still fragile economic recovery from the Covid pandemic.
- The surge in food and commodity prices, have exacerbated inflationary pressures across developed and emerging markets amidst escalating downside risks to growth.
- The economic consequences from China's lockdowns too are starting to be felt by companies and consumers across the globe, more fervently now.
- According to UN's latest World Economic Situation and Prospects report, the global economy is expected to grow by 3.1% in 2022, down from 4.0% projected in Jan-22.
- Reacting to the elevated inflation, monetary policy action across has become increasingly synchronised across both advanced and emerging market economies, with rate tightening cycle now firmly in place.

Global overview

The global economy continues to grapple with the effects of the Russia-Ukraine crisis, now running in its fourth month. The conflict has upended the still fragile economic recovery from the COVID-19 pandemic. The surge in food and commodity prices, have exacerbated inflationary pressures across developed and emerging markets amidst escalating downside risks to growth. The economic consequences from China's Covid-19 lockdowns too are starting to be felt by companies and consumers across the globe more fervently now.

Against this war backdrop, inflation continues to remain elevated in most advanced economies. The US CPI inflation eased marginally to 8.3%YoY in Apr-22 from 8.5% in Mar-22, owing to a decline in sequential energy prices. UK CPI surged to the highest level in more than 40 years coming in at 9.0%YoY in Apr-22 led by rising cost of gas and electricity. Euro area inflation too touched a fresh peak of 7.5%YoY in Apr-22 driven by energy prices along with food, alcohol and tobacco. Among high frequency indicators, global composite PMI index slipped to 51.0 in Apr-22 to mark a 22-month low, compared to 52.7 in Mar-22. Both services and manufacturing PMI's eased, with the latter slipping to a 20-month low weighed down by lockdowns in China. According to UN's latest World Economic Situation and Prospects report, the global economy is expected to grow by 3.1% in 2022, down from 4.0% projected in Jan-22. Growth forecasts for the United States, EU and China have been revised downward, with the EU registering the most significant downward revision.

Chart 1: Inflation continues to remain elevated in advanced economies, pushing central banks to normalise monetary policy quickly



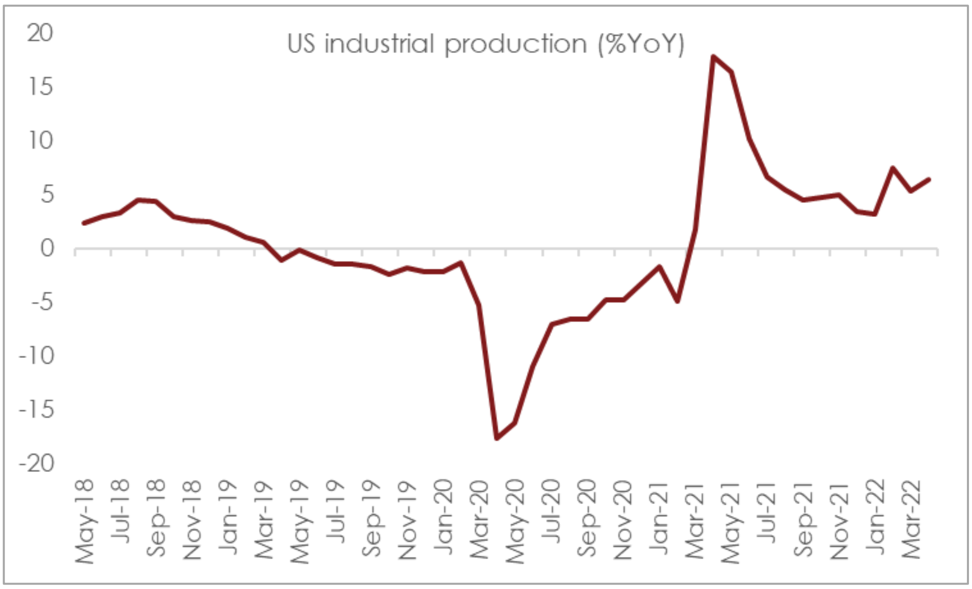
Reacting to the adverse growth-inflation dynamics, monetary policy action across has become increasingly synchronised across both advanced and emerging market economies, with rate tightening cycle now firmly in place. In line with market expectations, the Federal Reserve raised the policy rate by 50 bps to 0.75-1.0%, the first 50 bps hike since May-20. The Bank of England (BoE) raised its policy rate by 25 bps to 1.0% - the highest level since Feb-09, to take the cumulative rate tightening in this cycle to 90 bps now. In addition, the Bank of Canada and the Reserve Bank of New Zealand raised their policy rates by 50 bps each in Apr-22 to 1.0% and 1.5%, respectively along with a host of EM central banks following suit including Brazil, Poland, Peru and India.

US

Incremental macroeconomic data continues to underscore the economic recovery underway. US retail sales rose a tad below expectations by 0.9%MoM in Apr-22, accompanied by substantial upward revision to Mar-22 expansion to 1.4%MoM from 0.5% earlier. In addition, industrial production for Apr-22 rose by 1.1%MoM versus consensus expectation of 0.5%. Further, non-farm payrolls surged by 428k in Apr-22 to beat market consensus of 391k jobs by a fair margin. The Apr-22 additions matched the revised payrolls additions for Mar-22. The gains were however broad-based, led by sectors of leisure and hospitality, manufacturing, transportation and warehousing. Meanwhile, the unemployment rate remained unchanged at 3.6%.

On a somewhat positive front, US annualised CPI inflation eased marginally in Apr-22 to 8.3% from 8.5% in Mar-22. On a sequential basis, the index rose by 0.3%MoM, down from 1.2% in Mar-22 to mark the first fall since Aug-21. Despite this reprieve, inflation continues to remain close to a 40-year high with momentum in core inflation remaining firm in Apr-22.

Chart 2: US industrial production continues to underscore the post-COVID recovery underway, though downside risks are mounting



In a bid to tame the elevated inflation, the Fed raised its benchmark interest rate by 50 bps to a target rate range of 0.75-1.0%, to mark the largest hike since 2000. Cumulatively, the Fed has hiked by 75 bps since it commenced its rate tightening cycle in Mar-22. As per the Fed Chairman Powell, *"Inflation is much too high and we understand the hardship it is causing. We're moving expeditiously to bring it back down"*. In his more recent commentary, Powell indicated that getting inflation under control would cause some economic pain but it remains top priority. He further indicated that a soft landing will be quite challenging to accomplish. Underscoring the faster increase in rates that Fed has indicated, Federal Reserve Bank of Cleveland President Loretta Mester, a voting member on the FOMC, recently said that a 75 bps hike could not be ruled out later this year.

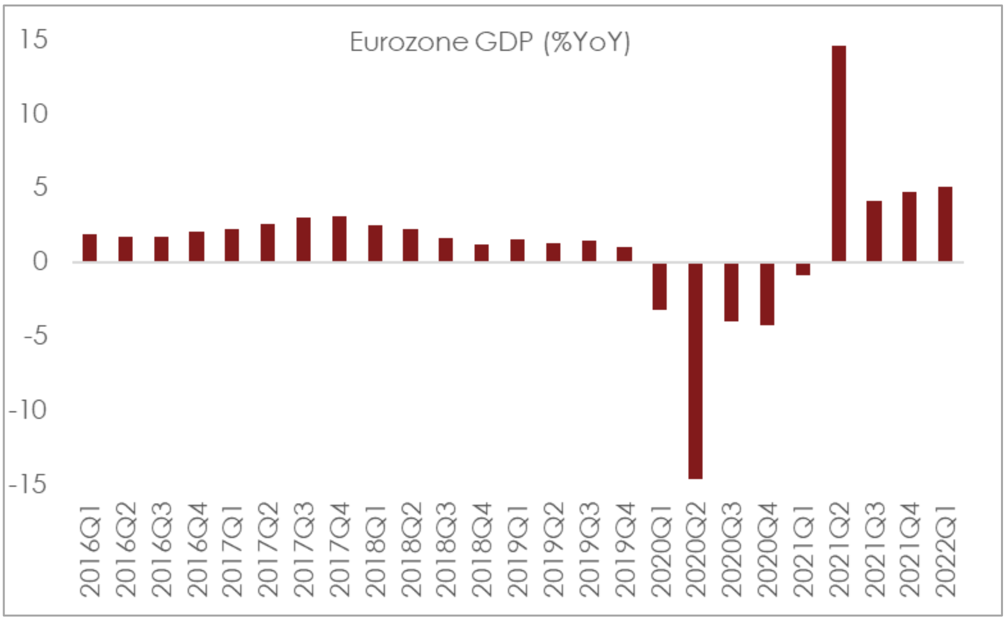
EUROZONE

Despite Omicron wave and the outbreak of the Russia-Ukraine crisis, the Eurozone economy managed to grow in Q1-22. The GDP expanded by 0.3%QoQ, to match the rate of growth of Q4-21. On an annualised basis, the economy grew by 5.1% to fare slightly above market consensus of 5.0% and Q4-21 growth of 4.7%.

As per the latest forecasts from European Union, the Eurozone economy is likely to grow at 2.7% in 2022 and 2.3% in 2023, both revised lower from 4.0% and 2.7% respectively, capturing the impact of the ongoing war. Retail sales fell by -1.3%MoM, more than expected in Apr-22, adding to fears of elevated inflation weighing on consumer spending. The European Commission's consumer confidence index fell to a 2-year low in Apr-22.

While ECB in its Jun-22 policy meeting kept interest rates unchanged, it confirmed its intention to hike interest rates by 25 bps at the policy meeting next month and downgraded its growth forecasts. It also expects a further hike at the September meeting but said the scale of that increment would depend on the evolving trajectory of the medium-term inflation outlook. On the other hand, headline inflation creeped up further accelerating to 8.1%YoY in May-22 (vs. 7.5% in Apr-22). This is likely to be fast changing ECB's narrative.

Chart 3: Q1-22 growth in Eurozone withstood the impact of the Omicron wave and the outbreak of Russia-Ukraine war



UK

The UK economy grew by 0.8%QoQ in Q1-22, with the output level surpassing the pre-COVID level by 0.7%. On a monthly basis, after a pickup in growth in Jan-22

(+0.7%MoM), output was flat in Feb-22 followed by a marginal contraction in Mar-22 (-0.1%MoM). In terms of growth drivers, Q1-22 growth was driven by build-up in inventories along with investment, which was offset by a wider trade deficit while consumer spending remained largely subdued.

UK jobs market continues to remain hot, with the unemployment rate easing to 3.7% - to fare better than pre-COVID lows. In the labour market, there is now one job vacancy for every unemployed worker, for the first time in last two decades. On the inflation front, the upside pressure remained intact with CPI inflation accelerating further to 9.0% in Apr-22 from 7.0% in Mar-22. At a 40-year high, inflation was driven by higher transport and food costs, along with a reversion of VAT on hospitality industry to 20% (from 12.5%). The unrelenting increase in price pressures further weighed on GfK consumer confidence index, that fell further to -40 in May-22 i.e., the lowest level in nearly 50 years.

The BoE expects inflation to continue to rise over the remainder of 2022. It expects CPI at over 9% in Apr-Jun-22 and to peak thereafter at around 10% in Q4-22. It also expects growth to slow in Q2-22 and has raised the prospect of recession this year. In its May-22 meeting, the BoE decided to continue normalising monetary policy, raising its key interest rate by 25 basis points to 1.0%. This is the fourth consecutive rate hike since Dec-21, taking cumulative rate hikes to 90 bps. Based on an updated assessment of the economic outlook, most members of the Committee believe that a further tightening of the monetary policy may still be appropriate in the coming months.

CHINA

Apr-22 incoming data for China underscored exacerbating pressures on growth, amidst continued lockdown in Shanghai. Retail sales contracted by a deep 11.1%YoY compared to a contraction of 3.5% in Mar-22. Industrial production too contracted by 2.9%YoY from a healthy growth of 5.0% in the previous month. The jobless rate jumped up to 6.1% from 5.8% in Mar-22.

Policies adopted by Chinese authorities since mid-Mar-22 to contain the spread of virus have led to extended lockdowns in the commercial hub of Shanghai stretching for over two months now. As per recent government commentary, COVID related restrictions are likely to see piecemeal relaxation, with a resumption of normal activity likely only by mid Jun-22. However, any recovery is likely to be slow with industrial GDP growth in Q2-22 likely to dip into a contraction.

In a bid to support the economy and the property sector specifically, China cut its main mortgage rate (i.e., the 5-year prime loan rate) from 4.6% to 4.45% to mark the sharpest reduction on record. This is likely to reduce the borrowing costs on outstanding mortgages across the country. Fitch Ratings cut its forecast for China's 2022 GDP growth to 4.3%, from 4.8%. This is lower than the "around 5.5%" growth target that the Chinese government had announced earlier this year in Mar-22. Meanwhile, the agency revised its 2023 growth forecast slightly higher to 5.2%, from 5.1%, on the assumption that the government will phase out its 'dynamic zero-Covid' policy only gradually over the course of next year. Despite the anticipation easing of monetary policy and a loose fiscal policy, growth slowdown in China in 2022 appears to be inevitable looking at current trends.

Corporate Sector Snapshot: FY20-22

The tale of Resilience & Recovery

Corporate India cleared the pandemic test but the emerging inflation test may be tougher

Acuité has undertaken a comprehensive analysis of the financial performance of 1370 listed non-financial companies (referred to as the group) over the two year pandemic period i.e. FY21 and FY22. The objective of the aggregated analysis has been to decipher the revenue and the profitability trajectory of the overall corporate sector since the beginning of the pandemic to the end of the third wave. We have also made an effort to understand the trend of leverage and capital expenditure in this group. Additionally, we have also undertaken a segment-wise analysis of the respective financial performance in the manufacturing, services, and the other sectors. Lastly, we have attempted to understand the dynamics of the MSME businesses in this group.

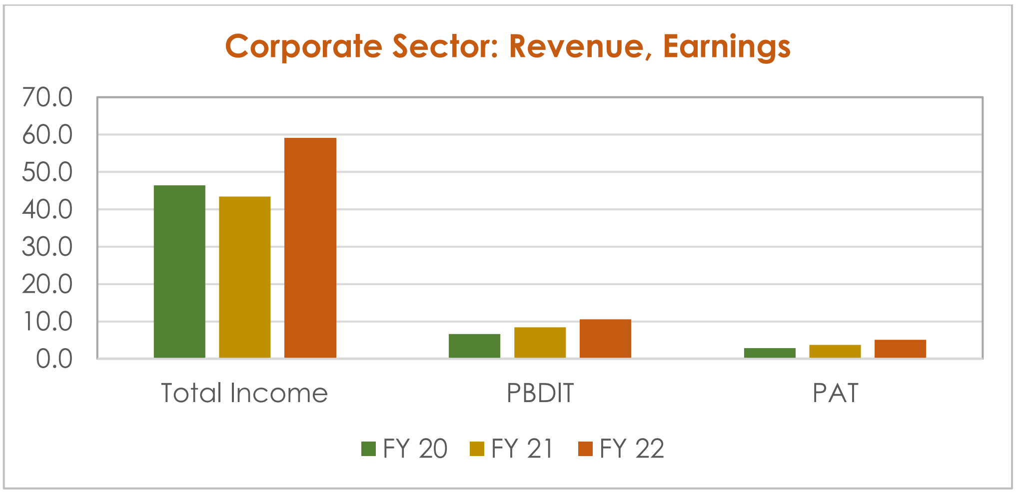
Key Messages

- While the Indian economy has seen a serious disruption due to multiple waves of the Covid pandemic and the consequent lockdowns over FY20-22, the financial performance of the corporate sector reflects its resilience to the challenges in the operating environment and its ability to recover from the early struggles.
- The healthy CAGR of 12.8% in total revenues and the strong CAGR of 34.8% in net profits for the group of 1370 listed companies highlights the opportunity that was available to the corporate sector due to lower commodity and lower operating costs. While the sharply increased operating margins in FY21 moderated in FY22, the average net margins were retained at a strong 8.6%.
- India Inc has seen a gradual deleveraging over the 2-yr period with the leverage of the sample group improving to 0.54 times from 0.60 times. This, however, has been primarily driven by the manufacturing sector where the absolute levels of debt has dropped over the 2-yr period. On the other hand, the services segment has witnessed a perceptible rise in leverage to 0.84 times due to an increase in debt intake through schemes such as ECLGS to support the shortfall in the operating cash flows in some of the businesses.

- As against the general perception that capital expenditure of Corporate India has been minimal in FY21 & FY22, our analysis shows that 56% in our sample of listed companies have incurred moderate to large capital expenditure over this period. Most of this capex, however, has been funded by internal accruals as evident from the leverage and the debt figures.
- The data in our sample also throws some interesting insights on the MSME sector. With a 2-yr revenue CAGR of 13.4% and a PAT CAGR of 63.7%, the uptick in the MSME sub-set has been more significant than the large corporate set. While the extent of improvement in the operating and the net margins has been slightly lower than in the large corporate sector, it reflects a healthy revival in the MSME sector. The distribution of leverage reveals that only 8.3% of the MSME listed companies have a leverage of over 1.5 times which can lead to a potential stress over the medium term.

Part I. Overall Corporate Sector

Chart 1: Total Revenue, PBDIT and PAT for the Group over FY20-22 in Rs Lakh Cr



On an aggregated basis, revenues of the group slipped by only 6.4% in the first year of the pandemic (FY21) and recovered sharply by 36.0% in FY22 despite the second and third Covid wave, effectively translating into a CAGR of 12.8% revenue growth over the 2-yr period.

The distinguishing element of corporate performance during this period, however, has been on the profitability front. Both operating profit (PBDIT) and net profit (PAT) have consistently grown over the last 2 years with a CAGR of 26.6% and 34.8% respectively, clearly one of the highest growth in any two year block over the last couple of decades.

As regards operating margins and net margins, the group witnessed an uptick of over 500 bps and 250 bps respectively in FY21 vs FY20. However, such high operating margins could not be sustained in FY22 due to the firming up of commodity prices, dropping thereby by 130 bps vs FY21. Nevertheless, the net margins have continued to hold on in FY22.

Largely, the improvement in the corporate sector margins over the 2 yr pandemic period has been driven by cost efficiencies and rationalization measures which significantly offset any impact of slower revenue growth.

Chart 2: Operating and Net Margins for the Group over FY20-22

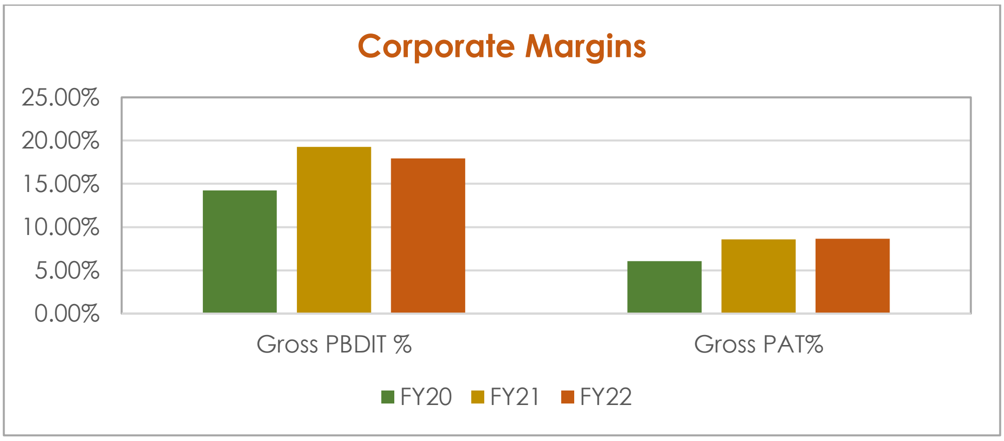


Table 1: Segmental data on revenues and profitability

Sectors	Nos	Share #s	Revenue	PBDIT	PAT
FY20-22			CAGR	CAGR	CAGR
Infrastructure	27	2.0%	8.1%	4.8%	15.5%
Manufacturing	950	69.3%	14.0%	24.8%	40.6%
Services	298	21.8%	8.9%	51.7%	26.4%
Trading	95	6.9%	12.5%	12.1%	25.4%
Total	**1370**	**100.0%**	**12.8%**	**26.63%**	**34.8%**

The group selected for analysis clearly has a bias for the manufacturing sector as this is the reflection of the overall listed entity portfolio. The manufacturing sector has grown its topline at a faster pace of 14.0% in FY20-22 as compared to the services sector @8.9% which can be explained by the disproportionately larger impact of the pandemic on the services businesses particularly those which are contact intensive. Clearly, manufacturing has been relatively resilient and demand has been driven also by sustained export growth over the last 2 years in certain product categories such as pharma and chemicals.

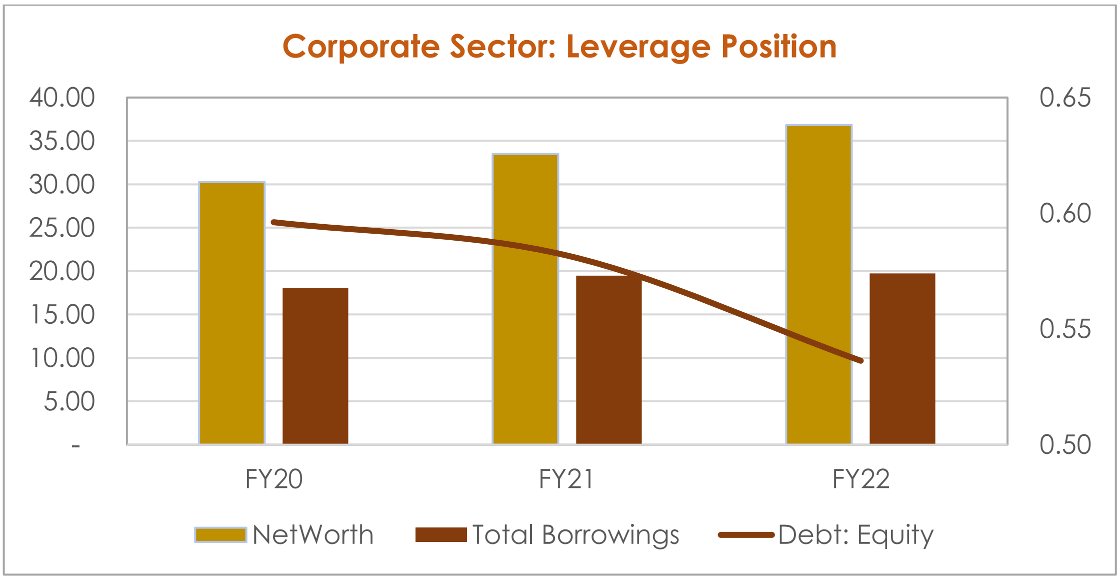
Table 2: Segmental data on corporate margins

	PBDIT Margin		PAT Margin	
Sector	FY20	FY22	FY20	FY22
Manufacturing	**12.3%**	**14.7%**	**5.3%**	**8.0%**
Services	**15.3%**	**29.7%**	**8.1%**	**10.9%**
Trading	7.8%	7.8%	2.5%	3.1%
Total	**14.2%**	**17.9%**	**6.1%**	**8.7%**

It is interesting to note the significant jump in the operating margins of the services sector despite the effect of the pandemic. The average operating margins rose sharply to 24.4% in FY21 and further to 29.7% in FY22. This is primarily driven by the significant recovery in the operating profitability of large telecom sector companies through tariff rationalization as also the improved volumes in the healthcare sector after the unlocking of the mobility restrictions.

The margin improvement in the manufacturing sector has been less sharp although in terms of absolute figures, the aggregate PBDIT in the 950 companies increased by 55.7% between FY20 and FY22. The key driver for the margin enhancement has been clearly the lower raw material and other operating costs in the larger part of the pandemic period. With the spurt in global commodity prices particularly after the geo-political crisis, such margins will clearly not be sustainable.

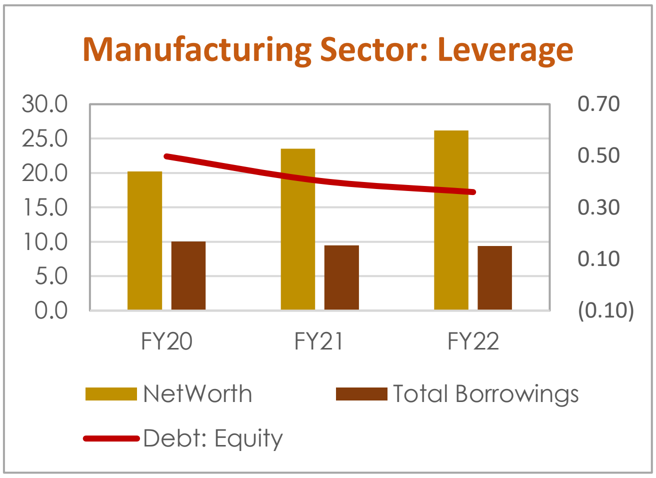
Chart 3: Moderate improvement in leverage

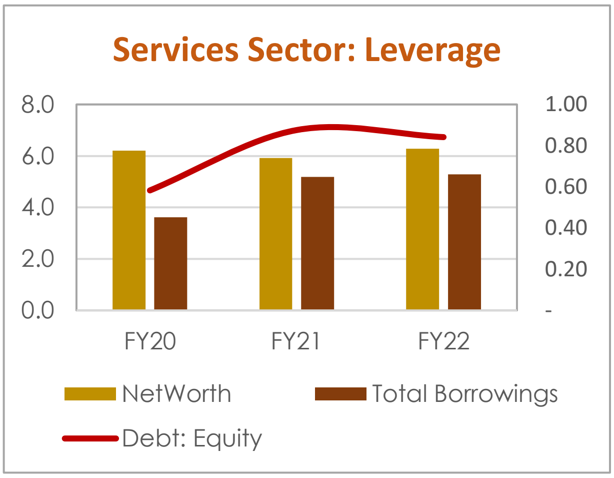


The deleveraging story in the corporate sector is borne out through the aggregated data with the overall leverage improving from 0.60 times as on Mar-20 to 0.54 times as on Mar-22. What has driven the improvement is the higher profitability and the cash accruals which have led the cumulative networth to climb up by 21.7% over the 2-yr period. While debt has increased to a moderate extent by 9.5%, a significant part is possibly due to the drawal of ECLGS loans were made available at a competitive rate.

From a segmental perspective, the trajectory of leverage is however, distinctly different in the case of manufacturing and services. For manufacturing companies, the average leverage has dropped to a larger extent from 0.50 times as on Mar-20 to 0.36 times as on Mar-22. Importantly, the absolute level of debt has decreased by 6.4% over FY20-22 for the set of 950 companies in our sample, highlighting the redemption of long term debt through operating cash flows.

Chart 4: Contrasting leverage trajectory in manufacturing vs services

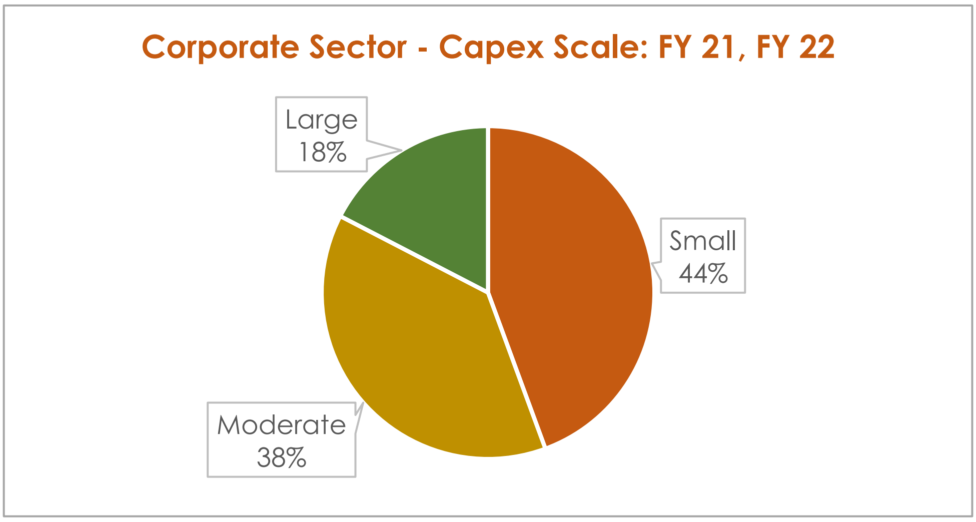




However, the scenario is different for the services businesses where the leverage has actually increased from 0.58 times as on Mar-20 to 0.84 times as on Mar-22. The gross borrowings in the services sector have actually increased by 46.0% during this period which reflects the raising of additional debt through schemes like ECLGS to fund the gap in the operating cashflows arising from the pandemic disruption. Clearly, the additional debt taken during the pandemic period will need to be repaid over the next 1-2 years and from that perspective, the revival in their respective markets will become critical. Our analysis shows that 8% of the services companies in our sample have a leverage over 1.5 times as on Mar-22 and may witness a deterioration in credit quality if their businesses don't see an adequate revival in the near to medium term.

In our analysis, we have also attempted to capture the corporate capex trajectory during the pandemic period. We computed the capital expenditure incurred by this set of 1370 companies over the FY20-22 period and looked at it from the materiality perspective vis-à-vis the net fixed assets as on Mar-20. Using a defined criterion, we thereafter categorised the capex into small, moderate and large buckets.

Chart 5: Corporate Capex Trajectory



The net fixed assets of the Group has grown modestly by 4.5% over the 2-yr period which is largely in line with expectations in a pandemic disrupted and muted demand environment. But our analysis shows that 56% in the Group have incurred moderate to large capital expenditure over this period. Most of this capex, however, has been funded by internal accruals as is observed from the leverage and the debt figures.

Part II. Dynamics of the MSME Sector

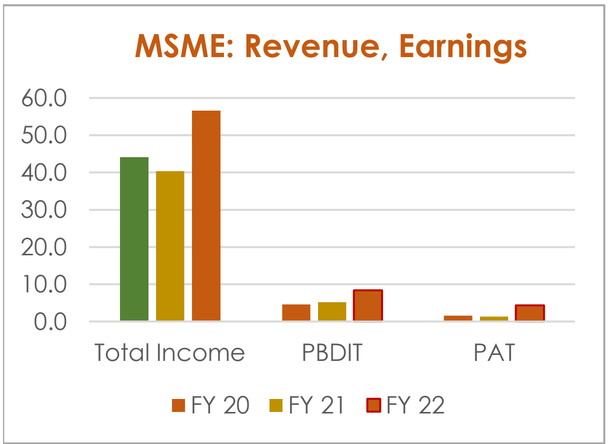
The last part of our analysis is focused on the performance of the listed MSME companies during the pandemic period. We have categorised MSMEs broadly in line with their revised definition i.e. average annual revenues less than Rs 250 Cr over FY20-FY22. The total numbers of such companies stood at 518 among the group size of 1370 companies with a slightly larger proportion of services and trading companies as compared to the overall portfolio.

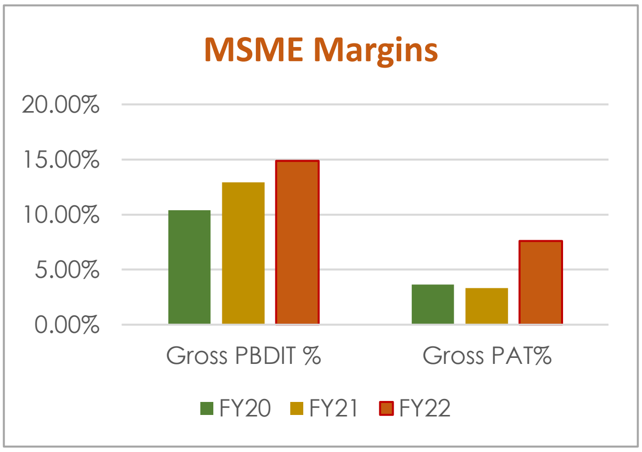
Table 3: Segmental data on revenues and profitability for MSME sector

Sectors	Nos	Share #s	Revenue	PBDIT	PAT
FY20-22			CAGR	CAGR	CAGR
Manufacturing	320	61.8%	15.3%	30.1%	60.3%
Services	140	27.0%	6.0%	30.8%	40.1%
Trading	58	11.2%	23.5%	-	-
Total	**518**	**100.0%**	**13.4%**	**35.6%**	**63.7%**

The data reveals that the recovery of the overall MSME sector has been more significant than the large corporate set with a 2-yr revenue CAGR of 13.4% and a PAT CAGR of 63.7%. Some of the trading businesses were actually incurring losses before the pandemic due to the economic slowdown and the supply bottlenecks have given them an opportunity to improve on their performance.

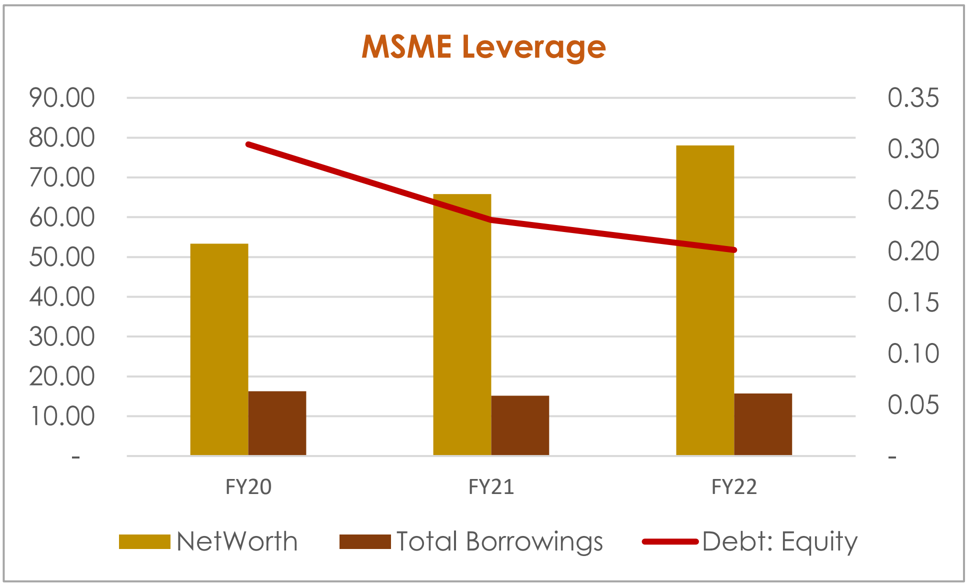
Chart 6: MSME Sector Performance





While the extent of improvement in the operating and the net margins have been slightly lower than in the large corporate sector, it is perceptible and reflects a healthy revival in the MSME sector as well.

Chart 7: MSME Leverage Trajectory



The average leverage in the MSME segment has declined to 0.20 times as on Mar-22 which is significantly lower than that in the overall corporate sector (0.54 times). The distribution of leverage reveals that only 8.3% of the MSME listed companies have a leverage of over 1.5 times which can lead to a potential stress over the medium term.

While the data in the current listed sample may not be reflective of the entire MSME ecosystem, it does highlight that the stress among the listed companies is quite limited after the recovery in FY22.

Concludes Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research, "The performance of the corporate sector over the last 2 years has clearly surprised on the upside given the severe impact of the prolonged pandemic on lives and livelihood and has been instrumental in the economy recovery seen in FY22. Some of the businesses particularly in the manufacturing sector have been fairly resilient and actually strengthened their financial performance during this 2-yr period while most of the others staged a significant recovery by end of FY22. While the corporate sector capitalized on the available supporting framework in terms of access to additional funds and lower interest costs, it has been also largely prudent in the intake of debt. Contrary to the general perception of an absence of capex, we have observed that the majority of the companies in the sample have undertaken moderate capex during this period which has been mostly funded through internal accruals. Lastly, our study doesn't indicate any material stress in the MSME sector except in a section which is engaged in contact intensive services and have availed additional debt (ECLGS) that needs to be repaid over the near term. In our opinion, corporate India has cleared the pandemic test successfully but they have been immediately subjected to another tough test –severe inflationary pressures and sharply higher cost structures that may be difficult to pass through."

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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