ICRA

OUTLOOK FY2022

FY2022 OUTLOOK FOR INDIAN ECONOMY

Indian GDP to grow by 10.1% in FY2022; current account to revert to deficit

JANUARY 2021

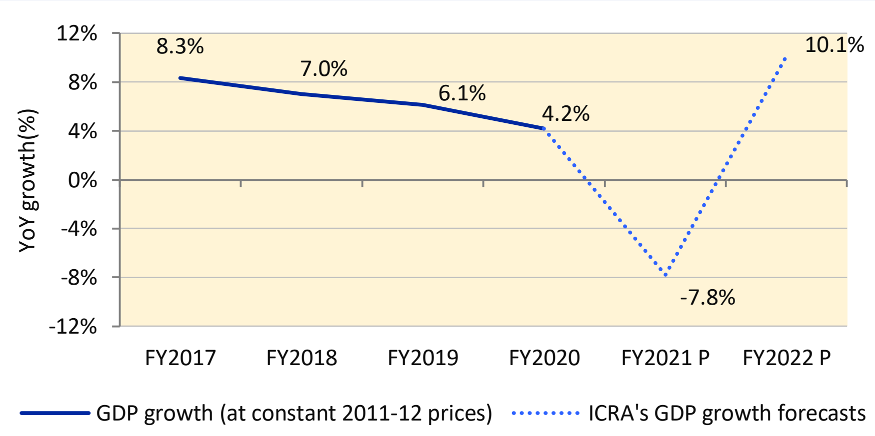
Summary

FY2022 Outlook

GDP	INFLATION	REPO RATE	FISCAL DEFICIT	EXTERNAL ACCOUNT
Real Growth: 10.1% Nominal Growth: 14.0%	CPI Inflation: 4.6% WPI Inflation: 3.8%	Extended Pause for Repo Rate Stance change to neutral in August 2021 Policy review or later	Government of India: 5.0% of GDP State Governments: 3.5% of GSDP General Government: 8.5% of GDP	Current Account: Deficit: US$15-20 billion INR: 71-74/US$

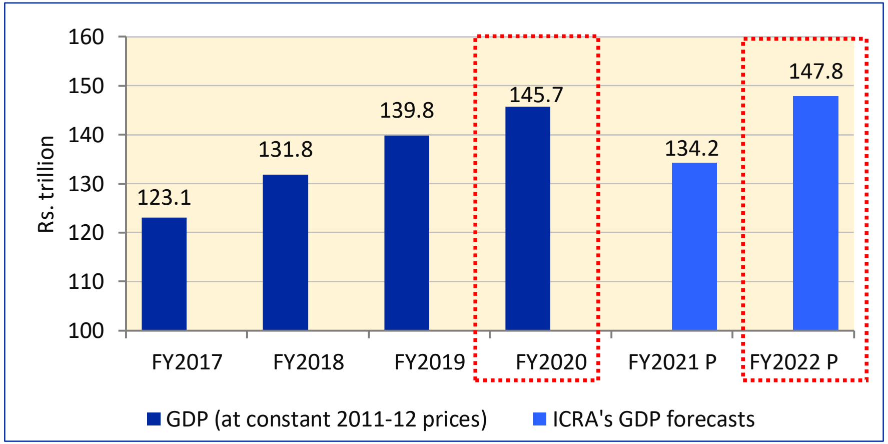
Indian GDP expected to rebound to 10.1% growth in FY2022

Exhibit: Growth of GDP (at constant 2011-12 prices)



P: Projected ***Source:*** *NSO; CEIC; ICRA Research*

Exhibit: Level of GDP (at constant 2011-12 prices) in absolute terms



P: Projected ***Source:*** *NSO; CEIC; ICRA Research*

- After a 7.8% pandemic-driven contraction in the ongoing fiscal, India's real GDP is projected to record an expansion of 10.1% in FY2022, led by the continued normalisation in economic activities as the rollout of Covid-19 vaccines gathers traction, as well as the low base.
- We expect a multi-speed recovery in FY2022, with the contact-intensive sectors, discretionary consumption and investment by the private sector lagging the rest of the economy.
- On an absolute basis, the value of Indian GDP in real terms in FY2022 is projected to be only mildly higher than the level recorded in FY2020.
- Nominal GDP is expected to expand by 14.0% in FY2022, the highest in the current-series.

CPI Inflation to ease, while exceeding mid-point of MPC's target

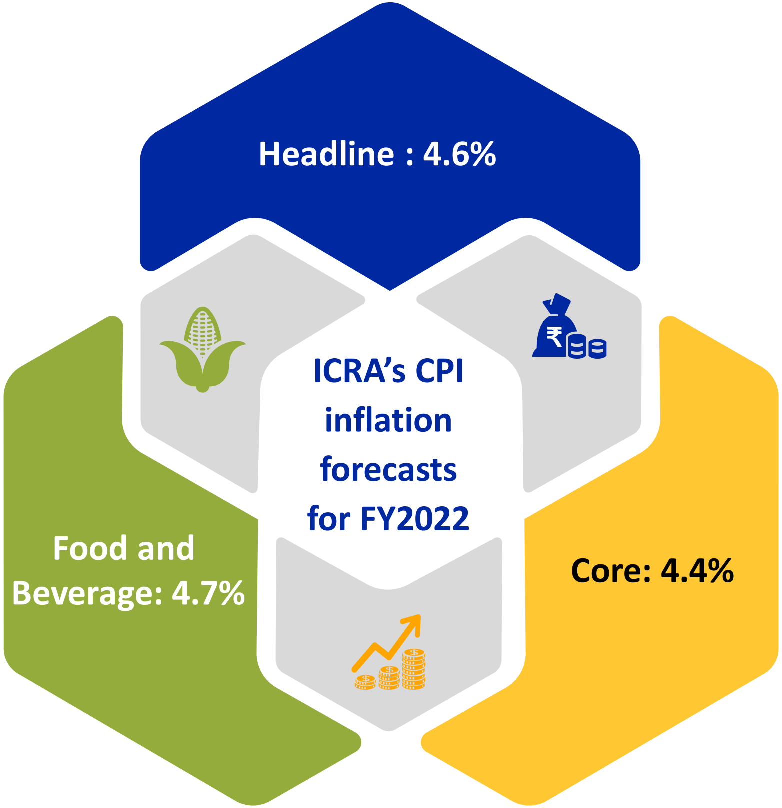
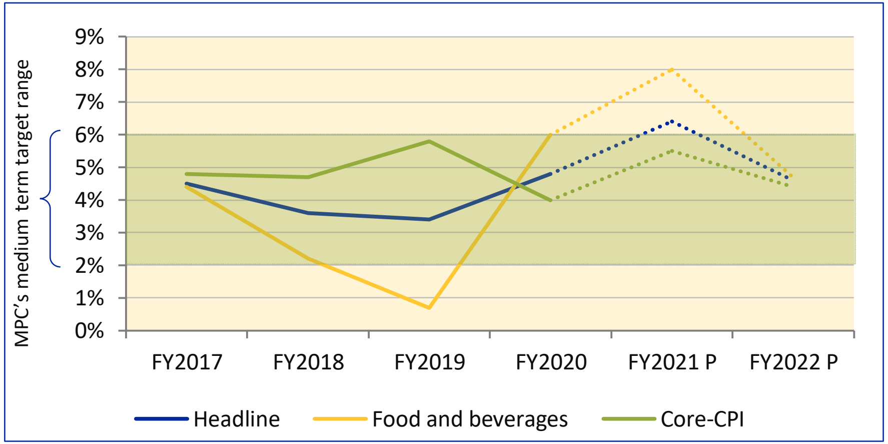


Exhibit: Headline, Food, and Core-CPI Inflation



P: Projected ***Source:*** *NSO, MOSPI; CEIC; ICRA Research*

- Headline CPI inflation to decline to 4.6% in FY2022, while exceeding the Monetary Policy Committee's (MPC's) medium-term target of 4.0%, for the third consecutive year.
- Favourable base to moderate food inflation despite pressures from edible oils, and protein items such as pulses.
- With demand expected to strengthen, core inflation may remain relatively sticky, and display a limited correction in FY2022.

WPI inflation to harden to 3.8% driven by rising core, commodities

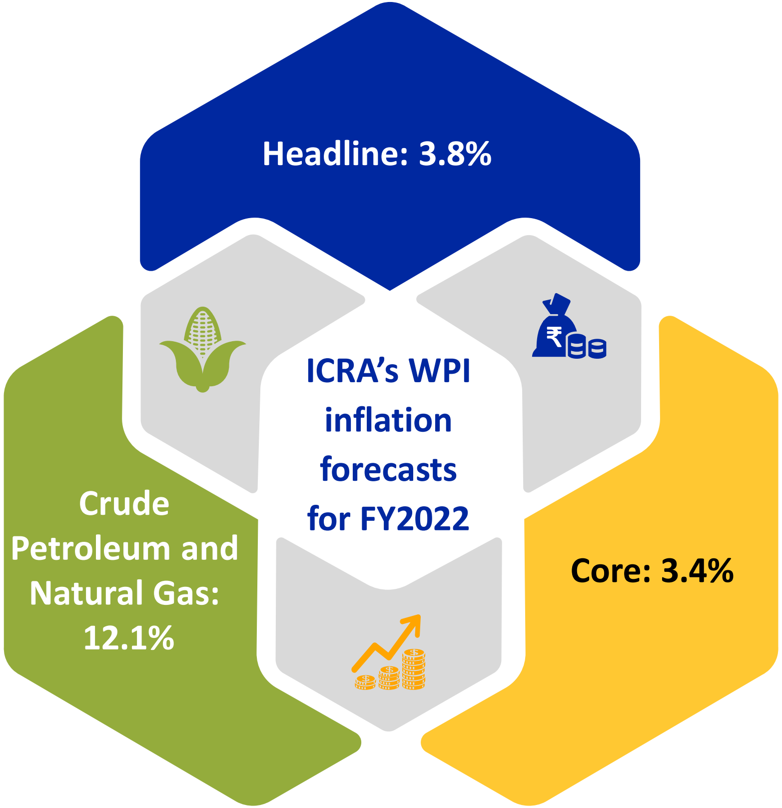
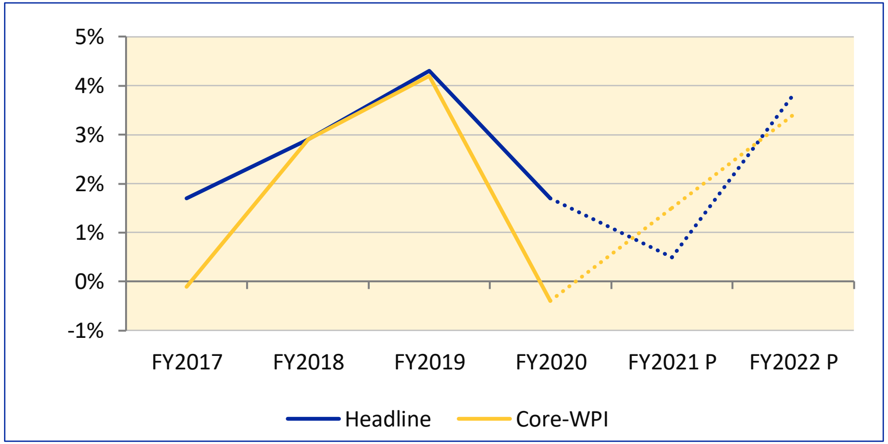


Exhibit: Headline and Core-WPI Inflation

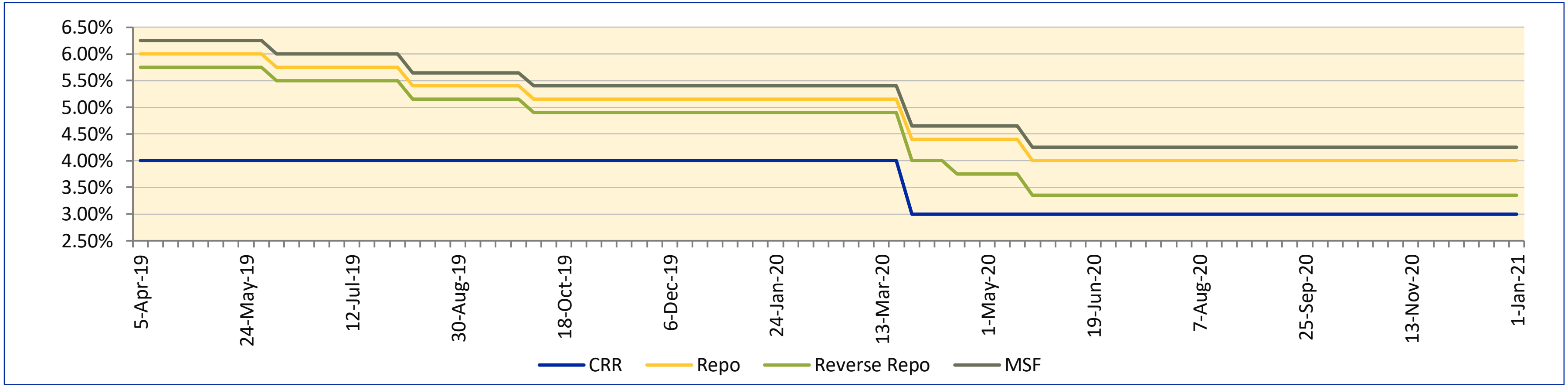


P: Projected ***Source:*** *NSO, MOSPI; CEIC; ICRA Research*

- ICRA expects the WPI inflation to harden to 3.8% in FY2022 from a mild 0.5% in FY2021, following a demand-driven uptick in inflation for core items (to +3.4% from +1.5%), as well as base-effect-led rise in prices of various commodities, especially, crude petroleum and natural gas (to +12.1% from -22.3%).
- Range-bound INR to keep imported inflation at bay, even as commodity prices normalise with recovery in global economy.

Inflation outlook suggests extended pause for repo rate

Exhibit: Movement in key rates: repo rate, cash reserve ratio (CRR), reverse repo rate and marginal standing facility (MSF)

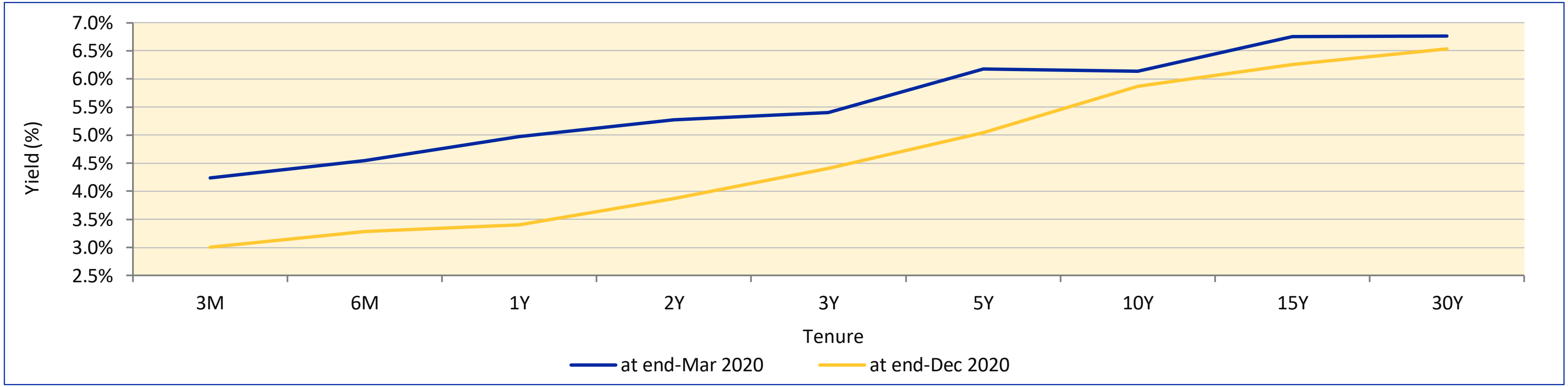


Source: *RBI; ICRA Research*

- With the CPI inflation expected to remain above the MPC's 4.0% target during FY2022, the room for further rate cuts appears negligible.
- The stance of the Monetary Policy is likely to be changed to neutral from accommodative in the August 2021 Policy review or later, only after there is greater certainty on the durability of the awaited economic revival.
- Simultaneously, the Reserve Bank of India (RBI) may initiate steps, in a calibrated manner, to reduce the magnitude of the systemic liquidity surplus.

Decline in liquidity surplus to flatten yield curve in H2 FY2022

Exhibit: G-sec yield curve

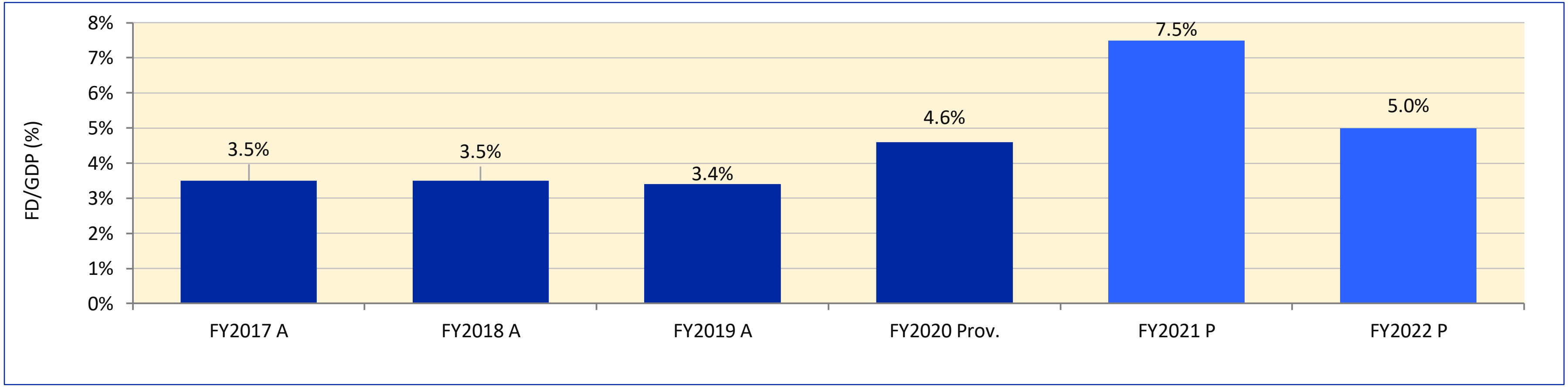


M: Month; Y:Year; ***Source:*** *RBI; CEIC; ICRA Research*

- G-sec yields will take a cue from the size of the borrowing programme of the Government of India (GoI) and the state governments for FY2022, as well as the outlook for inflation.
- Evolving expectations regarding the magnitude of incremental one-way and special open market operations (Twist OMOs) will also influence long-term yields.
- As the RBI starts to drain excess systemic liquidity, shorter-end yields are likely to display a relatively sharper hardening than longer-end yields in FY2022. Accordingly, the yield curve is expected to shift up, and flatten in H2 FY2022.

GoI's FY2022 fiscal deficit projected at 5.0%

Exhibit: GoI's Fiscal Deficit (as a percentage of Nominal GDP)

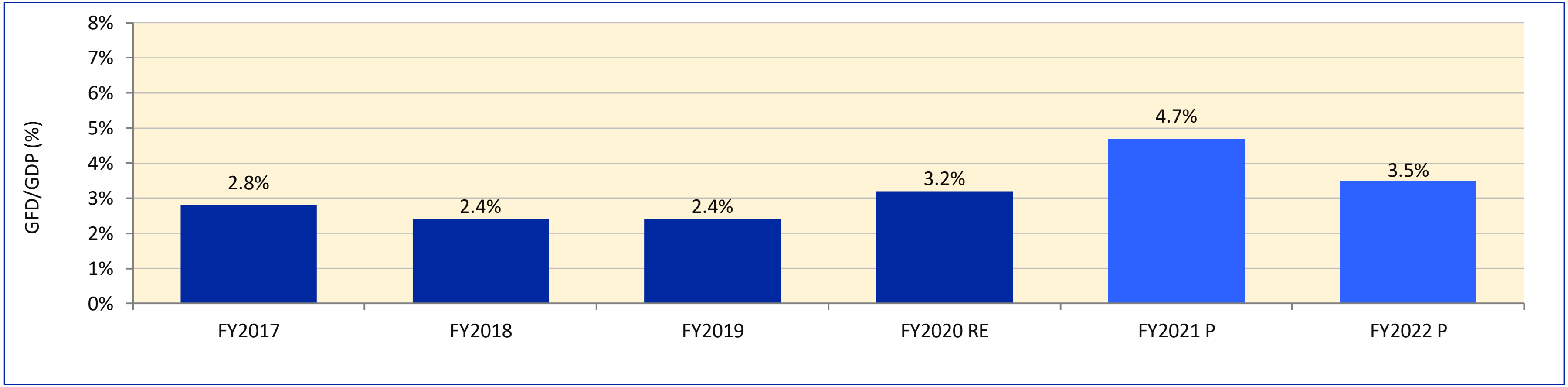


A: Actuals; Prov. : Provisional Estimate; P: Projected; ***Source:*** *Union Budget; Controller General of Accounts; Ministry of Finance; GoI; ICRA Research*

- Normalisation in economic activity should support a healthy rise in tax collections in the coming fiscal.
- While the pandemic is likely to constrain disinvestment proceeds in FY2021, the pipeline for FY2022 is healthy. However, non-tax revenues such as the inflows of the GoI from the telecom sector, and the surplus to be transferred by the RBI, would be muted in FY2022.
- A fiscal deficit of 5.0% of GDP would allow enough space for prioritising health expenditure, Covid-19 vaccine rollout as well as capital spending, in our view.
- The fiscal deficit target could either be set as a point estimate, or articulated as a relatively narrow range, around the mid-point of 5.0% of GDP.

States' fiscal deficit likely to be anchored at 3.5% of GSDP in FY2022

Exhibit: Gross Fiscal Deficit (as a percentage of Nominal GDP/GSDP) of all State Governments and Union Territories

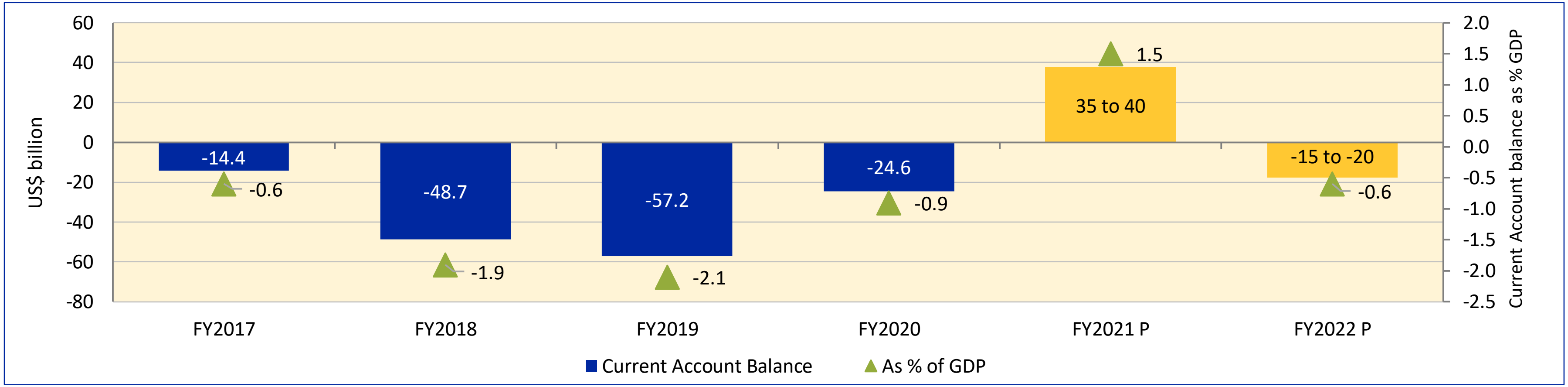


**FY2021 P based on sample of 12 state governments- Karnataka, Kerala, Tamil Nadu , Gujarat , Maharashtra , Punjab, Haryana, Rajasthan, West Bengal, Telangana, Andhra Pradesh and Uttar Pradesh*
RE: Revised Estimates; P: Projected ***Source:*** *Budget Documents of state governments; CAG; ICRA Research*

- Fifteenth Finance Commission's recommendations on revenue sharing and fiscal deficit targets, borrowing permission granted by the GoI, and extent of improvement in revenues will guide state fiscal trends in FY2022.
- A fiscal deficit target of 3.5% of gross state domestic product (GSDP) for the state governments for FY2022, may allow them to prioritise a portion of the capital expenditure that had to be deferred during the pandemic, in our view.
- We project the General Government (Centre + states) fiscal deficit at around 8.5% of GDP in FY2022, appreciably lower than the 12.2% of GDP expected in the current year.

Current account to revert to deficit of US$15-20 billion in FY2022

Exhibit: Current Account Balance (absolute and % of GDP)

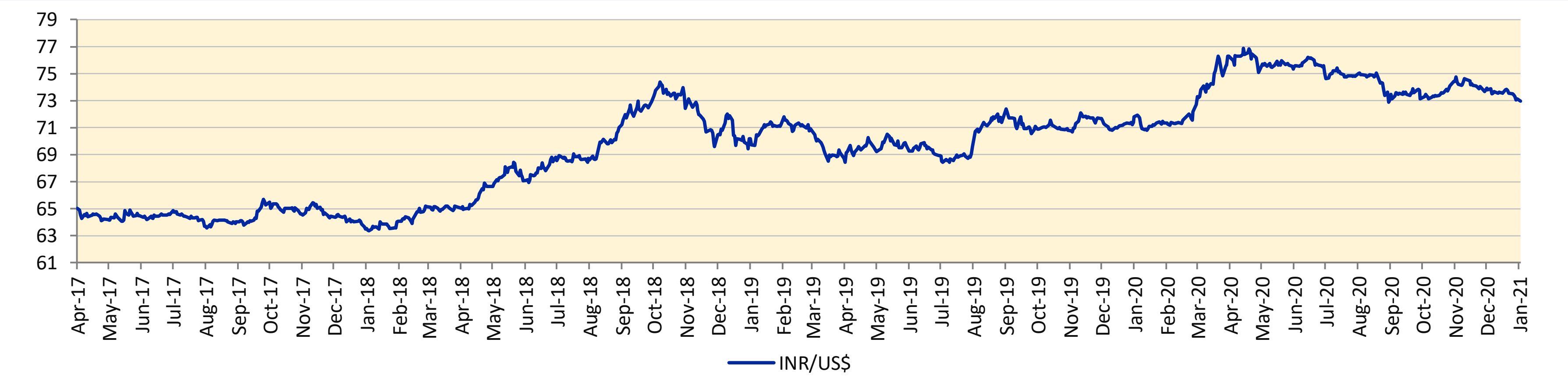


Deficit (-)/Surplus (+); P: Projected; ***Source:*** *RBI; ICRA Research*

- Curtailed merchandise imports during the pandemic resulted in a large current account surplus of US$34.8 billion during H1 FY2021.
- We expect imports to recover during H2 FY2021 with improving economic activity, rising commodity prices and demand for gold. Exports may experience hiccups, but are expect to strengthen in Q4 FY2021, as the vaccine rollout gains traction in major trading partners. Accordingly, ICRA expects the size of the current account surplus to be limited below US$5 billion in H2 FY2021.
- As domestic demand revives in tune with the projected recovery in economic activity, the current account balance is expected to revert to a modest deficit of US$15-20 billion (or 0.6% of GDP) in FY2022, led by a widening of the merchandise trade deficit.

INR likely to trade in the range of 71-74/US$ in FY2022

Exhibit: Trend in the US$-INR exchange rate



Source: *Bloomberg; ICRA Research*

- Improving momentum of economic growth, expected moderation in inflation, sustained FPI equity and FDI inflows are expected to impart appreciation bias to the INR in FY2022; weakness in Dollar Index will bolster this trend.
- Global monetary policy is expected to remain accommodative in FY2022, supporting global liquidity. With favourable risk sentiment, expected traction of the rollout of the Covid-19 vaccines and economic growth on an uptrend, India could see strong FPI inflows in FY2022.
- Simultaneously, the RBI's intervention in forex markets may be constrained by size of domestic liquidity surplus.
- INR is likely to trade between 71-74/US$ in FY2022; episodes of sharp rise in crude oil prices could result in INR temporarily overshooting this range.

Analytical Contact Details

Aditi Nayar

Principal Economist

aditin@icraindia.com

0124 - 4545 385

ICRA

OUTLOOK
FY2022

THANK YOU!