ICRA

ECONOMIC OUTLOOK AND MACRO TRENDS

India's GDP growth set to halve to 6.5% YoY in Q2 FY2023; external slowdown poses downside risks to H2 FY2023 GDP growth

NOVEMBER 2022

Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Rahul Agrawal
+91 22 6169 3331
rahul.agrawal@icraindia.com

Aarzoo Pahwa
+91 124 4545 835
aarzoo.pahwa@icraindia.com

Tiasha Chakraborty
+91 124 4545 848
tiasha.chakraborty@icraindia.com

Anusha Jindal
+91 124 4545 399
anusha.jindal@icraindia.com

Table of Contents

Table of Exhibit

Abbreviations

AE: Advance Estimates
AIDC: Agricultural Infrastructure and development cess
ATF: Aviation Turbine Fuel
BE: Budget Estimates
BEML: Bharat Earth Movers Ltd.
BPS: Basis Points
BoP: Balance of Payments
CAD: Current Account Deficit
CCS: Consumer Confidence Survey
CEA: Central Electricity Authority
CGA: Controller General of Accounts
CGST: Central Goods and Services Tax
CIL: Coal India Limited
CMIE: Centre for Monitoring Indian Economy
CNY: Chinese Yuan
CP: Commercial Paper
CPI: Consumer Price Index
CSI: Current Situation Index
CTD: Central Tax Devolution
DAM: Day-Ahead-Market
DBTL: Direct Benefit Transfer for LPG subsidy
DIPAM: Department of Investment and Public Asset Management
EOI: Expression of Interest
ECB: External Commercial Borrowing
EM: Emerging Markets
FAO: Food and Agriculture Organization
FCNR: Foreign Currency Non-Resident
FDI: Foreign Direct Investment
FII: Foreign Institutional Investor
FOMC: Federal Open Market Committee
FPI: Foreign Portfolio Investors
FRL: Full Reservoir Level
FRP: Financial, Real Estate and Professional Services
GAIL: Gas Authority of India Limited
GDP: Gross Domestic Product
GFCE: Government Final Consumption Expenditure
GFCF: Gross Fixed Capital Formation
GoI: Government of India
G-Sec: Government Securities
GST: Goods and Services Tax
GTR: Gross Tax Revenue
GVA: Gross Value Added
HLL: Hindustan Latex Ltd
HSD: High Speed Diesel
IDBI: Industrial Development Bank of India
IGST: Integrated Goods and Services Tax
IIP: Index of Industrial Production
IMD: Indian Meteorological Department
IMF: International Monetary Fund
IOS: Industrial Outlook Survey
IPCL: Indian Petrochemicals Corporation Ltd
IPO: Initial Public Offering
JPC: Joint Plant Committee
LAF: Liquidity Adjustment Facility
LIC: Life Insurance Corporation
LPA: Long Period Average
LPG: Liquefied Petroleum Gas
MEP: Monthly Expenditure Plan
MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act
MICE: Meetings, Incentives, Conferences, Exhibitions
MoM: Month-on-Month
MoRTH: Ministry of Road Transport and Highways
MPC: Monetary Policy Committee
MS: Motor Spirit
MSF: Marginal Standing Facility
NBFC: Non-Banking Finance Companies
NBS: Nutrient based Subsidy
NINL: Neelachal Ispat Nigam Limited
NR(E)RA: Non-Resident (External) Rupee Account
NRI: Non-Resident Indians
NRO: Non-Resident Ordinary
NSO: National Statistical Office
OBICUS: Order Books, Inventories and Capacity Utilisation Survey
OFS: Offer for Sale
OM: Office Memorandum
OMO: Open Market Operation
ONGC: Oil and Natural Gas Corporation
PADOS: Public Administration, Defence and Other Services
PE: Provisional Estimates
PFCE: Private Final Consumption Expenditure
PLI: Production Linked Incentive
POL: Petroleum Oil and Lubricants
PPAC: Petroleum Planning and Analysis Cell
PMGKY: Pradhan Mantri Garib Kalyan Yojana
PMGKAY: Pradhan Mantri Gareeb Kalyan Ann Yojana
QEP: Quarterly Expenditure Plan
RBI: Reserve Bank of India
RDB: Rupee Denominated Bonds
RMS: Rabi Marketing Season
RE: Revised Estimates
REER: Real Effective Exchange Rate
SAED: Special Additional Excise Duty
SDF: Standing Deposit Facility
SGB: Sovereign Gold Bonds
SGST: States Goods and Services Tax
SUUTI: Specified Undertaking of Unit Trust of India
THTCS: Trade, Hotels, Transport, Communication and Services related to broadcasting
VAT: Value Added Tax
VRR: Voluntary Retention Route
WMA: Ways and Means Advances
WPI: Wholesale Price Index
YoY: Year-on-Year
YTD: Year to Date

OVERVIEW

The demand for contact-intensive services is likely to remain upbeat in the near term with the onset of wedding and holiday seasons

Sustenance of demand for goods post the festive season remains unclear

Early sowing has brightened the prospects of rabi crops in FY2023; kharif output may be revised down following the untimely excess rains

ICRA maintains GDP growth forecast at 7.2% in FY2023, with downside risks emanating from a deepening external slowdown

The contact-intensive segment of the services sector displayed a robust recovery in Q2 FY2023, benefitting from the pent-up demand for leisure travel, resumption of corporate travel, and rising confidence levels amongst households. The demand for such services is likely to remain upbeat in the near term with the onset of wedding and holiday seasons, auguring well for associated sectors such as transport/mobility, hotels, and restaurants. We estimate GDP growth to record a base effect-led halving to 6.5% in Q2 FY2023 from 13.0% in Q1 FY2023. Moreover, a healthy demand for goods during the festive season is likely to have aided the manufacturing sector, although the sustenance of the same post the festive season remains to be seen. While kharif output may see a downward revision owing to the excess rainfall during Sep-Oct 2022, the prospects of rabi output are favourable with an early pick-up in sowing. At present, we maintain our FY2023 GDP growth forecast at 7.2%, with downside risks posed by the potential impact of the deepening external slowdown on India's exports. We project the CPI inflation at 6.6% for FY2023, with risks emanating from supply disruptions for perishables owing to excess unseasonal rains and a robust demand for services. Nevertheless, with an easing in the Oct 2022 CPI inflation and expectations of a further dip in Nov 2022, the quantum of the next rate hike is likely to be limited to 35 bps in the MPC's Dec 2022 policy meeting, vis-à-vis 50 bps in the last three reviews. The MPC's decision is likely to be non-unanimous, which may lend itself to a neutral tone regarding the pace and timing of future rate hikes.

ICRA's Macroeconomic Projections	FY2022	FY2023
GDP Growth (in real terms)	8.7%	7.2%
GVA Growth (in real terms)	8.1%	7.0%
CPI Inflation (average)	5.5%	6.6%
WPI Inflation (average)	13.0%	9.7%
Current Account Balance	Deficit of US$38.7 billion; 1.2% of GDP	Deficit of US$105-110 billion; 3.2% of GDP
GoI's Fiscal Deficit	Fiscal deficit at Rs. 15.87 trillion (6.7% of GDP) as per prov. estimates, below RE of Rs. 15.91 trillion (6.9% of GDP)	Fiscal deficit to overshoot the budgeted Rs. 16.6 trillion by Rs. 1.0 trillion or less, but print at 6.4% of GDP, in line with the BE
G-sec Yields	10-year G-sec yield to trade between 7.2-7.6% in the rest of CY2022, amidst the expectation of another repo hike in Dec 2022	
Repo Rate	Rate hike to continue in the Dec 2022 policy, with CPI inflation remaining above MPC's 6% tolerance level in Oct 2022; however, quantum of hike to ease to 35 bps, lower than the 50 bps seen in the last three reviews	
INR	USD/INR pair to trade between 80.5-83.0/US$ till end-March 2023	

EXECUTIVE SUMMARY

YoY GDP growth set to halve to 6.5% in Q2 FY2023 on a normalising base: Economic activity in Q2 FY2023 benefitted from a robust demand for services, healthy capital spending by the GoI and pre-festive season stocking of goods. The downsides arose from the mixed crop output trends revealed by the advance estimates of kharif production, adverse input cost movements for certain sectors with a higher fuel intensity, as well as the impact of flagging external demand on India's non-oil merchandise exports (YoY: -0.3%). On balance, we project the YoY growth of the GDP in Q2 FY2023 at 6.5%, a base effect-led halving from the 13.5% seen in Q1 FY2023, albeit somewhat higher than the MPC's forecast of 6.3% for that quarter. However, the growth in the GDP over the respective pre-Covid levels of 2019 is expected to double to around 8% in Q2 FY2023 relative to the 3.8% seen in Q1 FY2023, with a widening of the economic recovery.

FY2023 GDP growth forecast maintained at 7.2%: With the onset of busy season for travel and availing of leisure services during the holiday period, demand for services, especially the contact-intensive segment, is likely to remain upbeat in the near term, auguring well for the performance of transport/mobility, hotels, and restaurant segments. The output volumes of some industrial sectors such as infra/construction are likely to pick-up sequentially in H2 FY2023 after the end of monsoon season. Manufacturing output is likely to be supported by festive demand for goods in Q3 FY2023, boosting capacity utilisation, although the sustenance of this post the festive season is uncertain. While the excess rainfall during Sep-Oct 2022 may pose downside risks to the kharif output, early sowing has brightened the prospects of the rabi crops. Moreover, state governments have ample fiscal space to push up their capex in H2 FY2023. At present, we have retained our estimate of the real GDP growth for FY2023 at 7.2%, although a deepening of the external slowdown poses a risk. We will review our forecasts once the high frequency data for full month of Nov 2022 is available, as the average trends for Oct-Nov would provide a better gauge to assess the growth momentum given the shift in festive calendar in 2022 vs. 2021.

CPI Inflation to surge to 6.6% in FY2023: ICRA expects the CPI inflation to average at 6.6% in FY2023 (marginally lower than the MPC's projection of 6.7%), as against 5.5% in FY2022, on account of a broad-based uptick in inflation. The near-term outlook is clouded by emerging risks such as supply disruptions for certain perishables owing to excess rains, a robust demand for services and some evidence of a transmission of elevated headline inflation into categories such as housing rentals. Nevertheless, CPI inflation is expected to moderate in H2 FY2023 vis-à-vis H1 FY2023. With the CPI inflation remaining above the MPC's 6% tolerance level in Oct 2022, we believe that another rate hike is certain in the Dec 2022 policy to prevent inflationary expectations from un-anchoring. However, given the easing in CPI inflation in Oct 2022 and the anticipation of a further dip in Nov 2022, we expect the size of the hike to be restricted to 35 bps, lower than the 50 bps seen in the last three policy reviews. Moreover, we anticipate this vote to be non-unanimous, which may lend itself to a neutral tone regarding the pace and timing of future rate hikes.

CAD to touch 3.2% of GDP in FY2023: ICRA expects India's merchandise exports to rise by ~6% in FY2023, with a normalising base and flagging external demand tempering the pace of growth in H2 FY2023 vis-à-vis H1. Merchandise imports, on the other hand, are expected to rise by a relatively higher ~20%, as domestic demand growth is likely to appreciably outpace external demand. Accordingly, the merchandise trade deficit is expected to rise considerably to ~US$285-290 billion in FY2023, from ~US$189.5 billion in FY2022, with more than half of the widening stemming from the non-oil trade deficit. Consequently, we project the CAD to widen to an all-time high of US$105-110 billion (-3.2% of GDP) from US$38.7 billion (-1.2% of GDP) in FY2022, with an expected moderation in H2 FY2023 relative to the levels expected in H1 FY2023. A moderation in financial flows coupled with the large increase expected in the CAD will result in a substantial drawdown of reserves during H1 FY2023, followed by some respite in H2 FY2023. We expect the USD/INR pair to trade between 80.5-83.0/$ till end-March 2023.

Overshooting in FY2023 fiscal deficit of the GoI expected to be limited under ~Rs. 1 trillion: While the GoI's spending would sharply exceed the budgeted level for FY2023, driven by fertiliser and food subsidy, and excise revenues will be dampened by the cess reduction on petrol and diesel undertaken in May 2022, we expect the extent of the overshoot in the fiscal deficit to be modest at ~Rs. 1 trillion for FY2023, given the considerable upside seen in non-excise tax revenues (direct taxes and CGST revenues) as well as expected savings under some expenditure heads. As a proportion of GDP, the fiscal deficit in FY2023 is unlikely to exceed the budgeted 6.4%, on a higher nominal GDP (ICRA exp.: +15.0%) vis-à-vis what was indicated in the budget (+9.1% over the FY2022 provisional estimate of GDP). With limited fiscal concerns, we expect yield movements to be dominated by expectations around monetary tightening. We foresee the India's 10-year G-sec yield to trade between 7.2-7.6% in the rest of CY2022, amidst the expectation of another policy rate hike in December 2022.

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.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- 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.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: Jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: Communications@icraindia.com
Tel: +91 124 4545 860

Registered Office

B-710, Statesman House 148,
Barakhamba Road
New Delhi-110001
Tel: +91 11 23357940-45

Corporate Office

Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon - 122 002
Tel: +91-124-4545300

Ahmedabad

1809-1811, Shapath V,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

Bengaluru 1

'The Millenia', Tower B Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

4th Floor, 'Shoban'
6-3-927/A&B. Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

No. 7-1-58, 301, 3rd Floor, 'Concourse',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 1194

Email: Info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.Icraresearch.in