Resilience in the Indian economy

Acuité Ratings continue to peg the GDP growth at 7.5% for FY19

Overview

We continue to expect the economy to print an overall 7.5% GDP growth in FY19, the weakness in the second quarter notwithstanding. One of the key aspects of the economic resilience is that the threat of inflation seems to be under control with the headline inflation number remaining consistently below the targets of RBI. From the aggregate demand perspective, India remains the fastest growing major economy in the world. While the Q2 number disappointed a bit, the consumption led story shows a promise of sustainability.

The government expenditure remains the primary driver of growth with green shoots being witnessed in capital formation. Acuité believes that the maintenance of adequate systemic liquidity is the key to the sustainability of the India growth trajectory. While there were challenges in the liquidity scenario in late Q2, RBI has taken suitable measures to infuse liquidity which has led to the easing of the differential between the repo and the weighted average call money rate (WACR), which was in negative domain in August 2018.

There are also signs of revival in the debt capital markets which have been languishing due to interest rate volatility and significant duration risks. The headwinds from the global financial markets on the other hand seem to have dropped off now but one cannot take down guard in such a volatile environment. Although Acuité Ratings is confident about the resilience of the domestic economy, the government needs to do a fine balancing act which while ensuring the activation of all growth engines in the economy, will also adhere to fiscal prudence.

Acuité Ratings continue to maintain a positive outlook on the Indian macroeconomic landscape. While there were indeed several domestic and global headwinds that had led to economic uncertainty during the current year, their intensity has not only subsided but the economy has also developed a resilience against these threats. We expect the economy to print an overall 7.5% GDP growth in FY19, the weakness in the second quarter notwithstanding.

Inflation Outlook

One of the key aspects of the economic resilience is that the threat of inflation seems to be under control with the headline inflation number remaining consistently below the targets of RBI. The RBI, which raised rates in accordance with its inflation expectations in June and August 2018 has already indicated a stance away from calibrated tightening. With the hog cycles taking shape in India's food basket, food category inflation has been significantly impacting the overall CPI print. RBI expects headline inflation to remain range bound (3.9%-4.2%) by the end of FY19and the print not to exceed 4.5% in Q1 FY20, the latter figure being RBI's medium-term target level.

Aggregate Demand

From the aggregate demand perspective, India remains the fastest growing major economy in the world. While the Q2 number disappointed a bit, the consumption led story shows a promise of sustainability. The government expenditure remains the primary driver of growth with green shoots being witnessed in capital formation. While the OBICUS survey reveals that capacity utilization levels have diminished to around 73% in H1 of the current financial year, firms are positive about their pipelines and new orders. The IIP and core industries too have shown signs of consistency over the last 2-3 months. Strong show by the manufacturing sector has been resonating well with the healthy consumer durable and non-durable consumption and demand for capital goods. We also see a shift to higher value added categories, augmenting GVA figures. Also, the PMI manufacturing for November 2018 has reached a 9-month high level. The index's two months lag with IIP augurs well for the domestic manufacturing sector in the near term.

Systemic Liquidity

Acuité believes that the maintenance of adequate systemic liquidity is the key to the sustainability of the India growth trajectory. While there were challenges in the liquidity scenario in late Q2, RBI has taken suitable measures to infuse liquidity which has led to the easing of the differential between the repo and the weighted average call money rate (WACR), which was in negative domain in August 2018. Over the past month, the ratio, however has been hovering in the vicinity of 7-12 bps, bringing about a semblance of comfort in the money markets. Commercial Paper issuances have rebounded with over 35% growth YTD after a sudden dip in the second quarter. The relaxation of high quality liquid assets (HQLA) norms for banks are also expected to shore up the liquidity position.

State of Banking

The banking NPA crisis had already taken a significant toll on the lending ability of commercial banks particularly the public sector segment. While credit growth has jumped to 14.2% yoy in the April-December period, several sectors including MSME, infrastructure and NBFCs continue to face challenges in mobilising funds. However, the government has already committed a larger capital outlay for the public sector for the current year at Rs. 1.06 lakh Cr which includes an additional amount of Rs. 41,000 Cr. over and above the amount budgeted for FY19. This is expected to improve the capital position of several weak banks who are now expected to emerge from the shadow of the Prompt Corrective Action (PCA) category and revive their lending activities.

Capital and Money Market

There are also signs of revival in the debt capital markets which have been languishing due to interest rate volatility and significant duration risks. For much of this year, corporate bond issuances recorded an over 30% decline of late, green shoots are seen. This is primarily driven by an expectation that RBI may return to a neutral stance by the next MPC meeting, given the benign inflation outlook as well as the dovish stance of the US Fed Governor. The market nonetheless, continues to discount Indian debt higher than usual given the elevated US/ India 10 year G-Sec differential and India 10 year G-Sec/ AAA Corporate Bond spreads. Going forward, such differentials are expected to come down, pushing up issuances. The access to funds for NBFCs are also likely to improve in the near term with a revival in bond issuances for highly rated companies and the pick-up in the volume of retail securitisation transactions.

Global Scenario

The headwinds from the global financial markets seem to have dropped off now but one cannot take down guard in such a volatile environment. While there seems to be a consensus between US and Chinese trade negotiators regarding the tariff dispute, things seem desultory at best. The lack of consensus in the December 6th 2018 OPEC meeting regarding production controls (as well unfruitful negotiations with Russia) along with lack of American support for COP 24 are bigger risks to be considered. For now, oil prices along with other commodities are stable and are aiding the current account balance of import dependent emerging markets such as India.

Concluding Remarks

Although Acuité Ratings is confident about the resilience of the domestic economy, there are upcoming events which it believes, demand a constant vigilance on several macro-economic variables particularly the fiscal deficit. With the national elections on the horizon along with the concluded state elections, the demands for populism are set to increase as reflected in the recently announced farm loan waivers in the states of Rajasthan, Madhya Pradesh and Chattisgarh. The government needs to do a fine balancing act which while ensuring the activation of all growth engines in the economy, will also adhere to fiscal prudence.

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited *(Erstwhile SMERA Ratings 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 6000 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 Mumbai.

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