MACRO PULSE

OCTOBER 2021

Contents

From the desk of the Chief Analytical Officer

Let me first wish you and your family the best of health and prosperity on the auspicious occasion of Deepavali! The **tenth edition** of **Acuité Macro Pulse (Oct 2021)** is being released just in the peak of the festive season which has clearly brought in a level of optimism in the economy that we haven't seen for the last two years.

Most economists believe that the economy is finally coming out of the shadows of the Covid pandemic and we will get to witness a return of normal 'consumption demand' along with the play of 'pent up demand' in some contact intensive sectors. There is indeed a reason to believe that the Covid pandemic is largely behind us with continuous progress in vaccinations and the gradual decline in daily mortalities not only in India but also on a global level except for a recent spurt in nations like Russia. As regards India, the mortalities per day have sharply dropped from over 5,000 in the peak of the second wave in May'21 but seems to have got stuck to a band of 200-400 per day over the last one month. What is encouraging however, is the trajectory of daily caseloads in India with a seven day moving average of around 12,000-13,000 in early Nov in the peak of the festive season and in an environment where most of the lockdown restrictions have been removed, making us hopeful of much lower risks of a fresh wave. The data print on vaccination has continued to be robust – India has already reached the landmark of administering 1 bn vaccine doses for Covid-19 in Oct-21 (1.06 bn as on last month end). As on Oct 31, 2021, 52.6% of India's population has already been vaccinated by single dose and 23.6% by both doses, enhancing the likelihood of partial vaccination of at least 75% of the population by the end of the calendar year. With such a progress in vaccination and the pick up in the contact intensive sectors, the ongoing revival in private consumption, a favourable kharif crop estimate, continuing buoyancy in exports and also the accommodative policy environment, we continue to stick to our FY22 GDP growth forecast of 10.0%.

But there are a few headwinds which can slowdown the speed of economic recovery. While we retain our headline CPI inflation forecast at 5.5% for FY22 given the benign food inflation and the favourable kharif crop estimates, downside risks to that forecast are not insignificant due to continuously high crude oil and other commodity prices along with the emergence of industrial raw material shortages starting from semi-conductors to coal. While the Government has taken a few steps like the excise duty cut on petrol and diesel along with the import duty cuts earlier on edible oils, we believe there is a significant likelihood of a pass through of higher production costs to retail prices in some product segments particularly if pent up consumption demand plays out over the next 2 quarters.

Along with our regular coverage on the key macroeconomic variables spread over six chapters, we have included a **special chapter on the emerging landscape in the Passenger Vehicle market in India with the advent of the Compact SUVs**. The latter has become a gamechanger and has already captured a part of the market share of Passenger Cars. Hope you will enjoy reading this edition while celebrating the festival days. Cheers,

Suman Chowdhury
Chief Analytical Officer

Growth

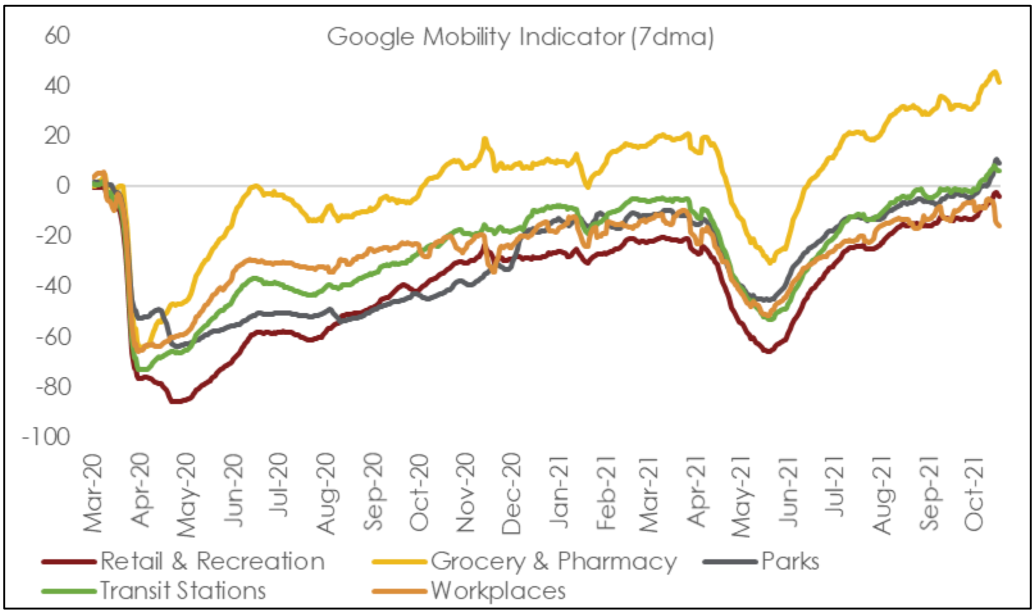
Gradual normalization underway

KEY TAKEAWAYS

- Growth recovery continues to linger into Oct-21, aided by the festive season
- Although incremental momentum has eased, encouragingly a large number of high frequency indicators have now recovered (or are close) to pre-pandemic levels.
- Easing of restrictions on economic activity has allowed an impressive improvement in mobility, especially to 'Parks' and 'Transit Stations' while encouragingly, Covid cases continue to trend lower, currently less than 15k (on a 7 day moving average basis)
- The progress on vaccinations, with more than 53% of the population having received the first jab, is slowly but steadily building confidence, auguring well for recovery in consumption of both goods and services.
- Further, amidst global support to domestic exports, anticipation of a record Kharif production and support from fiscal and monetary policies, we continue to hold on to our FY22 growth forecast of 10.0% (albeit with some downside risks).
- We remain mindful of risks from global supply chain disruptions, elevated commodity prices, recent global energy crisis and potential financial market volatility as key central banks begin to normalize monetary policy. Another wave of Covid still remains a possibility, though the economic fallout could be much lower.

India's growth recovery post the second wave of Covid infections continues to linger into the month of Oct-21, aided by the onset of the festive season. Although incremental momentum as eased, encouragingly a large number of high frequency indicators have now recovered (or are close) to pre-pandemic levels. Easing of restrictions on economic activity, has also allowed an impressive improvement in mobility. More recently, Google mobility for the purpose of 'Parks' and 'Transit Stations' moved into positive i.e., above the baseline for the first time since the onset of the pandemic. In further support, Covid cases continue to trend lower, currently less 15k (on a 7-day moving average basis) – a level last seen in early Mar-21. The progress on vaccinations, with more than 51% of the population having received the first jab is slowly but steadily building confidence, auguring well for recovery in consumption of both goods and services.

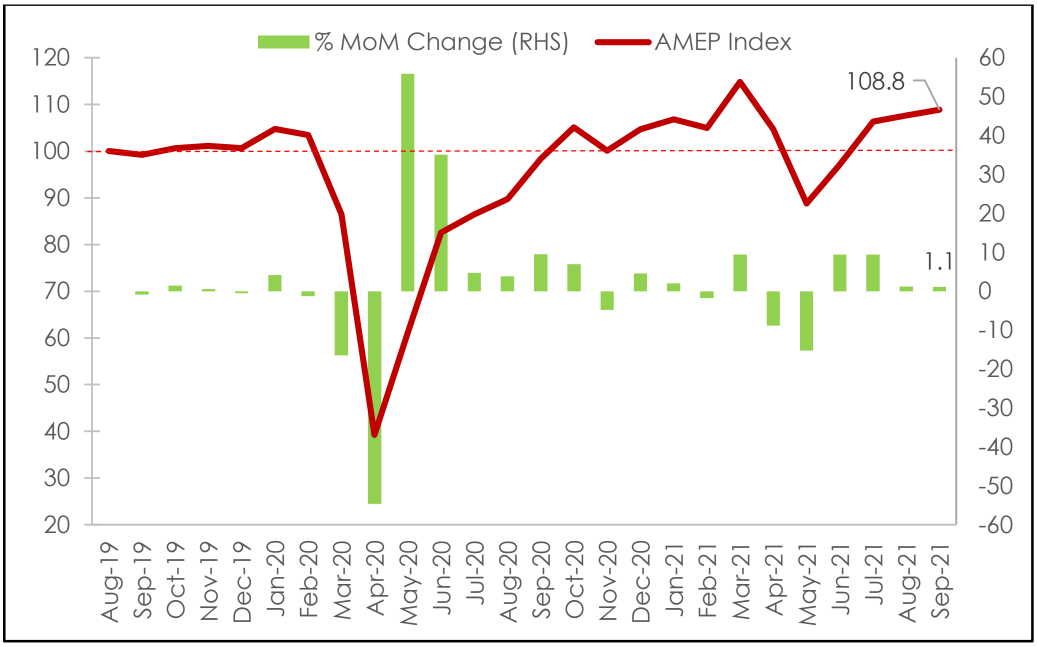
Chart 1: Mobility for 'Parks' and 'Transit Stations' moved passed the baseline, for the first time since onset of the pandemic



Acuité Ratings had launched its proprietary monthly **Macroeconomic Performance Index (AMEP)** in Oct-21, the objective of which is to track the monthly momentum in the Indian economy in the aftermath of the Covid pandemic. The index has been constructed deploying sixteen high frequency indicators encompassing a wide spectrum of domestic economic activities across four major categories – consumption demand, industrial production, external sector, and employment.

The trajectory of AMEP in the current year reflects two aspects clearly – one, the impact of the second Covid wave was less severe from the economic perspective with the index in May-21 higher than the index levels in each of the months Mar-Jul'20, the severe period of the first Covid wave. Secondly, post the disruption caused by the second Covid wave, most of the economic activities have recouped their lost momentum as reflected by the average value of the index in Q2FY22 at 107.6, almost touching the average of 108.9 seen in Q4FY21, the latter partly driven by the spike in activity in Mar-21 just before the second wave. After trailing below 100 for two consecutive months in May-Jun 21 due to the intense second Covid wave, AMEP index went well beyond that level from Jul-21 and stands at 108.8 in Sep-21 which is not only10.7% higher YoY but also 9.7% higher than the pre-pandemic level at Sep-19.

Chart 2: While AMEP index ticked up in Sep-21, the recovery momentum has slowed



The uptick of 11.1%QoQ in the average index in the second quarter of the current fiscal has been primarily driven by a pickup in industrial activity. However, the sequential momentum of the index has clearly slowed with index growing by 1.1%MoM in Sep-21 and 1.2%MoM in Aug-21 from 9.5% MoM in Jul-21. Only 9 of the 16 high frequency indicators have shown a positive sequential growth in Sep-21, reflecting the fact that the strength of the economic recovery is currently moderate.

High frequency lead indicators: A granular look at recovery

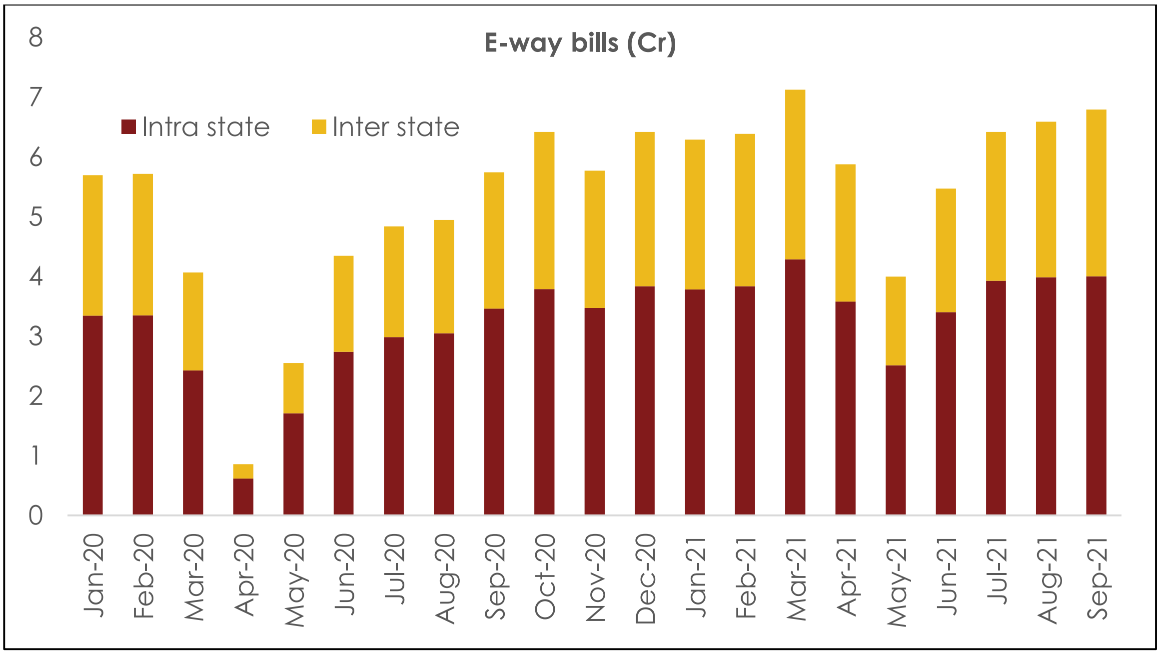
On a monthly basis, high frequency indicators underscore sequential recovery continuing into the months of Sep/Oct-21, though the pace of improvement has somewhat slowed down, as activity levels inch closer to/surpass pre-pandemic levels. To put this in perspective –

- India's IIP growth rose a tad in Aug-21 to 11.9%YoY from 11.5% in Jul-21, largely in line with market expectations. The expansion was entirely the outcome of a favorable base, as sequentially the index contracted by 0.2%MoM after posting a strong momentum over Jun-Jul-21. On sectoral basis, mining and manufacturing sectors contracted sequentially, with electricity being the lone sector in expansion. On use-based basis, in similar vein, annualized growth driven by a positive base masked the weak sequential performance across sub-sectors. Nevertheless, Aug-21 IIP index was 4.0% above Aug-19 levels, reflecting an expansion of IIP output on a 2-year basis; underscoring the completeness of headline industrial recovery vis-à-vis pre-pandemic levels.
- PMI manufacturing index rose to an 8-month high of 55.9 in Oct-21 from 53.7 in Sep-21, as the manufacturers scaled up production in anticipation of improvement in demand ahead of festive season. The Oct-21 upside was led

by a recovery in new orders and output sub-indices. However, rising fuel, raw material and transportation prices also pushed the overall pace in input costs to an eight-year high. On the other hand, output prices rose at a slower pace, continuing to impinge on producer margins.

- The latest PMI services index has shot up to a 10 year high of 58.4 in Oct-21 after remaining in expansion in Sep-21 at 55.2, albeit at a slower pace compared to 56.7 in Aug-21. The index has surpassed pre-pandemic level with support from recovery in demand amid easing of COVID related restrictions.
- GST collections remained about the Rs. 1.1 trn mark in Oct-21, 24% higher compared to same period last year.

Chart 3: E-way bills continue to rise sequentially



Outlook

The following factors are expected to support the growth momentum -

- Festive season augmenting pent-up demand for both goods and services; the gradual easing of Covid related restrictions has seen a strong revival in demand for services like tourism, travel, dining etc. We expect a further impetus to our **Acuité Macroeconomic Performance (AMEP) index** from Oct-21 with further easing of restrictions in contact intensive sectors and several states opening up schools and recreational services, leading to personal mobility (as per google mobility data) to surpass Feb-21 levels across nearly all location sub-categories.
- While the vaccination momentum has eased in Oct-21 so far, with the daily pace of vaccination dropping to an average of 5.4 mn doses compared to a record of 8.0 mn in Sep-21; India has inoculated more than 53% of its population with the first dose. We continue to anticipate that nearly 80% of the population

will be vaccinated partially before the end of 2021. This could lead to a stronger revival in consumer sentiment as seen in case of few developed economies.

- With the lagged pick up in rainfall in Sep-21 supporting kharif crops acreage, the anticipated Kharif food grain output as per the First Advance Estimate is pegged at a record high of 150.5 MT in 2021-22. Higher agriculture incomes should in turn brighten prospects of rural recovery. CMIE rural consumer sentiment index is already corroborating a faster recovery in rural sentiment vs. urban over Sep-21 and Oct-21 so far.
- Exports have emerged as the strongest growth pillar in FY22. On a FYTD (Apr-Sep) basis, exports have grown by 58.0% compared to a contraction of 21.2% over the same period in FY21, with sectors such as chemicals, textiles, agri & allied products, gems & jewellery etc. leading the gains. A strong V-shaped global growth recovery along with conscious efforts to implement a China plus one strategy by several nations, is aiding demand for India's exports.
- Notwithstanding the moderation in pace, it is encouraging to see a relatively healthy capital expenditure growth of 38.3% YoY (41.4% of FY22 BE) during H1 FY22 vis-à-vis a contraction of 11.6% (39.0% of FY21 actuals) seen in the corresponding period in FY21. Continued thrust on public sector capital expenditure provides comfort and would be important for supporting the economy at a time when private sentiment could remain subdued, at least in the near term.

We continue to estimate India's FY22 GDP at 10.0% with mild downside risk vis-à-vis a contraction of 7.3% seen in FY21. In addition to the factors outlined above, accommodative fiscal and monetary policy too, at least in the near term, are expected to support growth. On the downside, we are mindful of risks from global supply chain disruptions along with elevated commodity prices, the more recent global energy crisis and potential financial market volatility as key central banks begin to normalize monetary policy. Another wave of Covid still remains a possibility, though the economic fallout could be much lower on account of vaccine penetration and existing seroprevalence.

Inflation

A short-lived reprieve

KEY TAKEAWAYS

- CPI inflation moderated to a 5-month low of 4.35% YoY in Sep-21 from 5.30% in Aug-21.
- This was accompanied by softening of sequential momentum with CPI rising by a subdued 0.18% MoM in Sep-21 vis-à-vis 0.25% in Aug-21 and 0.90% over Apr-Jul-21.
- With support from subdued food inflation, retail inflation can remain somewhat benign in Q3 FY22.
- However, escalating price pressures in case of manufacturing inputs along with further acceleration in energy inflation could continue to play an offsetting role.
- Possibility of upside pressure from vaccine led temporary surge in pent-up demand can keep core inflation sticky at elevated levels.
- For FY22, we continue to expect average CPI inflation to print at 5.5% (within RBI's tolerance band), moderately lower vis-à-vis the 7-year high level of 6.2% in FY21.

Overview

Continuing with its recent comfort, India's CPI inflation moderated to a 5-month low of 4.35% YoY in Sep-21 from 5.30% in Aug-21. Notwithstanding the supportive statistical base that pulled down the headline rate of annualized inflation, the month of Sep-21 also saw further softening of sequential momentum - CPI rose by a subdued 0.18% MoM in Sep-21 vis-à-vis 0.25% in Aug-21 and 0.74% over Jul-21.

After attaining a peak in May-21 (at 6.30% YoY) amidst the second wave induced supply disruptions, CPI inflation has eased monotonically over the last four months. The reversion to RBI's inflation tolerance band of 2-6% offers reprieveto the policy makers. RBI in its latest policy meeting, in fact pared its FY22 CPI inflation estimate by 40 bps to 5.3%. Further, after increasing in last 3 rounds, household's inflation expectations for 3-months and 1-year ahead horizon too have eased by 50 bps and 60 bps respectively in Sep-21.

Table1: Key highlights of CPI inflation

CPI Inflation: By sub-components (%YoY)			
	Sep-20	**Aug-21**	**Sep-21**
Headline CPI	**7.3**	**5.3**	**4.3**
Food and Beverages	9.8	3.7	1.6
Pan, Tobacco & Intoxicants	10.7	4.0	4.2
Clothing & Footwear	3.0	6.8	7.2
Housing	2.8	3.9	3.6
Fuel & Light	2.8	12.9	13.6
Miscellaneous	6.9	6.4	6.4
Core CPI	**5.4**	**5.9**	**5.8**

Drivers of Sep-21 CPI inflation

At a granular level, the comfort on sequential momentum was led by -

- Food and beverages index which increased by a nominal 0.06% MoM compared to -0.06% in Aug-21 and 2.15%YoY over Sep-20. The month-over-month jump in price of 8 out of 12 items within the food and beverages basket got nearly offset by decline in prices of the remaining 4 items.
    - Price pressures firmed up further for edible oils in Sep-21, taking the annualized inflation under this category to a record high level of 34.2% YoY. The incessant price pressure seen in case of edible oils in the last one year is a global phenomenon (edible oils constitute 5-6% of India's non-oil-non-gems & jewellery imports) with root cause linked to Covid disruptions as well as global weather related disturbances. The government slashed import duties on certain categories of edible oils by bringing them to a decade low in the month of Sep-21. This could provide a breather to the monthly price momentum in the near term.
    - Meanwhile, sequential price pressures accelerated in case of Sugar & Confectionery, Pulses, and Prepared Meals & Snacks amidst the onset of festive season.
    - On the other hand, prices dropped sequentially in case of Fruits, Eggs, Vegetables, and Meat & Fish.

- Overall, the F&B index registered a 2.2% QoQ uptick in Q2 FY22. This is one of the lowest price increases seen on quarterly basis during Q2 in the current CPI series beginning 2011 (the average change in Q2 for the F&B series stands at 3.9%). Less severe summer seasonality and government interventions to provide relief from excessive price pressures in case of select food products appears to be having some impact.

- Fuel and Light index registered a sequential increase of 0.74% MoM in Sep-21, up from 0.44% in Aug-21, with inflation for the sub-category scaling to an all-time high of 13.6%YoY. Compared to the previous month, price pressures accelerated primarily in case of LPG and Kerosene, an impact of a lagged pass through from elevated international energy prices. In contrast, Petrol and Diesel prices (captured in the Transport & Communication part of the Miscellaneous index) saw a sequential decline. We believe this could be short lived as domestic oil companies have been regularly undertaking an upward adjustment in retail prices after the recent run up in price of India Crude Basket (from an average of USD 73 pb in Sep-21 to USD 81 pb in Oct-21 so far). The recent cut in excise duty by Central Government can however, provide some moderate relief to fuel inflation.
- Core index (CPI ex Food, fuel and PTI) increased by 0.19% MoM in Sep-21, lower than the 0.45% jump seen in Aug-21. The deceleration was across the key categories of Clothing & Footwear, Housing, and Miscellaneous.
    - Despite the steep fall in annualized headline inflation in last three months, the annualized core inflation remains in a tight and elevated range of 5.8-5.9%. The pandemic has resulted in a persistence of high core inflation due to supply disruption along with sporadic evidence of pass through of escalation in input prices in manufactured products. The FYTD build-up in core inflation stands at 3.5% in FY22, same as FY21 – this we note is much higher than the average build-up of 2.6% seen in the corresponding 5-year period between FY16-FY20.

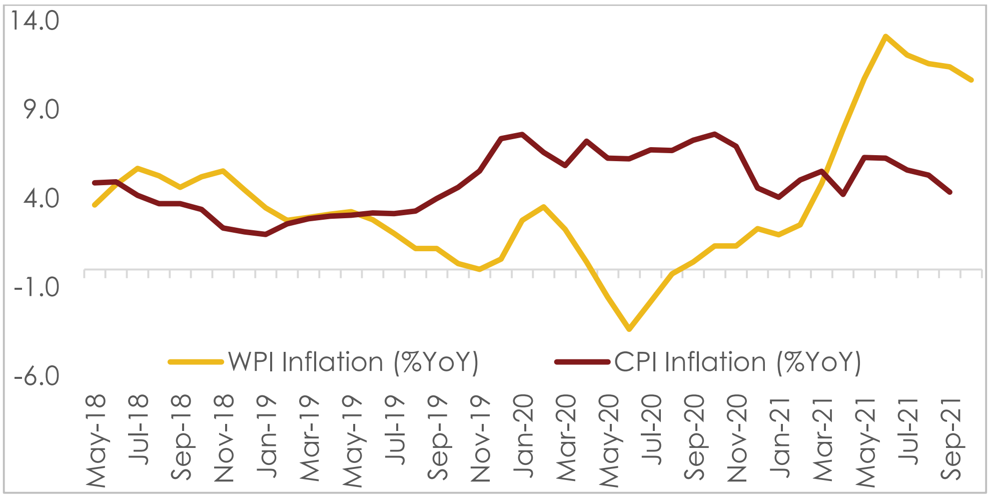
WPI inflation: Core creates a new record high

Following the deceleration in CPI inflation, headline WPI inflation moderated to a 6-month low of 10.66% YoY in Sep-21 from 11.39% in Aug-21. Meanwhile, WPI inflation for Jul-21 saw a sizeable upward revision to 11.57% YoY vs. 11.16% reported earlier. The down-move in annualized inflation in Sep-21 was accompanied by a subdued sequential momentum of 0.07% MoM vis-à-vis 0.67% in Aug-21.

- Sequential momentum in consolidated food & beverages inflation remained moderate at 0.13% MoM in Sep-21, unchanged from the previous month. Barring the surge in Apr-21 on account of summer seasonality and lockdown impact, food prices have followed a restrained trajectory so far.
- Fuel inflation posted a sequential decline of -1.12% MoM in Sep-21 driven by Mineral Oils (-1.75% MoM). Although prices of coal and electricity remained broadly unchanged from the previous month, we expect this comfort to be short lived given the recent surge in global crude oil prices currently trading at a one-year high of USD 84 pb. Additionally, the latest energy crisis triggered by lower coal supplies could further lead to a rise in coal and electricity prices thereby keeping overall fuel inflation elevated.

- Momentum in Core WPI (non-food manufacturing) rose by 0.58% MoM in Sep-21, lower compared to 0.72% increase seen in Aug-21. Despite the sequential moderation in momentum, the annualized core inflation print created a new series high of 11.2% YoY in Sep-21. High sequential pressure was observed in case of Wearing Apparel (1.20% MoM), Rubber & Plastics (1.15% MoM), Fabricated Metals (1.01% MoM), Basic Metals (0.96% MoM), Furniture (0.95% MoM), Chemicals (0.84% MoM), and Machinery Equipment (0.75% MoM).

Chart1: Both CPI and WPI inflation have come off their peak



Will the comfort last?

Last three consecutive readings of CPI inflation have provided considerable comfort with headline inflation now getting close to the mid-point of the policy target band. The 4-5% range is likely to persist in Q3 FY22 as overall food inflation is expected to remain benign on account of an anticipated record Kharif output and supply/price-based policy interventions by the government in select food items (in addition to a favourable base).

However, we see this as a brief reprieve, with CPI inflation projected to climb up thereafter towards 5-6% range in Q4 FY22 and Q1 FY23. The drivers for this include:

- Energy inflation may accelerate further in the coming months, predominantly on account of elevated energy prices with some push also coming from the recent bout of currency weakness. India Crude Basket has seen over 15% jump in price since end Aug-21. In addition, the tightness in global coal supply has begun to have a spill over impact on domestic prices.
- Some bit of elevated energy inflation will carry a second order impact on the non-energy inflation. In this context, we note that this would coincide with ongoing sequential pick-up in economic activity on account of progress on both state level unlock as well as vaccination coverage.
- With expectation of nearly 80% of the population getting partially vaccinated before end Dec-21, a temporary spike in demand side inflation remains a possibility as economic activity normalizes. This in turn could keep core inflation pressures firm.

As such, we continue to stick to our call of average 5.5% CPI inflation in FY22 vis-à-vis 6.2% in FY21.

Government Finances

Disinvestment holds the key

KEY TAKEAWAYS

- India's central government fiscal deficit for H1 FY22 stood at 35.0% of budget estimates (BE) for FY22 compared to 50.2% of actuals over the corresponding period in FY21.
- The relatively lower accretion to fiscal deficit this year continues to reflect better revenue collection (barring disinvestments) while the pace of overall expenditure has also improved.
- Revenue expenditure grew by 6.3% YoY (47.7% of FY22 BE) during H1 FY22 vis-à-vis an expansion of 1.0% (42.6% of FY21 actuals) seen in the corresponding period in FY21.
- It is encouraging to see a relatively healthy capital expenditure growth of 38.3% YoY during H1 FY22 vis-à-vis a contraction of 11.6% seen in H1 FY21.
- Budgeted expenditure in FY22 may however, overshoot by Rs 1.9-2.0 tn on account of Covid relief packages, increase in fertilizer subsidy, higher outlay for vaccination, hike in DA/DR, and likelihood of expanding the MGNREGS budget.
- Despite the expectation of a back loaded expenditure slippage, risks on headline fiscal print could remain contained due to strong tax and non-tax revenue collections.
- Having said so, the realization of record high disinvestment target of Rs 1750 bn would be crucial in managing the fiscal risks.

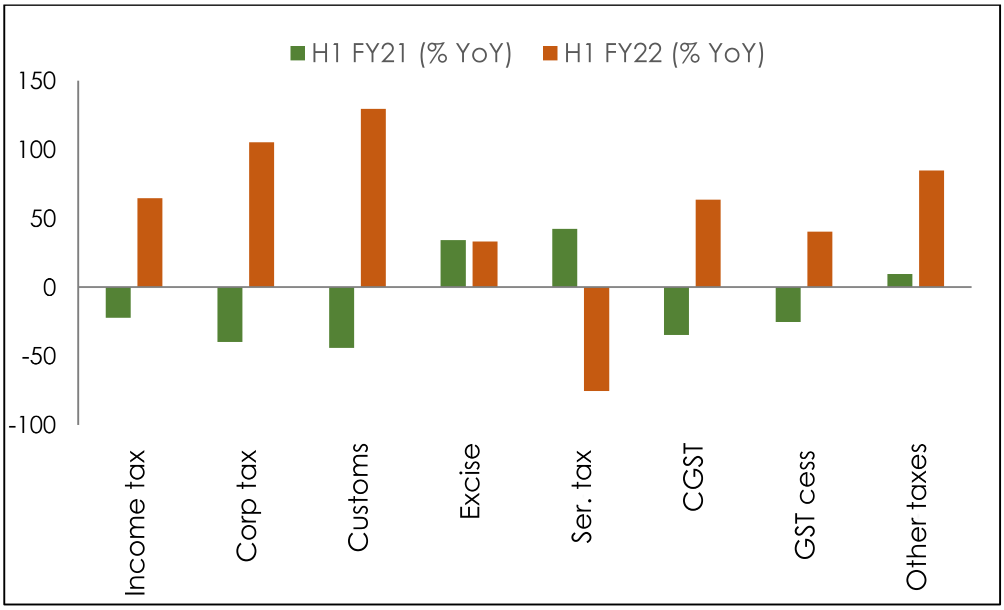
India's central government fiscal position is gradually crawling out of the precarious pandemic hit scenario in FY21, with fiscal deficit for H1 FY22 standing at 35.0% (Rs. 5.3 trn) of the budget estimate (Rs. 15.06 trn), just half as compared to an average of 70.5% of actuals recorded in the first half of preceding three years.

Receipts: The healthy run continues

Total receipts have been buoyed by robust tax as well as non-tax revenue accretion.

- For H1 FY22, gross tax revenue collection witnessed a sharp growth of 64.2% YoY compared to the contraction of 21.6% seen in H1 FY21. Barring service tax collection that contracted in H1 FY22, all other key tax sources recorded healthy growth, with impressive growth seen in customs followed by corporate tax collections (Chart 1). Despite the supportive statistical base of last year, gross tax revenue collection as compared to the BE already stands at 53.6% in H1 FY22 (vs. 35.6% of actuals in the corresponding period in FY21) with custom duties, corporate tax, excise, and central GST exceeding 50% of BE.
    - We expect the trend to continue in the second half of the current year with GST collections expected to remain above Rs. 1.1 trn supported by festive demand leading to an improvement in consumer spending.
- Healthy gross tax collection and relatively lower tax devolution to states has led net tax revenue in H1 FY22 to grow by 100.8% YoY from a contraction of 24.5% in H1 FY21.

Chart 1: Except service tax all other tax sources recorded a healthy performance



Non-tax revenue also registered a healthy growth of 73.8% YoY in H1 FY22 compared to a contraction of 55.9% seen during H1 FY21. The key reason for robust performance under this category, however, stems from the significantly higher than budgeted dividend from the RBI at Rs 991.0 bn, transferred in the month of May this year due to the synchronization of RBI's financial year with the Government of India.

Expenditure: Revex and capex registers a healthy growth

Total expenditure increased by 9.9% YoY in H1 FY22 vis-à-vis a contraction of 0.6% seen in the corresponding period in FY21. However, on BE basis, this translates into 46.7% of the full year target vis-à-vis 42.1% disbursal seen in the corresponding period in FY21. Few granular trends:

- Revenue expenditure grew by 6.3% YoY (47.7% of FY22 BE) during H1 FY22 vis-à-vis an expansion of 1.0% (42.6% of FY21 actuals) seen in the corresponding period in FY21. However, non-interest revenue expenditure- a better metric to gauge the quality of spending rose merely by 2.5% YoY in H1 FY22 as compared to H1 FY21. For H2 FY22, we expect the revenue expenditure momentum to remain strong as all the government departments have now been permitted to spend as per their own approved budget for this year from an earlier mandate of restricting expenditure within 20% of BE FY22 in second quarter of FY22 in the wake of the second Covid wave.
- Notwithstanding the moderation in pace, it is encouraging to see a relatively healthy capital expenditure growth of 38.3% YoY (41.4% of FY22 BE) during H1FY22 vis-à-vis a contraction of 11.6% (39.0% of FY21 actuals) seen in the corresponding period in FY21. Continued thrust on capex provides comfort and would be important for supporting the economy at a time when private sentiment could remain subdued, at least in the near term. The central government under the scheme entitled 'Special Assistance to States for Capital Expenditure for 2021-22' has approved capital projects worth Rs 29 bn in 8 states while also releasing Rs 14 bn to these states.

Outlook

Despite the economic challenges at the beginning of FY22, the central government's fiscal situation has clearly recovered backed by tax and non-tax revenue collections. However, as per our estimates, the combination of vaccination cost, Covid relief program, hike in DA/DR allowance, and higher fertilizer subsidy outgo (that recently got extended by Rs 287 bn to cover the upcoming rabi sowing season) would entail an additional spending of Rs 1.9-2.0 tn (0.8-0.9% of GDP) in FY22. In addition, there is a likelihood of topping up the FY22 MGNREGS budget of Rs 730 bn by an additional Rs 250 bn (0.1% of GDP) in the wake fast pace of fund utilization amid increased demand for rural employment.

Overall, the central government's fiscal position in the current year is witnessing a significant recovery backed by healthy tax and non-tax revenue collections. Basis available trend, we expect government's tax as well as non-tax revenue outturn to likely exceed full year budget estimates by around Rs. 2.0 trn led by strong indirect tax mop-up, recovery in most of the sectors amidst unlocking of economy, and various compliance measures taken by the government.

Meanwhile, we continue to emphasize that the realization of record high disinvestment target of Rs. 1.7 trn would be crucial in managing the overall fiscal risks. The recent announcement of Air India disinvestment is an important milestone, but it is not significantly revenue accretive. The traction in case of large ticket size disinvestments, like LIC, BPCL could boost confidence further. The recently unveiled National Monetization Pipeline (NMP) is estimated to raise Rs 6.0 trn by monetizing core assets of the central government, over FY22-25 (out of which Rs 882 bn is earmarked for the current financial year). Timely execution on this front could generate additional revenue for the government.

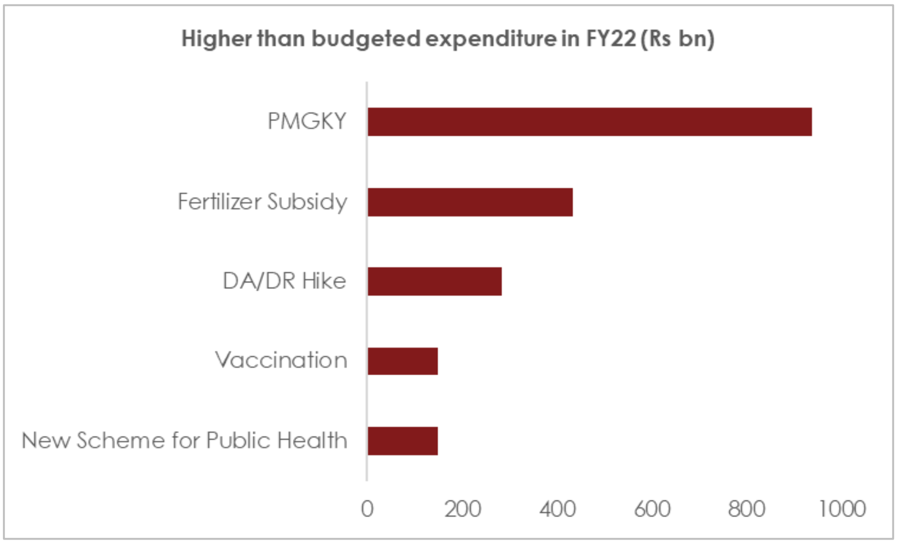
In our base case scenario, we anticipate a fiscal slippage of around Rs. 268 bn compared to the BE figures; however, the fiscal deficit as % of GDP is likely to be marginally better at 6.6% (vs. the budget estimate of 6.8%) in FY22 taking into consideration higher nominal GDP led by higher inflation.

Given the backdrop of elevated domestic fuel prices feeding into India's inflation basket, we had an expectation of a moderate cut in fuel excise duties and this decision has been recently taken by the Central Government with effect from Nov 4, 2021. While the excise duty on petrol has been reduced by Rs 5 per litre, that on diesel has been reduced by Rs 10 per litre which may be further supported by reduction in VAT by some states. Our internal calculations indicate that the potential revenue loss on this acount may be around Rs 300-400 bn which will be less than 0.2% of GDP and will not materially alter the projected fiscal deficit.

Table1: FYTD (Apr-Sep) comparison of key drivers of fiscal deficit

Key Fiscal Variables (Cumulative Position as of Apr-Sep)				
	% of FY Actual/Target		%YoY	
	FY21	FY22	FY21	FY22
Revenue Receipts	33.7	60.4	-32.5	96.3
Net Tax	32.2	59.6	-24.5	100.8
Non-Tax	44.3	66.0	-55.9	73.8
Non-Debt Capital Receipts	25.4	9.6	-28.9	23.8
Total Receipts	**33.5**	**55.6**	**-32.5**	**94.4**
Revenue Expenditure	42.6	47.7	0.96	6.33
Capital Expenditure	39.0	41.4	-11.57	38.30
Total Expenditure	**42.1**	**46.7**	**-0.62**	**9.91**
Fiscal Deficit	**50.2**	**35.0**	**-**	**-**

Chart 2: FY22 government expenditure to increase budgeted target by Rs 1.9-2.0 tn



Rates

Global risks weighing

KEY TAKEAWAYS

- India's 10Y g-sec yield closed Oct-21 at 6.32% from 6.24% as on end Sep-21. Yields have further hardened, with the 10Y benchmark trading around 6.38% currently, the highest since Apr-20.
- Relief from concerns over additional borrowing in H2 FY22 on account of GST compensation loan along with the moderation in inflation trajectory provided a propitious domestic backdrop.
- However, sharp acceleration in global commodity prices along with aggressive pricing of interest rate normalization in the US has turned the global rates environment rather hostile.
- With progress on vaccination, we continue to expect the RBI to start normalizing policy corridor from Dec-21 onwards via upward adjustment in reverse repo rate, however, the likelihood of the postponement onto next quarter is on the rise given RBI's more gradual approach towards policy normalization.
- We continue to stick to our 10Y g-sec yield forecast of 6.50% by Mar-22.

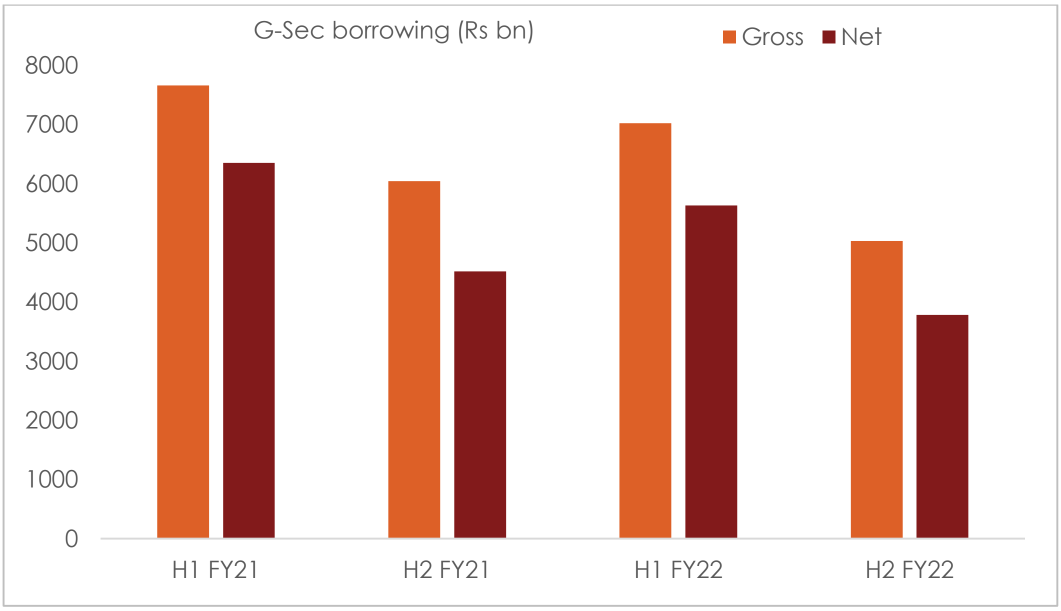
On monthly basis, after bottoming out at 6.02% in May-21, India's 10Y g-sec yield has been gradually creeping up. It closed the month of Oct-21 at 6.32%, higher than 6.24% in Sep-21. Yields have hardened thereafter, with the 10Y benchmark trading around 6.38% currently, the highest since Apr-20.

Global risks get the better of supportive domestic backdrop

To recall, the bond market did have a propitious setting from two fundamental corners:

- The run up to the announcement of H2 FY22 market borrowing calendar was laced with concerns regarding announcement of additional market borrowing due to GST compensation loan of Rs 840 bn (to be provided to state governments in the second half of the year). However, the government stuck to its budgeted target for FY22 while subsuming the additional borrowing requirement on account of GST compensation loan to states. So, while the net g-sec borrowing in H2 FY22 now stands at Rs 3780 bn, the effective borrowing adjusted for GST compensation loans, gets reduced to Rs 2940 bn.
- CPI inflation decelerated sharply in Sep-21 to 4.35% YoY from 5.30% in Aug-21. The down move was accompanied by softening of sequential momentum. It is important to note that the full-blown impact of state level lockdowns had catapulted CPI inflation to 6.30% in May-21. Since then, not only has headline inflation been moderating every month, but it has also managed to post downside surprises consistently vis-à-vis market expectations.

<u>Chart 1: Borrowing pressure set to reduce in H2 FY22</u>

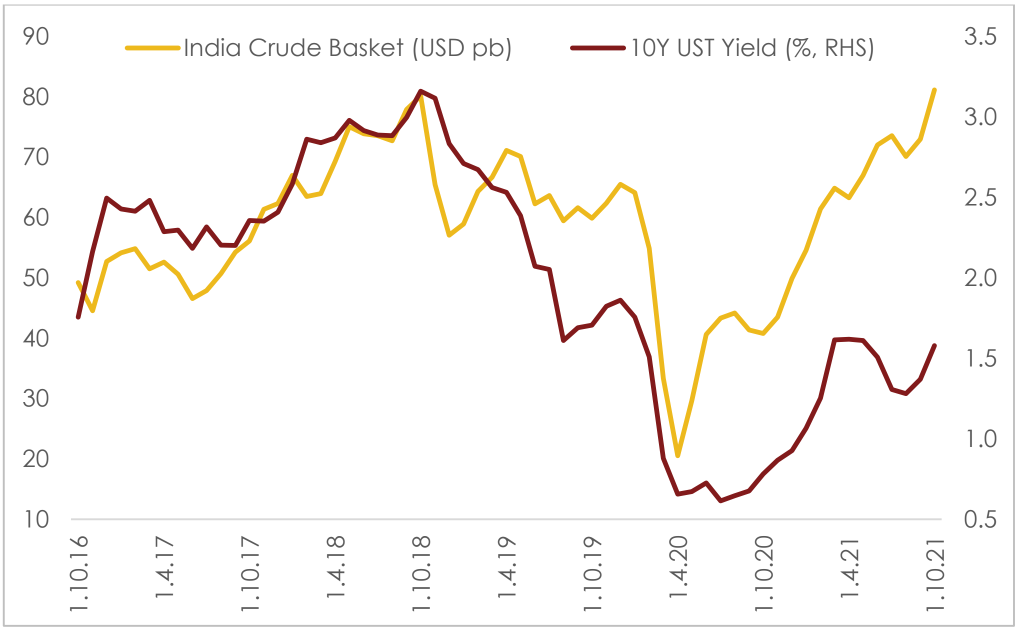


However, two global developments (with some degree of multicollinearity) managed to hinder the comfort:

- Global commodity prices have hardened considerably since end Aug-21. This is partly a reflection of the ongoing V-shaped global economic recovery aided by rapid vaccination coverage in most DMs and select EMs, persistence of accommodative monetary and fiscal policy backdrop in most countries, and lingering of Covid related supply disruptions, besides other idiosyncratic factors like geopolitics and weather. Compared to the pre-Covid levels in Feb-20, the price of a generic commodity basket is up by about 40% as of Oct-21. However, there are significant pressure points in the form of base metals (+63%), fertilizers (82%), coal (125%), and natural gas (184%). Moreover, the runup in price for oil has gathered pace further with India Crude Basket averaging at USD 82 pb in Oct-21 so far (+12.3% MoM), the highest in last 7-years. As per RBI's latest Monetary Policy Report (Oct-21), a 10% increase in crude oil price could increase CPI inflation by 30 bps. The overall risk to inflation is not just limited to crude oil now as other components of energy, viz. coal and natural gas appear significantly overstretched in comparison.

- Rising inflationary pressure in most DMs and EMs (on account of the factors cited above) is expected to persist in the remaining months of 2021 (as per IMF's WEO, Oct-21). While the debate on how transitory the inflation drivers are, is far from settled, the backdrop of prolonged supply disruptions, commodity and housing price shocks, and ballooning of public debt levels has started to rattle investor sentiment, forcing few central banks to start considering normalization of pandemic era accommodative policies. After pricing in the commencement of Fed taper from Dec-21 onwards, market participants have in recent weeks started to price in two rounds of rate hike by Dec-22. This appears aggressive compared to the FOMC median dot plot of one rate hike before the end of 2022. Nevertheless, we note that with the 10Y UST yield rising by 34 bps since the Sep-21 FOMC meet, global yields have moved in tandem.

Chart 2: Oil and US yields have hardened considerably from their 2021 lows



Outlook

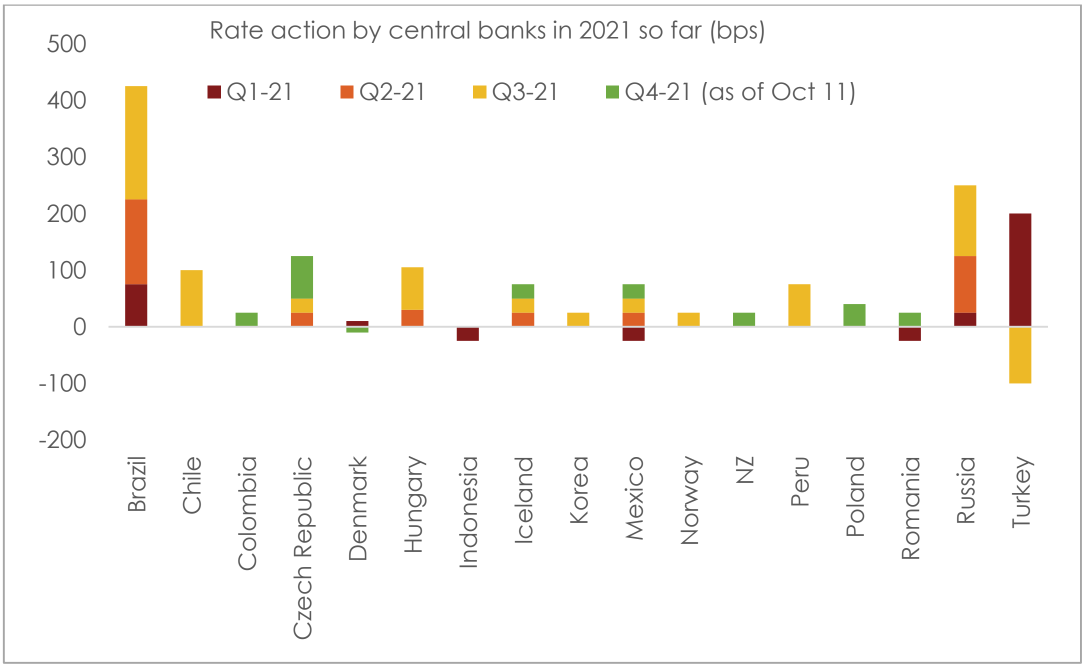
Taking comfort from the recent moderation in CPI inflation, the RBI's Monetary Policy Committee continues to highlight the need for maintaining accommodative stance (barring one out of six MPC members who voted against the continuation of accommodative policy stance for second time in a row) "as long as necessary in a bid to support growth on a durable basis".

However, the central bank did make an attempt to nudge short term money market rates in upward direction (towards the LAF corridor) by calibrating the liquidity surplus through the expansion of the scope of VRRR auctions along with discontinuation of G-SAP operations (negative for g-secs). To us, this becomes a precursor to interest rate normalization that we envisage to happen in Dec-21. However, given RBI's approach of 'gradualism' the likelihood of the postponement onto next quarter is on the rise. In terms of the timing, this is likely to succeed US Federal Reserve's formal announcement of taper plans in Nov-21.

This would provide some hardening in the 10Y g-sec yield towards 6.50% by Mar-22. While the recent run up in yields increases the risk of earlier than anticipated achievement of our forecast, we note that there are three factors that could potentially limit any aggressive upside:

- India's CPI inflation is set to remain benign in the near term (4-5% range in Q3 FY22).
- Fed fund futures have already run ahead of the official dot plot in terms of rate hike expectations for 2022. Further upside appears unlikely at this stage.
- Expectation with respect to India's inclusion in the global bond indices in CY22 is gaining traction. We believe the upcoming FY23 Union Budget in Feb-22 would shed some light on the policy aspects and preparedness for the same.

Chart 3: Few central banks have started to normalize interest rates



Rupee

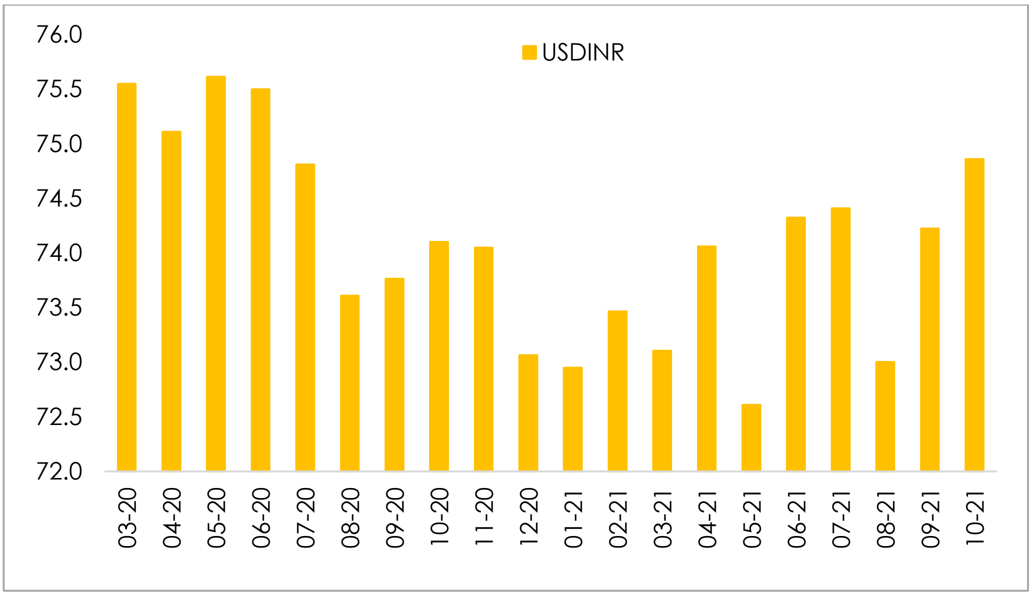
Reverts to weakness

KEY TAKEAWAYS

- After appreciating in Aug-21, the INR weakened in Sep-21 with depreciation pressures persisting in the month of Oct-21.
- As expected, USD continues to remain buoyed by relatively strong US economic performance, anticipated commencement of Fed's monetary policy normalization, and credit market uncertainty emanating from China.
- Domestically, the combination of gradual unlock and progress on vaccination is seen to be putting pressure on India's merchandise trade deficit from the demand side along with elevated price impact of global commodities providing an adverse backdrop.
- Despite the reported current account surplus in Q1, we revise upwards our forecast for FY22 current account deficit to USD 38 bn from USD 30 bn projected earlier.
- We continue to expect USDINR to move up towards 77.0 by end March 2022.
- While INR would face depreciation pressures on account of Fed's taper, the intensity is likely to be less severe vis-à-vis the 2013 "Taper Tantrum" episode on account of relatively better domestic macros, strong FX Reserve cover, and likelihood of India's inclusion in the global bond indices.

After appreciating by 1.9% in Aug-21 against the US dollar, the Indian rupee weakened by 1.7% and closed Sep-21 at 74.23, somewhat stronger than our forecast of 75.0. However, depreciation pressures have persisted in the month of Oct-21, with INR currently trading between 74.2-74.6 vis-à-vis the USD in early Nov-21.

Chart 1: INR has weakened considerably since end Aug-21



As highlighted in the Sep-21 edition of the "Acuité Macro Pulse" report, we were skeptical of the knee-jerk weakness in USD seen post the Jackson Hole speech by Fed chief Powell that outlined his thoughts on QE taper and interest rate normalization in the US. Indeed, the DXY index touched 94.5 in early Oct-21, hitherto its highest level in 2021, before retreating a tad. This in fact seems to be one of the important reasons driving INR weakness in the last few weeks. Moreover, the factors supporting USD strength continue to persist:

- With continuing support from exceptionally accommodative policy mix, the US economic recovery is powering ahead. Averaged over 2021 and 2022, the IMF expects US GDP to grow by 5.6%, thereby making it one of the strongest growth centers among DMs. Recall, the US economy surpassed its preCovid levels in Q2 2021.
- Prospects of monetary policy normalization in the US vis-à-vis its close DM peers would continue to set the tone for the USD. The Fed chief Powell has just announced the commencement of taper in the FOMC policy review. From late Nov, the Fed will start to taper its ongoing USD 120 bn per month QE by USD 15 bn per month – i.e. USD 10 bn in treasuries and USD 5 bn in mortgage securities, implying a conclusion of the current QE program by Jul-22.
- Meanwhile, the recent run up in energy and housing prices in the US (besides existing supply side disruptions) pushed CPI inflation to more than a 13-year high of 5.4% YoY in Sep-21. With repricing of upside risks to inflation, market participants have now left the Fed behind the curve – the Fed Funds Futures

market currently expects nearly two rate hikes before end 2022 vis-à-vis one rate hike projected by the FOMC median dot plot.

- In addition, potential credit risk event in China associated with its second largest real estate developer – the Evergrande group, continues to linger. The possibility of a government-guided restructuring appears to be the consensus view in the market. The non-consensus view of a complete liquidation could however precipitate a full-blown contagion in global markets. The near-term uncertainty with respect to Evergrande's prospects and the degree of policy intervention by China could keep risk aversion sentiment alive, thereby favoring the USD.

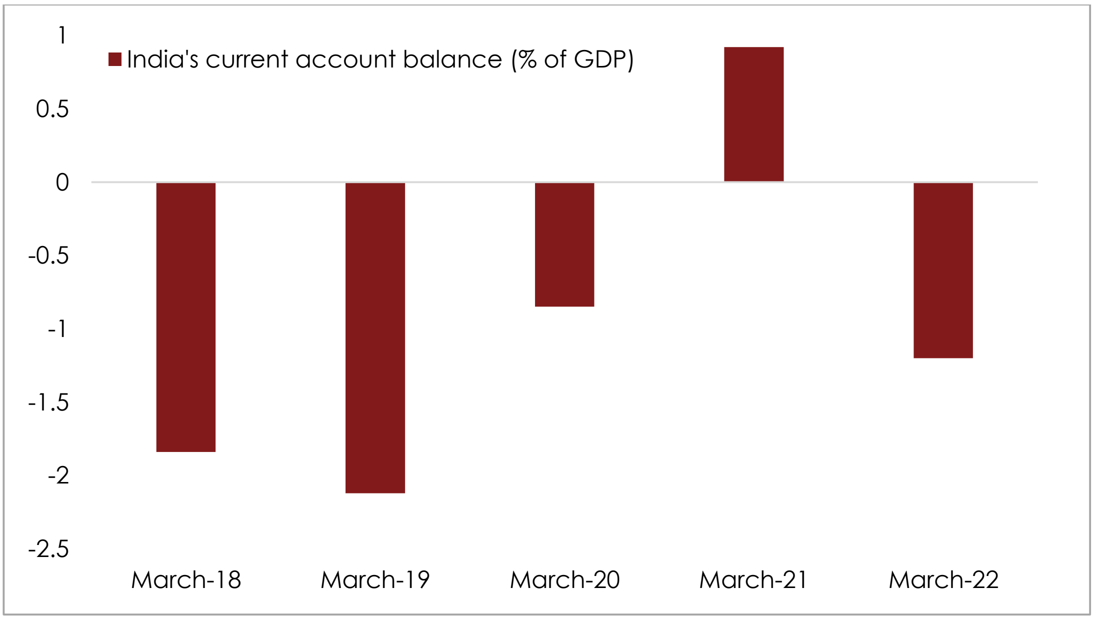
Outlook

As highlighted earlier, in the near term, the ongoing gradual normalization of domestic economic activity post the second wave of Covid will continue to remain one of the most important factors driving INR. With improvement in mobility indicators to pre-Covid, demand for imports is seen to be picking up at a faster pace vis-à-vis exports resulting in a widening of the merchandise trade deficit. Simultaneously, the progress on vaccination coverage is also likely to support demand conditions. As of end Oct-21, India inoculated over 51% of its total population with one dose of Covid vaccine. Going forward, we expect 75% of the total population to get the partial vaccination cover by Dec-21.

In addition, high commodity price effect (especially in case of energy items) would also weigh on total merchandise trade deficit. Hence, we recently revised upwards our forecast for FY22 current account deficit to USD 38 bn from USD 30 bn earlier (FY21 recorded USD 24 bn surplus). We also take this opportunity to adjust our FY22 BoP forecast upwards (on account of the stronger than expected performance in Q1) to USD 50 bn from USD 44 bn projected earlier (FY21 recorded a surplus of USD 87 bn). While the projected full year BoP surplus appears healthy, one needs to note that this is inclusive of the robust USD 32 bn surplus recorded in Q1. As such, the expected incremental BoP surplus between Q2-Q4 FY22 would moderate substantially to USD 18 bn. The relatively lower BoP surplus vs-a-vis USD 87 bn in FY21 could potentially increase INR's sensitivity to global FX volatility on account of:

- Near term uncertainty with respect to prospects of edible oil and energy prices (together they constituted 34% of India's import basket in H1 FY22).
- Fate of foreign portfolio flows could get determined by the impact of tapering of Fed's asset purchases as well as prospects for interest rate hikes
- Amidst the likelihood of a USD supportive backdrop and moderation in incremental BoP surplus, we continue to expect INR to face depreciation pressures. Having said so, the intensity of adjustment is likely to be less severe vis-à-vis the 2013 "Taper Tantrum" episode on account of relatively better domestic macros and strong FX Reserve cover (USD 640 bn currently that corresponds to about 14.5 months of import cover). In addition, prospects of India's inclusion in global bond indices would also limit any runaway pressure on the currency. As such, we continue to expect USD-INR pair to touch 77 levels by Mar-22.

Chart 2: India's current account balance expected to revert to deficit in FY22



Global Overview

New forces to reckon with

KEY TAKEAWAYS

- Two developments appear to have dominated incrementally, the global economic discourse since our last edition of the Macro Pulse.
- First, is the global energy crisis, which could weigh on global economic recovery that was just beginning to get back on its feet.
- Second, it appears that Bank of England (BoE) is on course to become the first major central bank to hike interest rate, though considerable difference in opinions with respect to timing of the hike remains.
- The US Fed is on course to begin QE tapering of USD 15 bn per month from late Nov-21 onwards, while ECB is believed to be mulling over initiating a new bond-buying program to prevent any market turmoil.
- Progress on vaccination globally continues to offer hope, though headwinds to growth from rising commodity prices and supply chain disruptions are mounting.
- In China, post Covid rebound in economic activity has peaked with most indicators registering a faster than anticipated slowdown; Q3-21 real GDP growth slipped to a 1-year low of 4.9%YoY.

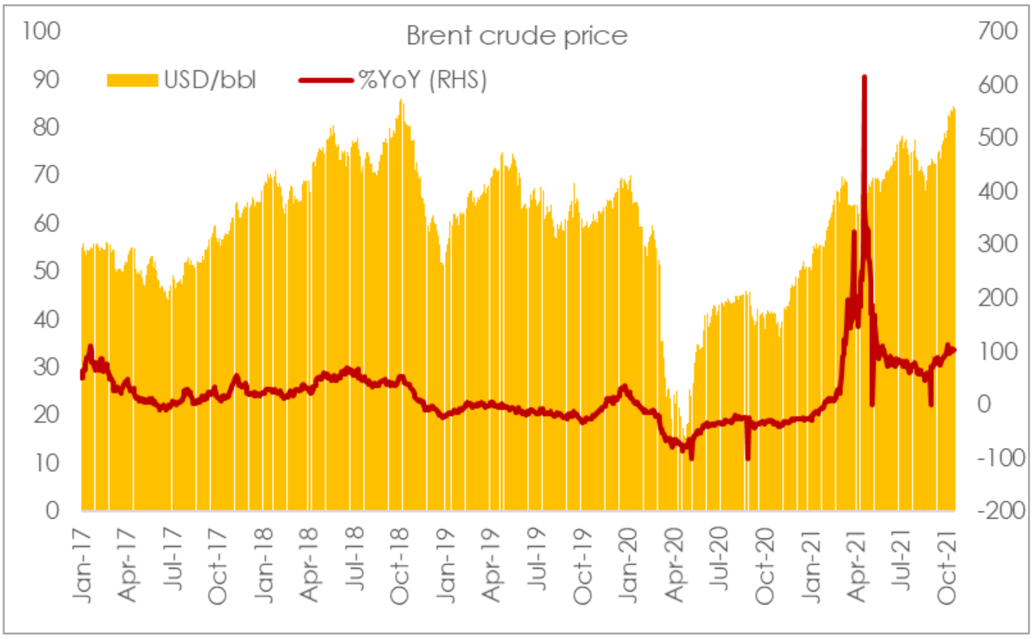
Introduction

Two developments appear to have dominated incrementally the global economic discourse since our last edition of the Acuite Macro Pulse.

First, is the global energy crisis. Bouncing back from the COVID pandemic, global economy has run headlong into an energy crisis. With supply unable to keep up pace with strengthening demand, crude oil prices have rallied to near a 3-year high of USD 85 pb, with price of natural gas and coal also witnessing a strong surge. This has led to a feedback loop, with price of metals such as steel, nickel, copper soaring along with electricity prices across Europe, US and Asia. It is being assessed that global energy markets could remain tight, with shortages weighing on global economic recovery that was just beginning to get back on its feet post the pandemic.

The International Monetary Fund (IMF), in its latest World Economic Outlook (WEO) downgraded global growth forecast for 2021 by 10 bps to 5.9%. This reflects a downward revision for Advanced Economies (AEs) in part due to supply disruptions and also for low-income developing economies from worsening of pandemic dynamics. IMF foresees significant divergence in the recovery process, with AEs expected to attain pre-pandemic trend path by 2022. In contrast, output for EMDEs ex. China (Emerging Market and Developing Economies) is expected to remain 5.5% below pre-pandemic forecasts even by 2024.

Chart1: Global crude oil price has soared to a near 3 year high



Second, it appears that Bank of England (BoE) is on course to become the first major central bank to hike interest rate. Over the last few weeks, MPC members have increasingly turned hawkish, including Governor Bailey and newly appointed Chief Economist Huw Pill. The basic premise of their discomfort stems from the recent rally in inflation, which is proving to be more permanent than transitory in nature. However, there still remains a fair degree of divergence between policy expectations of economists versus market participants. The former cohort is pencilling in rate hikes, albeit at a gradual pace beginning next year. In contrast, market participants have begun to price in a greater probability of the first-rate hike as early as in Nov/Dec-21 policy, to be followed more aggressively in 2022. Notwithstanding the latest reprieve in Sep-21, UK CPI inflation as per the BoE, is expected to exceed 4% later this year only to fall back close to the 2.0% target in the medium term.

Prospects of a shift to a relatively hawkish stance by the BoE will provide a head start over ECB and the US Federal Reserve, which are also grappling with elevated inflation. This can be perhaps attributed to UK's history of higher inflation (i.e., above central bank's target of 2.0%), lingering ramifications of Brexit and trend depreciation in the Pound.

US

The US economy is likely to register a slowdown in Q3-21, owing to the waning of a stimulus driven demand seen up to H1 amidst the surge in Delta variant and rising inflation. In addition, supply disruptions especially of semi-conductors are likely to have weighed on economic output. While the official GDP data will be released by the end of this month, Atlanta Federal Reserve's nowcast GDP model is predicting a growth of just 0.5% for Q3-21 (as of 19th Oct-21) down from nearly 6.0% two months ago (see chart). Clearly, economic growth appears to have peaked with IMF too downgrading its 2021 US growth estimate by 10 bps to 6.0%

Having said so, sentiment appears to be improving amidst a sharp decline in COVID cases across the country of late. Lead indicators suggest a positive turnaround in consumer sentiment, with revival in contact services such as dining, air travel and tourism. With nearly 57% of the population fully vaccinated, consumer sentiment should remain supported. However, supply side disruptions and labour market shortages could continue to impart binding constraints to growth. As such, inflation is expected to remain elevated heading into next year. Given this, the Federal Reserve has already announced tapering of QE by USD 15 bn per month from late Nov-21, implying a conclusion of the current QE program by Jul-22. This will provide adequate time to the FOMC to assess the possibility of interest rate normalization from 2023 onwards.

EUROZONE

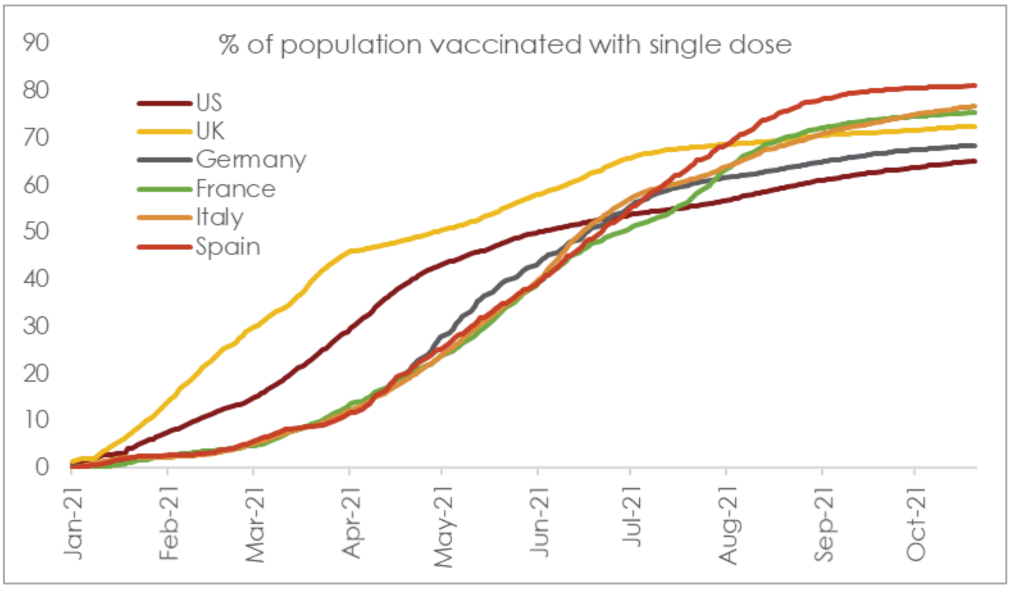
The recent macroeconomic data released for the Eurozone has seen a mixed performance. On balance, it appears that growth recovery continues to remain intact, though its pace may be tapering a bit. Encouragingly, high vaccination rate - with nearly 69% of the population fully vaccinated has helped to keep COVID infections under control in the region.

Inflation continues to surprise on the upside, with HICP inflation at 3.4%YoY in Sep-21 marking the highest level in nearly 13 years. While soaring energy prices were the prime driver, core inflation too picked up. This reflects the impact of supply chain disruptions and higher input prices. The ECB President Lagarde in her public commentary continues to maintain that "inflation is largely transitory" though ECB is expected to pay "very close attention" to wage negotiations and other potential second-round effects. Amidst the phasing out of the net asset purchases under its

Pandemic Emergency Purchase Program (PEPP) by next year, ECB is believed to be mulling over initiating a new bond-buying program to prevent any market turmoil.

Notwithstanding the continued recovery in the domestic economy, there are downside risks emerging from – 1) Slowing growth in the rest of the world, especially in China, which is likely to impact eurozone exports 2) Lingering supply side disruptions and 3) Soaring energy prices.

Chart 2: Vaccination for Eurozone countries has continued at an impressive rate



UK

UK's GDP grew by 0.4%MoM in Aug-21 amidst continued easing of COVID related restrictions across the country. Notably, output in consumer-facing services increased by 1.2% in the month, with most of the growth in services coming from "a 5.9% increase in food and beverage service activities, and a 47.9% increase in travel agency, tour operator and other related reservation services (growing from historically low levels)", as per the official press release.

The Government has consciously decided not to reimpose any COVID related restrictions despite COVID cases persisting above 30k since early Sep-21. In fact, the city of London is scheduled to resume all-hours metro rides from Nov-21. Despite a rise in infection rates among school children, UK Health secretary has put the onus on the general public to get vaccinated and behave responsibly.

In a temporary reprieve, CPI inflation dipped marginally to 3.1%YoY in Sep-21 from 3.2% in Aug-21. Looking at inflation drivers, it is expected that the recent surge in energy prices, higher fuel prices along with end of low VAT on hospitality are likely to keep price pressures intact in the near term. BoE, too expects inflation to top 4% later this year. While markets are pricing in BoE to begin hiking rates as early as in Nov/Dec-21, supply side shortages including the energy crisis, may weigh on BoE's decision of hiking rates this year. Nevertheless, it appears that BoE is on course to become the first major central bank to hike interest rates.

CHINA

China's Q3-21 real GDP growth slipped to a 1-year low of 4.9%YoY, coming slightly below market expectations compared to 7.9% in Q2. Quarterly growth too slowed significantly to 0.2% QoQ (seasonally adjusted) compared to 1.2% in the previous quarter. Q3-21 witnessed renewed tightening of mobility restrictions following a resurgence in COVID infections leading to localised lockdowns. As such, the services Caixin Purchasing Managers' Index (PMI) contracted to 46.7 in Aug-21. However, the decline has proved to be short-lived with the PMI gauge rebounding to a level 53.4 in Sep-21 yet again. Currently, with restrictions easing (as resurgence was contained) and ~78% of population vaccinated fully, there is likely to be some bounce back in activity in Q4-21 especially in consumption-oriented sectors. Early lead indicators do confirm this. Retail sales came in stronger than expected in Sep-21 at 4.4%YoY vs. 2.5% in Aug-21 and so did exports (+28.1%YoY vs. 25.6% in Aug-21). However, headwinds to industrial growth are mounting. Growth in industrial production took a hit in Sep-21 as it slipped to 3.1%YoY from 5.3% in Aug-21. The impact of rise in commodity prices, power shortages, subdued investment climate especially in real estate sector following Evergrande fallout along with the tightening of regulations in certain sectors and supply-chain constraints, all appear to be weighing cumulatively. Looking ahead, as highlighted in the previous edition of Macro Pulse, support from monetary and fiscal policies is expected to continue in a bid to cap the downside in domestic growth.

Sports Utility Vehicles (SUVs)

-The game changer in the Indian Automobile Industry

Compact SUVs set to alter the landscape of the Indian PV sector

SUV market share climbs to 38% in FY21 from 25% in FY17

Key Takeaways

- SUVs have been a bright spot in the domestic PV sector which has been plagued by growth challenges even before the Covid pandemic.
- While passenger car (PC) volumes dropped significantly by 8.6% in FY21 on a lower base, SUV volumes have climbed by 13.8% in the same year. The growth in SUVs has been spectacular in the first half of the current fiscal at 92.7%YoY and it could have been higher had there not been a waiting period for some models due to the lack of adequate availability of semi conductors.
- The increasing demand for SUVs has led to a steady increase in its market share in the PV space from 25% in FY17 to 39% in FY21 and this is set to increase further going forward.
- What is driving the growth of the SUV market is the development of the Compact SUV category (which we have defined as sizes upto 4400 mm costing less than Rs 20 lakhs). Both existing and the new players launched several new models in this category over the last few years that are not only cost competitive vs sedans but also come with several value added features.
- In our opinion, the increase in per capita incomes in the urban areas particularly among the younger generation and the structural benefits of a SUV as compared to a sedan such as spaciousness, ground clearance, new technological features and suitability for highway rides are driving the demand for Compact SUVs.
- Going forward, Acuité believes that the SUV segment will continue to show a solid growth trajectory over the medium term especially with the growing popularity for the compact SUVs along with the support of new launches such as Mahindra XUV700, Volkswagen Taigun, Skoda Kushaq and the recently launched Tata Punch. However, a slowdown is expected in factory despatches the near term due to the continuing shortage of semi-conductors that has already led to an increasing waiting period for selected models.

Since the liberalisation of the economy in the 1990s, the Indian automobile industry has not only been one of the fastest growing industries in the country but also one of the largest in the whole world both in terms of sales and production. The alliance between Maruti and Suzuki was the first joint venture in the Indian automobile segment between an Indian and a foreign company. Later in 2000s, the implementation of economic reforms led to the entry of major foreign auto players in the industry such as Hyundai, Honda, and Toyota among others and by 2010 almost all the major auto company expanded their presence in India by establishing manufacturing facilities across different parts of the country. The Indian automobile industry is currently divided into four major segments namely Two Wheelers (2Ws), Passenger Vehicles (PVs), Commercial Vehicles (CVs) and Three Wheelers (3Ws). The 2W segment is the largest segment in terms of volumes with 81% market share followed by PV, CV and 3W with 15%, 3% and 1% respectively.

Undoubtedly, the PV segment in the Indian auto industry has been one of the biggest beneficiaries of economic growth, increasing urbanisation and the rise in per capita income of the country over the last two decades. With better affordability, availability of retail finance and the change in demographics in favour of the younger generation, the PV market has seen a huge scale up. The market is further divided into three sub segments namely Passenger Cars (PCs), Sports Utility Vehicles (SUVs) and Vans. Clearly, the SUV category has evolved as the fastest growing segment in the whole PV industry in the last five years.

Nevertheless, not all was hunky dory for the PV market in the pre-pandemic period. Before the onset of the Covid pandemic and starting from H2FY19, the Indian automobile industry witnessed one of the worst slowdowns in over a decade and the sales across all the segments of the industry including PV segment reflecting a distinct slowdown in the economy followed by various regulatory changes from the government in a short span of time particularly the introduction of BS VI standards. The domestic sales of the overall PV segment witnessed a CAGR volume growth of only around 5% over the 3 yr period (FY17-19) period. Expectedly, the emergence of Covid pandemic led by nationwide lockdown, massive economic disruption and the restriction in movements of goods and people across the country led to a decline in domestic PV sales by 18.8% and 1.2%YoY in FY20 and FY21 respectively.

However, the volume trajectory in the SUV segment has moved in a different manner with a CAGR of around 11.0% over the same period, FY17-FY19. It registered only a marginal decline of 0.9%YoY in FY20 and a growth of 13.8%YoY in FY21. Further, an upsurge in the demand for compact SUVs is clearly visible in the current year which has led to a growth of 93%YoY in UV sales during H1FY22 compared as H1FY21. The momentum in UV volumes have been a key factor behind the growth of 58% YoY in H1FY22 despite the impact of the second Covid wave in Q1FY22 and shortages in semiconductors.

The growth witnessed in the domestic sales of SUVs in H1FY22 provided a much needed relief to the PV industry during the Covid pandemic. While passenger cars had been continuously dominating the PV industry over the last two decades, a gradual transformation in favour of SUVs have been visible over the last five years. The market share of SUV in the PV space has significantly increased from 25% in FY17 to 39% in FY21 whereas the market share of PC has dropped from 69% in FY17 to 57% in FY21.

We believe that there are several factors which are driving the popularity of the SUV. One of the key reasons for the emergence of the SUVs is the growth in incomes in the upper middle class category particularly among the younger generation and in the major urban areas. With the change in lifestyles and better quality of highways, urban consumers prefer a sturdy and spacious vehicle with new amenities. Given the risk of flooding in the urban roads, the consumers also prefer a vehicle with high ground clearance. To cater to such consumer needs while making the product affordable, some of the major as also some new OEMs started to launch compact SUVs over the last few years. These were priced competitively compared to the sedans and also had on offer, accessories derived from the latest technology. Clearly, this has expanded the SUV market in a big way. In FY17, there were five major players who had around 90% of the total SUV space whereas in FY21, there are around 8 players whose market share aggregated to 92%. The emergence of new players and introduction of various new models such as Vitara Brezza, Hyundai Creta & Venue, Kia Seltos & Sonet, Tata Nexon, Nissan Magnite and Renault Kiger among others has clearly brought in a transformation in the PV industry.

The compact SUV (which we have defined as sizes upto 4400 mm costing less than Rs 20 lakhs) has clearly been one of the major game changer in the overall SUV segment. The compact SUV segment gained popularity from the year FY20 with new model launches from all major key players in the industry and its affordable prices compare with sedans along with advance technological gadgets such as high infotainment system, steering mounted key controls, sunroof etc. in the vehicle. The compact SUV segment grew around 15% CAGR over the FY19-21 period compared to the 6% growth of the overall SUV segment during the same period.

Going forward, Acuité believes that the SUV segment will continue to show a solid growth trajectory over the medium term especially with the ever growing popularity for the compact SUVs along with the support of new launches such as Mahindra XUV700, Volkswagen Taigun, Skoda Kushaq and the recently launched Tata Punch. However, a slowdown is expected in factory despatches the near term due to the continuing shortage of semi-conductors that has already led to an increasing waiting period for selected models.

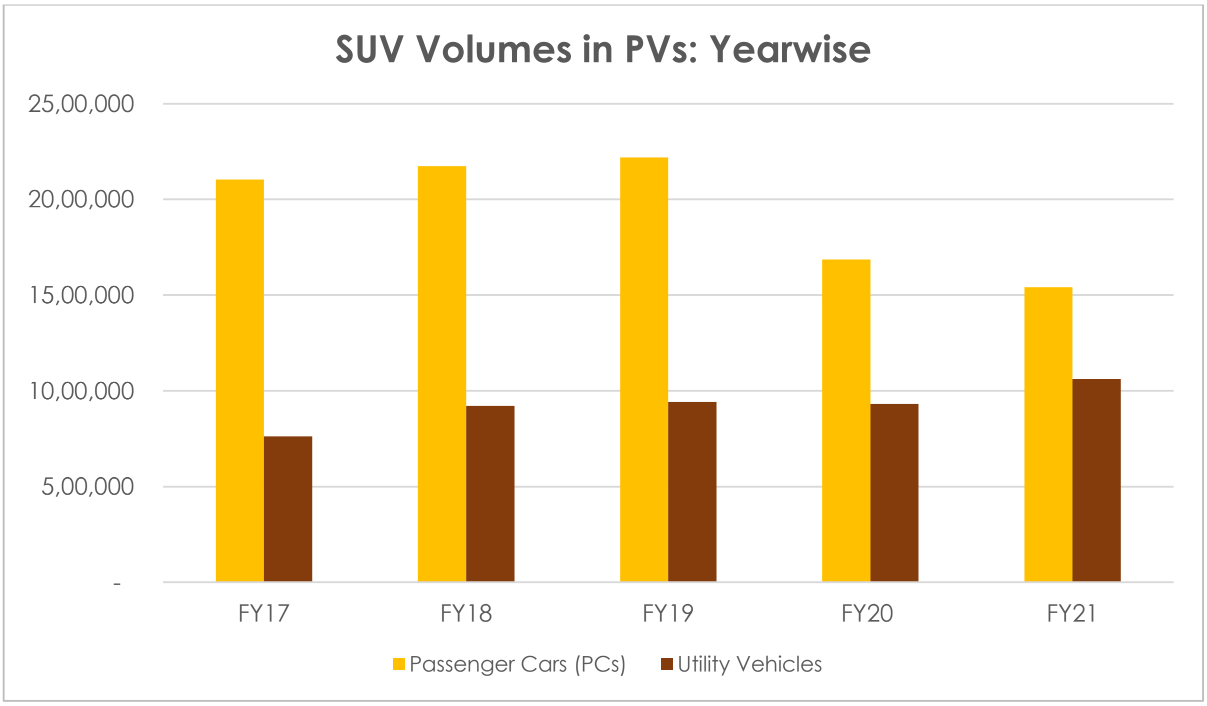
Annexure

Table 1: SUVs has been an outperformer in the PV industry

Segment	FY17	FY18	FY19	FY20	FY21	H1FY21	H1FY22
Passenger Cars	21,03,355	21,74,024	22,18,489	16,85,167	15,40,799	5,05,356	6,81,791
YoY (%)		**3.4**	**2.0**	**-24.0**	**-8.6**		**34.9**
Utility Vehicles	7,61,996	9,22,322	9,41,535	9,32,632	10,61,361	3,38,841	6,52,888
YoY (%)		**21.0**	**2.1**	**-0.9**	**13.8**		**92.7**
Vans	1,81,728	1,92,235	2,17,426	1,25,083	1,06,022	35,052	51,687
YoY (%)		5.8	13.1	-42.5	-15.2		47.5
Total	**30,47,079**	**32,88,581**	**33,77,450**	**27,42,882**	**27,08,917**	**8,79,249**	**13,86,366**
YoY (%)		**7.9**	**2.7**	**-18.8**	**-1.2**		**57.7**

Source: CMIE, Acuité Research

Chart 1 1: SUV sales continue to grow at a faster rate vs Passenger Cars



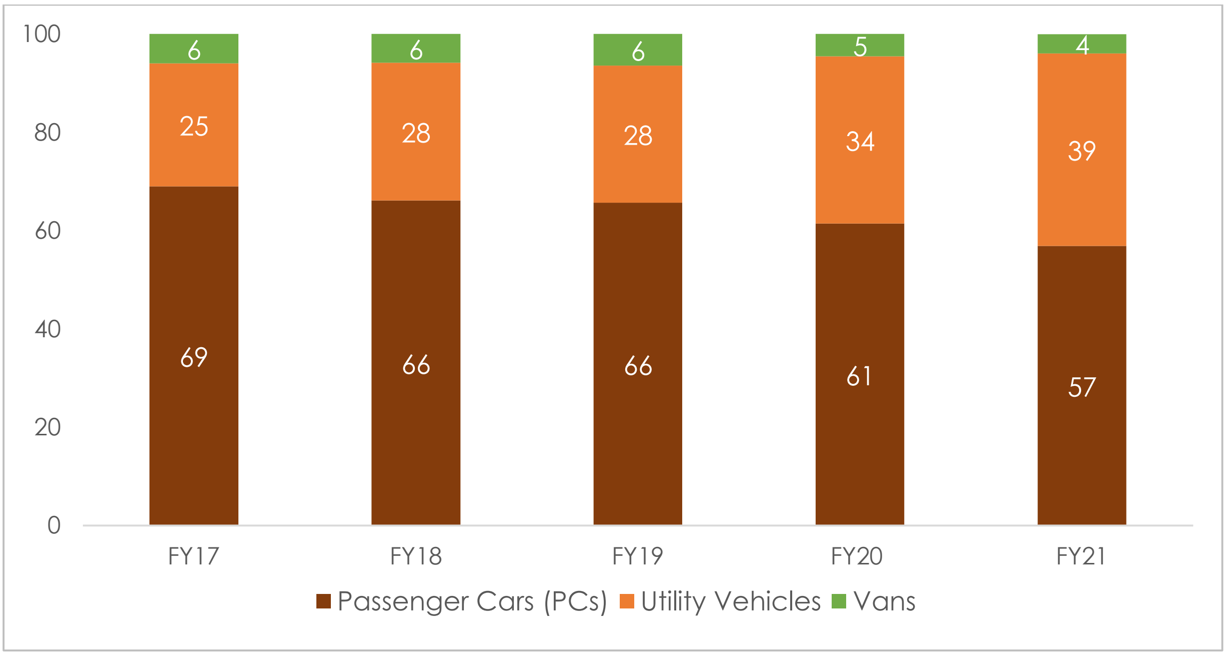
Source: CMIE, Acuité Research

Table 2: Compact SUVs has been a game changer for UVs

Segments	FY18	FY19	FY20	FY21	H1FY21	H2FY22
Upto 4,400mm and price < Rs.20 Lakhs	6,53,988	6,66,723	7,16,440	8,84,798	2,79,703	5,33,647
YoY (%)		**1.9**	**7.5**	**23.5**		**90.8**
4,401mm-4,700mm and price < Rs.20 lakhs	1,93,162	2,12,780	1,22,162	1,02,572	34,881	70,888
YoY (%)		10.2	-42.6	-16.0		103.2
Above 4,700mm and price < Rs.20 lakhs	17,821	10,673	55,902	38,672	13,102	23,475
YoY (%)		-40.1	423.8	-30.8		79.2
Price between Rs.20- 30 lakhs	54,712	48,006	15,391	13,041	4,638	10,739
YoY (%)		-12.3	-67.9	-15.3		131.5
Price above Rs.30 lakhs	2,639	3,353	22,737	22,278	6,517	14,139
YoY (%)		27.1	578.1	-2.0		117.0
Total	**9,22,322**	**9,41,535**	**9,32,632**	**10,61,361**	**3,38,841**	**6,52,888**
YoY (%)		2.1	-0.9	13.8		92.7

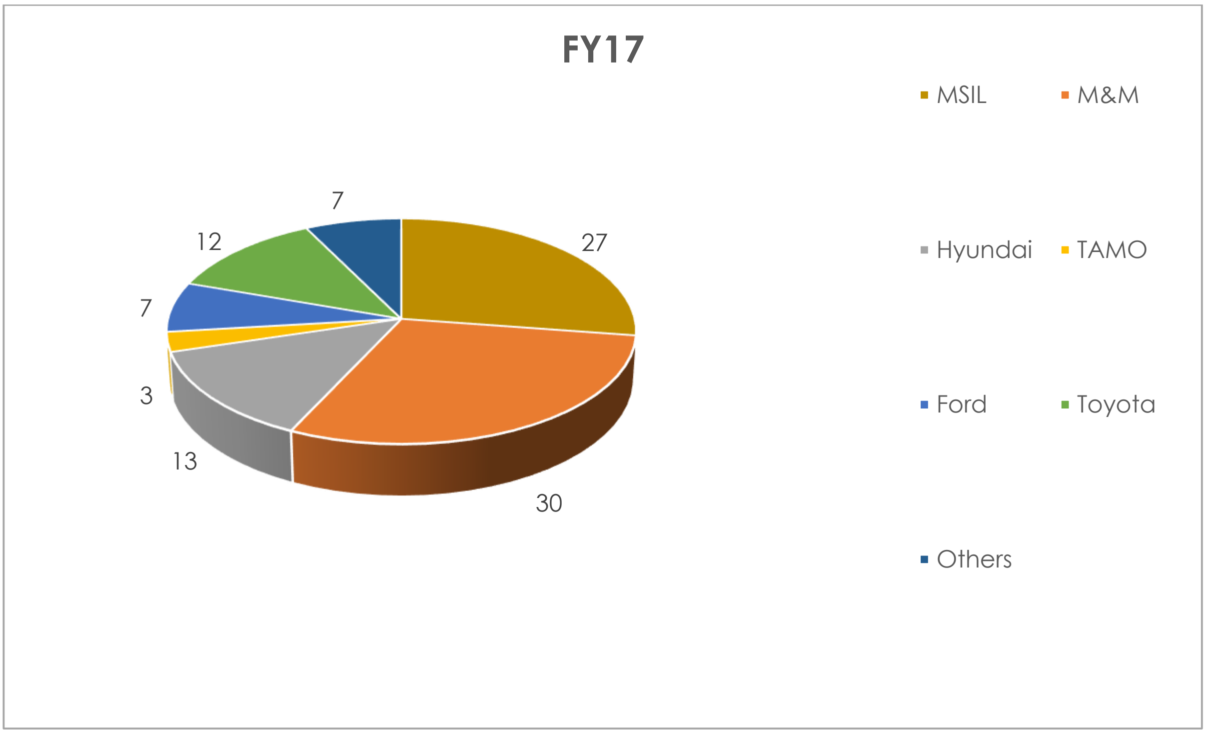
Source: CMIE, Acuité Research

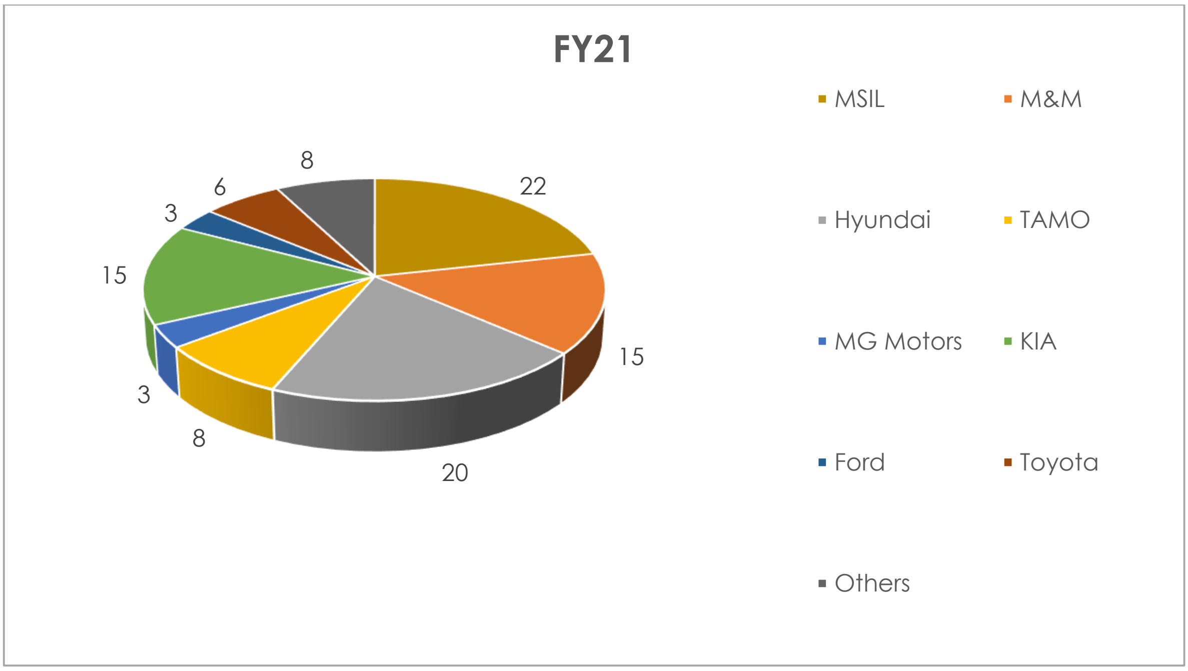
Chart 2: Segment wise market share of PVs over the years



Source: CMIE, Acuité Research

Chart 3-4: Variation in player wise market share in the SUV space (FY17-21)





Source: CMIE, Acuité Research

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 8,850 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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