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INDIAN ECONOMY: GDP OUTLOOK

JULY 2020

"Recovery interrupted: ICRA revises GDP forecast for FY2021 to a contraction of 9.5% owing to localized lockdowns, rising Covid-19 infections"

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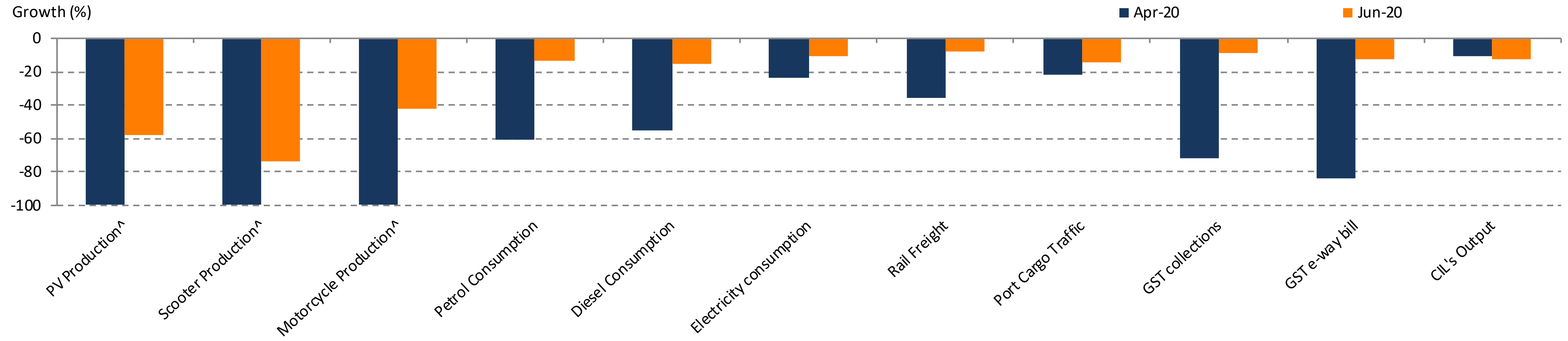
OUTLOOK

The Indian economy had started to recover from the troughs experienced in April 2020, when the lockdown was at its severest, and many sectors seemed to be adjusting to a new normal. However, the unabated rise in Covid-19 infections in the unlock phase and localised re-imposition of lockdowns in several states, have interrupted this recovery in recent weeks. Given the severity of the pandemic and the duration of the safety measures that need to be employed, we now expect a deeper pace of GDP contraction in Q2 FY2021 relative to our earlier forecast. We also anticipate more unevenness, as different regions move in and out of lockdowns, and persisting labour supply mismatches affect supply chains and consumption patterns. Additionally, the timeline for a firmer recovery out of the contractionary phase is now being pushed ahead to at least Q4 FY2021 from Q3 FY2021. This presumes that a vaccine will be widely available by then, which now appears necessary for discretionary consumption to recover in certain sectors such as travel, hospitality and recreation. We have also tempered our expectations regarding the extent of fiscal support that may be forthcoming, given the revenue shock being experienced by various levels of governments. However, we remain optimistic regarding the outlook for agricultural growth and rural consumption. On balance, we have revised our forecast of the contraction in Indian GDP in FY2021 to 9.5% from 5.0%.

The available data up to June 2020 provided some broadly encouraging cues of a gradual, yet uneven recovery across different sectors relative to the troughs experienced in April 2020. For instance, from a situation of virtually no production in April 2020, the output of passenger vehicles, scooters and motorcycles resumed in May 2020, and recorded a YoY de-growth of 57.7%, 74.2% and 42.4%, respectively, in June 2020 (refer Exhibit 1). The de-growth in petrol and diesel consumption narrowed sharply to 13.6% and 15.4%, respectively, in June 2020 from 60.4% and 55.5%, respectively, in April 2020. Moreover, data released by POSOCO indicates that the contraction in electricity consumption narrowed to 10.5% in June 2020 from 24.0% in April 2020, which is expected to mirror the trends in broader economic activity in that period.

Exhibit 1: YoY performance of economic lead indicators in April 2020 and June 2020



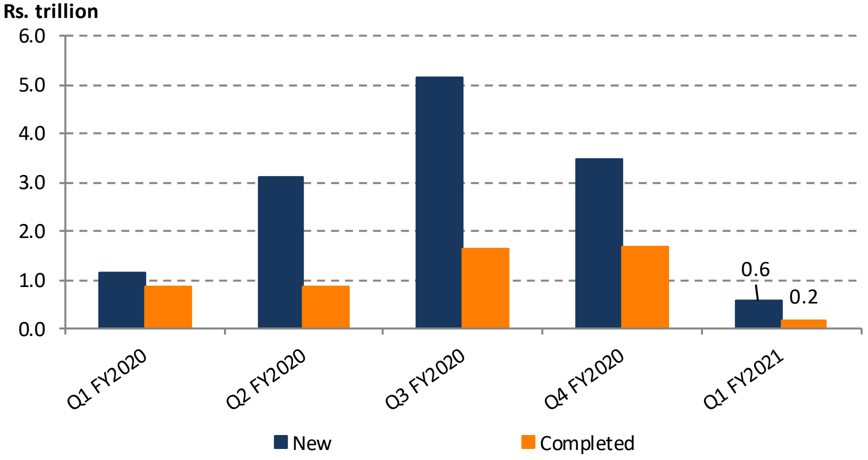
^Auto data for April 2020 was not reported; with most factories closed on account of the lockdown, we have assumed output to be zero in that month; Source: Society of Indian Automobile Manufacturers (SIAM); Power System Operation Corporation Limited (POSOCO); Petroleum Planning and Analysis Cell (PPAC); Indian Ports Association; Indian Railways; Goods and Services Tax Network (GSTN); Controller General of Accounts (CGA); Coal India Limited (CIL); ICRA Research

Indicators for freight and GST collections and e-way bills were also encouraging. The contraction in rail freight eased appreciably to a modest 7.7% in June 2020 from 35.3% in April 2020, whereas ports cargo traffic reported a moderate improvement to 14.5% from 21.1%, respectively. GST collections as a percentage of the year-ago levels recovered sharply from a low 28% in April 2020 to 91% in June 2020. However, the inflows in June 2020 included late payments for the previous three months as well, and are therefore unlikely to be a good representation of the level of collections we should expect in the subsequent months. Data on e-way bills also provided a similar picture. GST e-way bills as a percentage of the year-ago levels rose from a muted 16% in April 2020 to 87% in June 2020. ***In our view, pent up demand, especially for items that are now considered to be essential under the new normal of work from home, could lead to a temporary uptick in the production and sales of small to mid-ticket consumer durables in the initial unlock period. This would boost both e-way bills and GST collections, but may not sustain subsequently.***

However, not all indicators have shown a secular improvement. For instance, the pace of de-growth in the output of Coal India Limited worsened to 12.8% in June 2020 from 10.9% in April 2020, reflecting the lagged impact of subdued offtake levels.

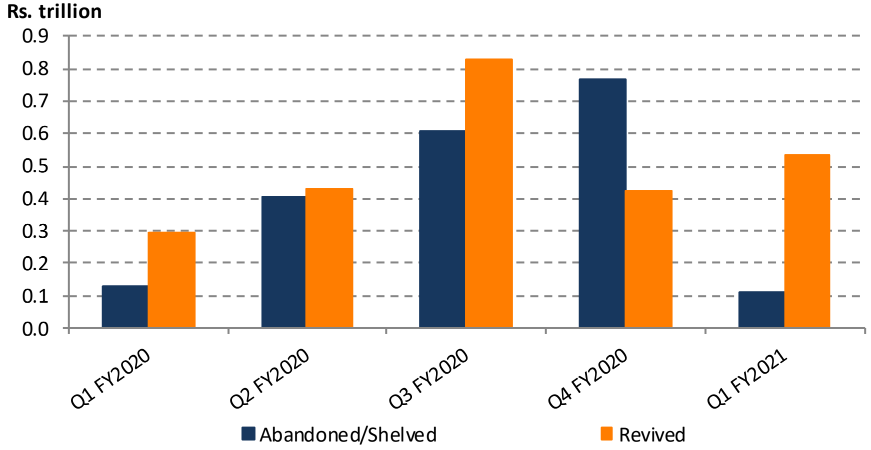
Additionally, the early data released by the Centre for Monitoring Indian Economy (CMIE) indicates a decline in the value of new and completed projects in Q1 FY2021 (refer Exhibit 2). For instance, new project announcements moderated sharply to Rs. 0.6 trillion in Q1 FY2021 from Rs. 1.2 trillion in Q1 FY2020 and Rs. 3.5 trillion in Q4 FY2020 (source: www.economicoutlook.cmie.com, Centre for Monitoring Indian Economy, July 16, 2020), led by both the Government and private sector. The value of completed projects plunged to a low Rs. 0.2 trillion in Q1 FY2021, from Rs. 0.9 trillion in Q1 FY2020 and Rs. 1.7 trillion in Q4 FY2020, highlighting the disruption caused by the lockdown. On a somewhat positive note, the value of revived projects rose to Rs. 0.5 trillion in Q1 FY2021, from Rs. 0.3 trillion in Q1 FY2020 and Rs. 0.4 trillion in Q4 FY2020 (refer Exhibit 3). Moreover, the value of abandoned projects declined sharply to Rs. 0.1 trillion in Q1 FY2021, from Rs. 0.8 trillion in Q4 FY2020, while remaining similar to the level of Rs. 0.1 trillion in Q1 FY2020.

Exhibit 2: Value of new and completed projects



*Source: CMIE; www.economicoutlook.cmie.com ; *July 16, 2020*

Exhibit 3: Value of abandoned and revived projects



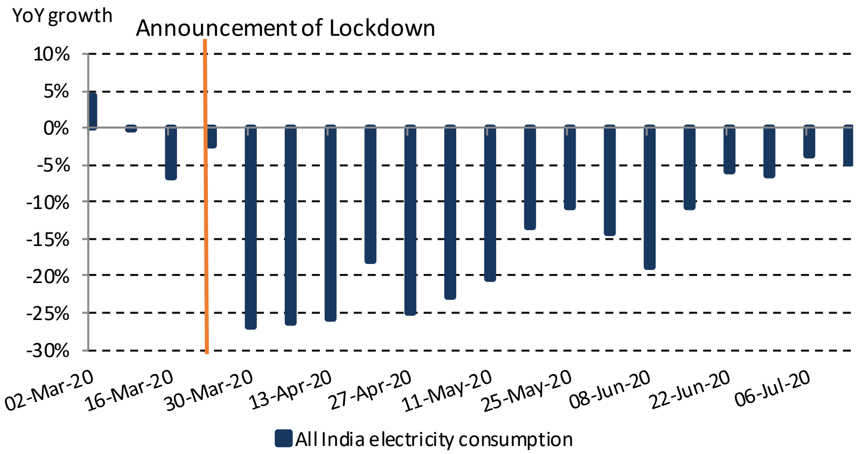
*Source: CMIE; www.economicoutlook.cmie.com ; *July 16, 2020*

Exhibit 4: Re-imposition and extension of lockdown by state governments*

States/Districts	Till
Tamil Nadu	July 31, 2020
Maharashtra	July 31, 2020
Pune	Section 144 during July 14 -18, 2020
West Bengal	July 19, 2020
Siliguri Municipal Corporation	July 16-22, 2020
Assam	July 31, 2020
Odisha (nine urban areas of Ganjam district)	July 21, 2020
Bihar	July 16-31, 2020
Noida, Ghaziabad and other parts of UP	Weekends in the month of July 2020 starting from July 18
Madhya Pradesh	Every Sunday
Bengaluru	July 14, 2020 to July 21, 2020
Kerala (critical coastal areas)	July 23, 2020
Jharkhand	July 31, 2020
Karnataka (Dharwad and Dakshina district)	July 21, 2020/ July 23, 2020

**As on July 16, 2020; Source: ICRA research*

Exhibit 5: YoY performance of electricity consumption on weekly basis

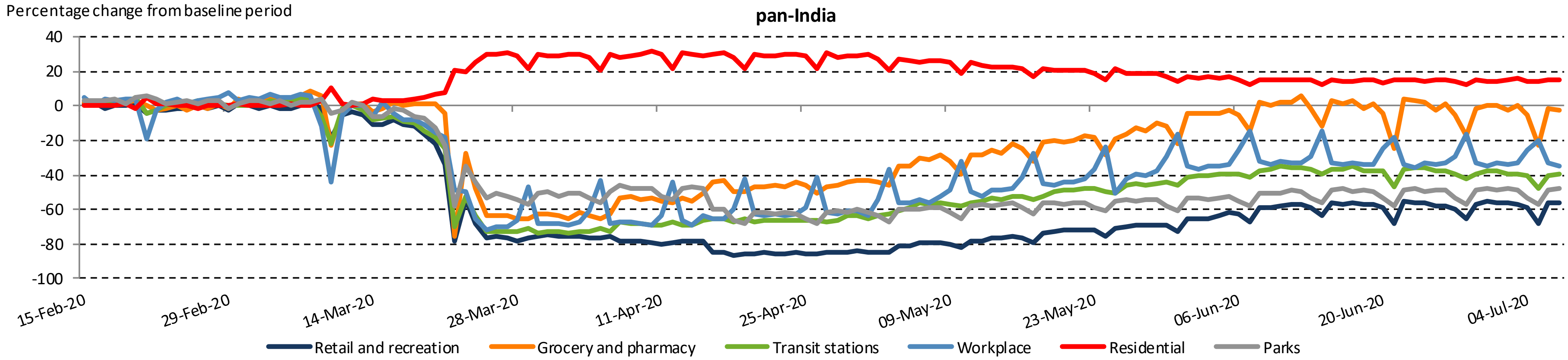


Source: POSOCO; ICRA research

However, the unabated rise in Covid-19 infections in the unlock phase has resulted in localised re-imposition of lockdowns in several states (refer Exhibit 4), which has interrupted this recovery in recent weeks. For instance, data on electricity consumption signals a mild worsening in the pace of contraction to 4.9% for the week ending July 13, 2020 from 3.7% for the week ending July 6, 2020 (refer Exhibit 5). Additionally, data on mobility sourced from Google indicates a plateau in the recent weeks (refer Exhibit 6).

Moreover, news reports suggest that some production facilities have had to halt operations temporarily, given a spurt of Covid-19 infections amongst their workers. ***Given the severity of the pandemic and the duration of the safety measures that need to be employed, we now expect a deeper pace of GDP contraction in Q2 FY2021 relative to our earlier forecast. We also anticipate more unevenness, as different regions move in and out of lockdowns, and persisting labour supply mismatches affect supply chains and consumption patterns. Additionally, the timeline for a firmer recovery out of the contractionary phase is now being pushed ahead to at least Q4 FY2021 from Q3 FY2021. This presumes that a vaccine will be widely available by then, which now appears necessary for discretionary consumption to recover in certain sectors such as travel, hospitality and recreation.***

Exhibit 6: Category wise mobility of people to places on a pan-India level[1]



Source: Google LLC; Google Global Mobility Report; ICRA Research

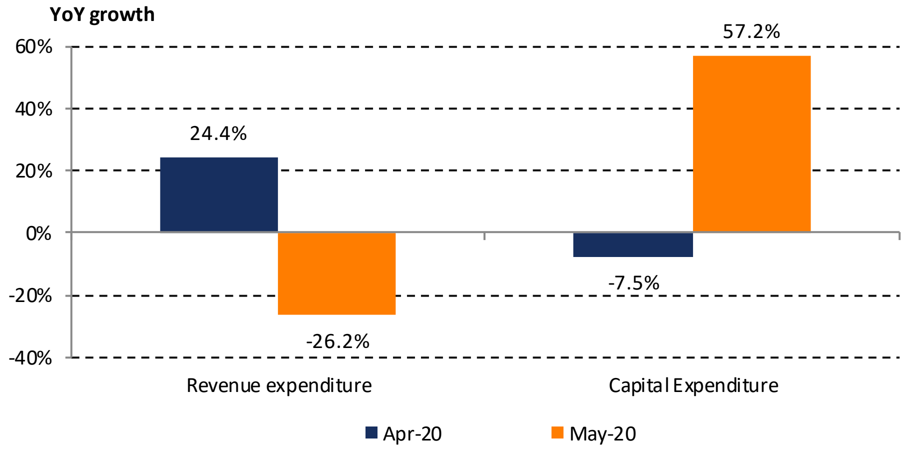
We have also tempered our expectations regarding the extent of fiscal support that may be forthcoming, given the revenue shock being experienced by various levels of governments. Available data indicates a mixed trend in the revenue and capital spending of the Government of India (GoI) during the lockdown months. After expanding by a sharp 24.4% in April 2020, partly reflecting the upfronting of some expenditures, the GoI's revenue spending contracted by 26.2% in May 2020 (refer Exhibit 7). In contrast, its capital outlay had shrunk by 7.5% in the first month of the lockdown, before displaying a substantial 57.2% increase in May 2020, as the lockdown restrictions were partly eased. Overall, the GoI's total spending in April-May 2020 was largely stagnant at year-ago levels (refer Exhibit 8).

The fiscal support under the "Aatma Nirbhar Bharat Abhiyan" announced by the GoI is estimated at a modest 1.0% of GDP or around Rs. 2.0 trillion. Subsequently, the provision of free foodgrains under the Pradhan Mantri Garib Kalyan Ann Yojana, was recently extended to November 2020, with an aggregate cost of Rs. 1.5 trillion. Our understanding is that only Rs. 0.3 trillion towards such costs was included in the fiscal support announced earlier by the GoI; whether the balance amount would be funded through budgetary resources remains unclear.

The previously enhanced outlay for MGNREGS, and the subsequently launched Prime Minister Garib Kalyan Rojgar Abhiyaan, would refocus the spending of the Government on the rural areas that have received large numbers of returning migrants. A portion of the higher expenditure may get funded by the savings released by the spending restrictions imposed on various ministries and departments, which have recently been extended to Q2 FY2021. Moreover, it has been clarified that the amount remaining unspent in a particular month/quarter, will not get automatically carried forward to the next month/quarter. While assessing the extent of savings that can be generated by such restrictions is challenging, this nevertheless poses a downside risk to economic activity in the coming months.

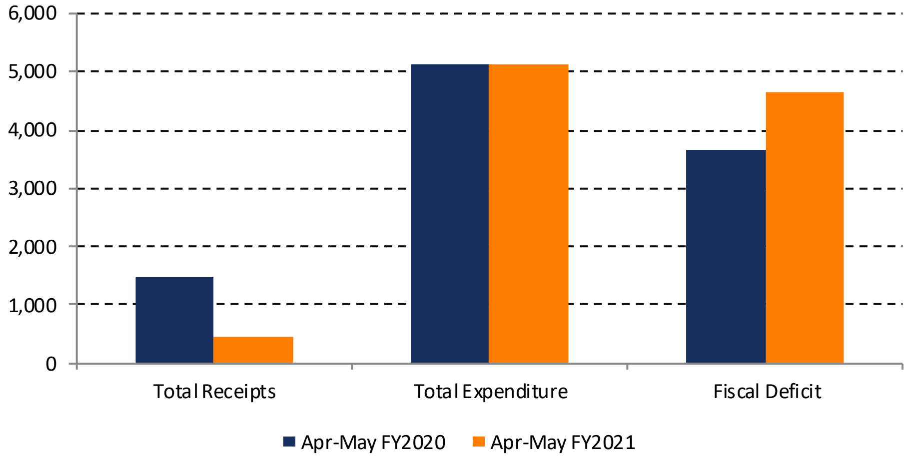
[1] *The percentage change is compared to a baseline value for the same day of the week, calculated on a median basis during the 5-week period January 3, 2020- February 6, 2020; we have taken seven day rolling average*

Exhibit 7: Monthly trend of the GoI's revenue and capital expenditure



Source: CGA; ICRA Research

Exhibit 8: Trend in the GoI's total receipts, expenditure and fiscal deficit



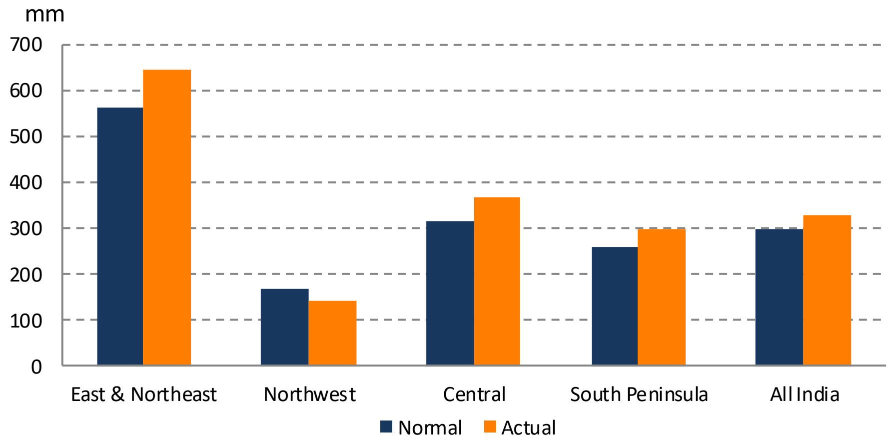
Source: CGA; ICRA Research

Faced with an unfolding revenue shock, amidst an increase in expenditure on health and social security to address the ongoing pandemic, many state governments have ordered a compression in revenue expenditure, including freezing levels of dearness allowance etc. With multiple extensions to the lockdown, the GoI has enhanced the net borrowing limit of the state governments for FY2021 to 5.0% of gross state domestic product (GSDP) from 3.0% of GSDP. However, the unconditional increase is limited to 0.5% of GSDP only, which we estimate at a modest Rs. 1.0 trillion. While the conditional increase in the borrowing limit is an ample Rs. 3.0 trillion, it is subject to conditions that some states may not be able to achieve in the specified time period. The borrowing limit of the state governments acts as a soft constraint to the size of their fiscal deficits. Ultimately, capital expenditure would have to be cut or deferred, for many of the states to remain within their fiscal deficit/borrowing threshold for FY2021. ***Those states whose fiscal profile has supported a revenue surplus over the last few years, may be relatively better off, in terms of the amount of capital expenditure that they have to sacrifice in the current situation. However, states that are having to resort to a re-imposition of lockdowns may witness an extended revenue compression, and have to further slash capex to remain within the fiscal threshold. We caution that the looming cut in state capex will prove counter-productive in reviving economic activity and animal spirits over the next few quarters.***

However, the outlook for the kharif season remains favourable. The monsoon rainfall recorded a timely onset, and the rains covered the entire country well ahead of the normal date. Benefitting from favourable moisture conditions, seasonally high reservoir levels, and returnee labourers at least in some parts of the country, kharif sowing was 44.1% higher than the year-ago level, as on July 10, 2020, and more than half of the 2019 kharif acreage had been covered (refer Exhibits 9, 10, 11 and 12). ***We continue to expect agricultural GVA to rise by 3.5-4.0% in FY2021, supporting rural sentiment.***

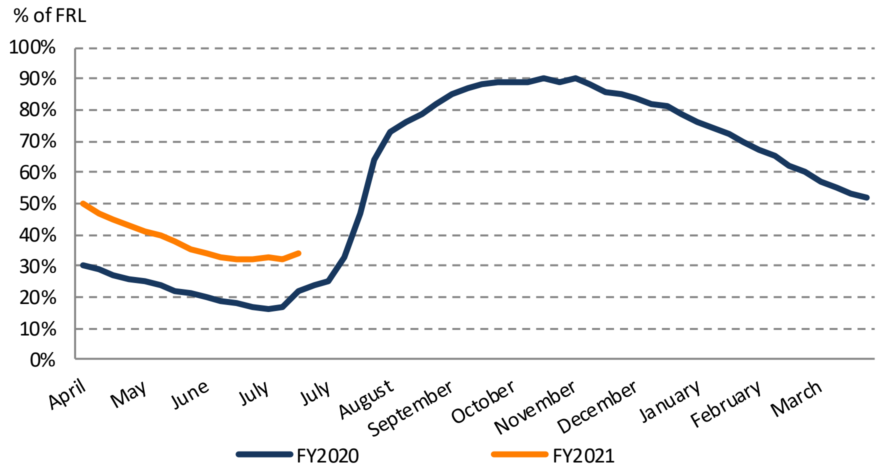
Tractor sales appear to have recovered in May 2020, suggesting that rural consumer confidence has been relatively insulated during the lockdown (refer Exhibit 13). Moreover, sales of motorcycles, which are largely rural focussed, have outperformed scooters, with a contraction of 35.2% and 47.4%, respectively, in June 2020 (refer Exhibit 14). ***Moreover, the reverse migration of a large portion of migrant workers back to the rural areas, suggests a shift in where consumption will take place at the bottom of the pyramid.***

Exhibit 9: Sub-division wise monsoon rainfall as on July 15, 2020



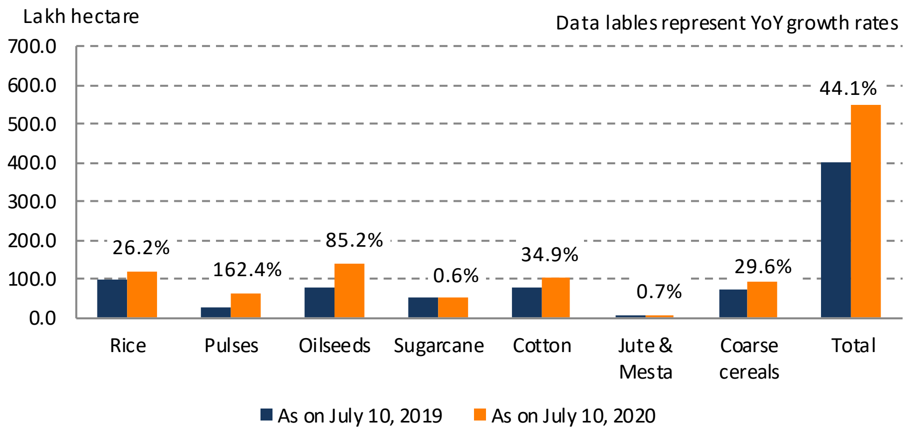
Source: Indian Meteorological Department (IMD), GoI; CEIC; ICRA Research

Exhibit 10: Reservoir Storage level in FY2020 and FY2021 YTD*



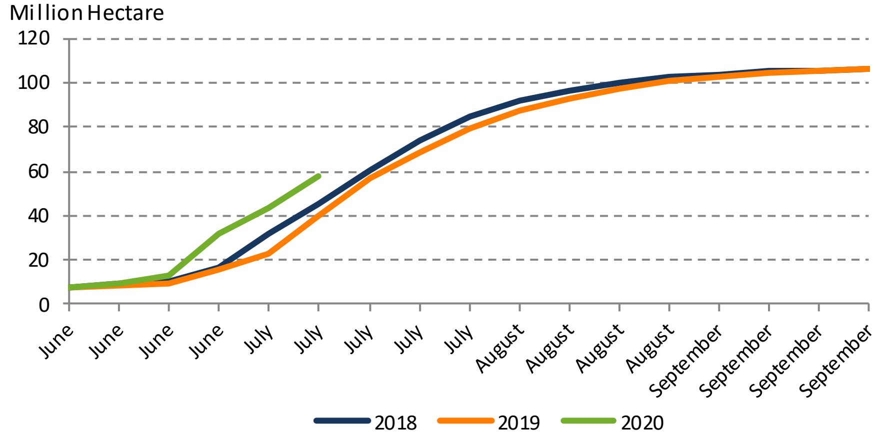
**Till July 9, 2020; Source: Central Water Commission (CWC); CEIC; ICRA research*

Exhibit 11: YoY performance of kharif sowing crops as on July 10, 2020



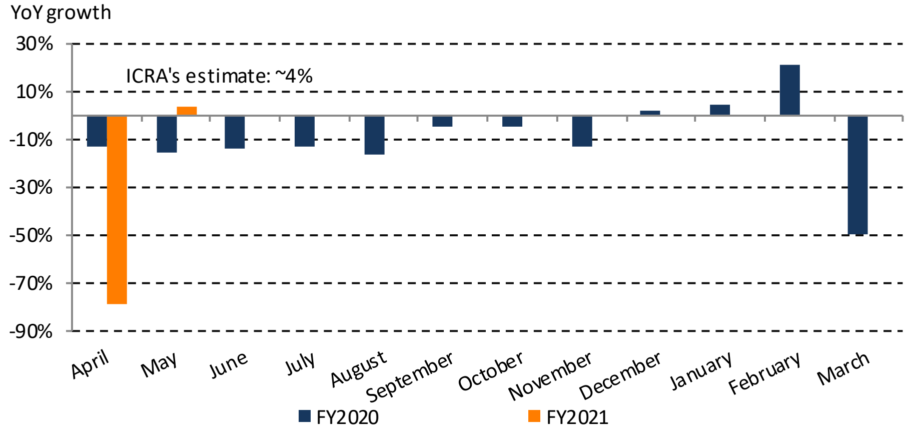
Source: Ministry of Agriculture and Family Welfare; GoI; ICRA research

Exhibit 12: Cumulative kharif sowing in 2018, 2019 and 2020 season



Source: Ministry of Agriculture and Family Welfare; GoI; ICRA research

Exhibit 13: YoY performance of domestic tractor sales



Source: CMIE; CEIC; ICRA research

Exhibit 14: YoY performance of domestic motorcycle and scooter sales

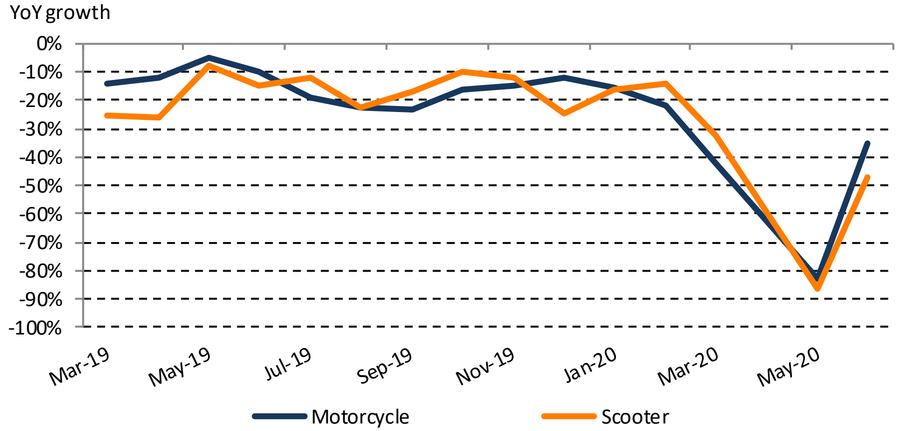
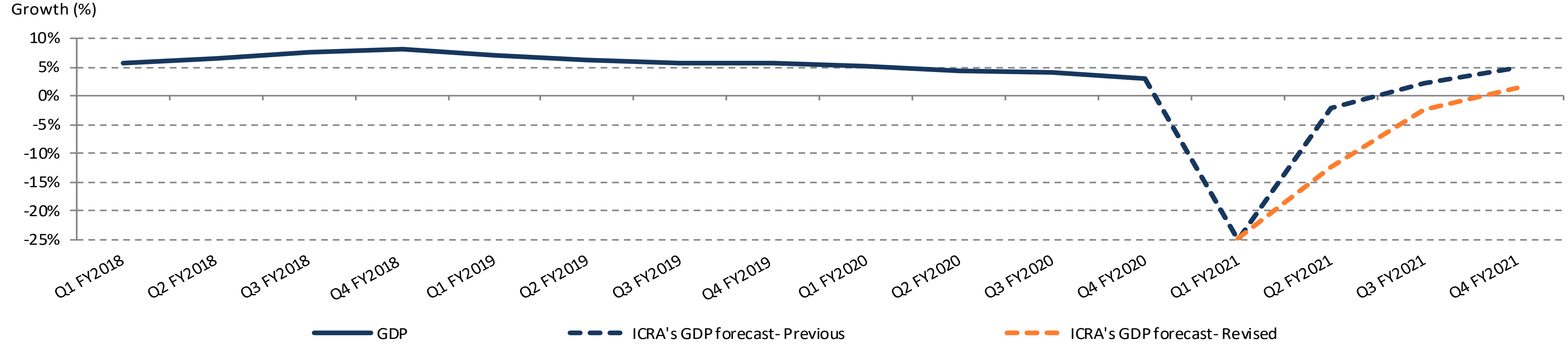


**Exhibit does not include data for April 2020 Source: SIAM; ICRA research*

Exhibit 15: YoY Growth in GDP (at constant 2011-12 Prices) and ICRA's forecasts for FY2021



Source: CSO; CEIC; ICRA Research

Our base case for Indian GDP had built in a YoY decline of 25.0% and 2.1%, respectively, in Q1 FY2021 and Q2 FY2021, followed by a mild growth of 2.1% and 5.0%, respectively, in the subsequent two quarters, resulting in a full-year contraction of 5.0% in the ongoing fiscal. ***Given the aforesaid concerns, we now expect a deeper contraction of 12.4% in Q2 FY2021, a mild contraction of 2.3% in Q3 FY2021 and an anaemic growth of 1.3% in Q4 FY2021 (refer Exhibit 15), implying a full year contraction of 9.5%.***

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ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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