

# Macro Outlook

Static to weak growth trends to persist

28 September 2017

INDIA | INDONOMICS | Update

**Growth concerns have returned to the foreground.** In August, we lowered our FY18 GDP estimate to 6.5-7.0% (with downward risk) due to no growth triggers. We built in a 'no rate cut' stance, raised CAD estimate to 1.9-2.4% of GDP, and have been of the opinion (since the beginning) that GST is growth-positive, but only in the long run. Currency will remain stable to weak, assuming FII capital outflow and dollar strength. However, ample domestic liquidity (banking and otherwise), will be the only key positive trigger (RBI expects CIC at US\$ 16.5tn by the festive season).

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**Liquidity tightening by the Fed** (we anticipated near-term negative impact across Indian asset class; [click here](#)), along with status quo from other central bankers (ECB, BoE), should be manageable due to domestic liquidity comfort (assuming economic stability). That said, we are watchful of slippage in positive sentiments towards India, which led to surge in asset prices for the last few years (in the absence of real positive economic progress), as that can spiral into adverse economic and political impact. Recently, there is buzz that the government is loosening its grip on fiscal deficit to stimulate the economy – adding to currency, bond, equity weakness and growth concerns. We have always said that the Indian government should allow fiscal expansion to boost economic growth, but the recent fiscal slippage has come as a surprise and could possibly be due to weak revenue collection (disinvestment, GST).

**Growth – static to weak:** Barring favourable base-effect impact on macro variables, we have been of the view that growth will be muted in FY18 ([Dissection of Economic growth](#)); we lowered FY18 estimate to 6.5-7.0% (with downward risk) ([Click here](#)) due to GST impact, persisting excess capacity, weak demand, and muted job generation. Even for the next couple of years, GDP could be in the range of 6.0-7.5% (vs. our earlier expectation of 7.5-8.0%). Monsoon could be a concern in 2018, as two successive years of good monsoon have already played out. BSE500 companies' revenue/PAT growth for Q1FY18 was at 7%/6% vs. 15%/-11% a year ago and 6%/28% a quarter ago.

**RBI to stay focused on inflation targeting:** While we would like the RBI to contribute to growth by lowering interest rates, based on RBI's commentary so far, it is likely to stay focused on inflation management. Based on this (unless the RBI makes a U-turn), we do not expect it to accommodate monetary policy any further, as inflation is likely to be around its expected trajectory (4.0-4.5% in Q4FY18). Banking liquidity should remain in surplus until festive season (aggressive liquidity absorption likely after the new instrument SDF is launched) and CIC is likely to widen to Rs 16.5tn (by the festive season) from Rs 15.6tn currently; LAF surplus should turn neutral by FY18-end. WPI-CPI inflation gap has merged, which is a reflection of likely corporate margin stress ahead vs. benefits enjoyed for the last four years.

**Fiscal deficit to widen?** The government has not commented on the buzz about a fiscal stimulus of Rs 500bn (0.5% of GDP), which would imply fiscal slippage for FY18 from the budgeted 3.2%. However, this talk has affected the stability of Indian bonds and currency as the Indian government has so far firmly followed fiscal consolidation path for many years, with hardly any slippage. We have been saying that the government should focus on fiscal expansion through quality spending to support growth, as other growth-boosting factors are absent. However, we anticipate that FY18 slippage will be due to poor revenue collections from GST, disinvestment, and telecom auctions, not due to a surge in quality spending.

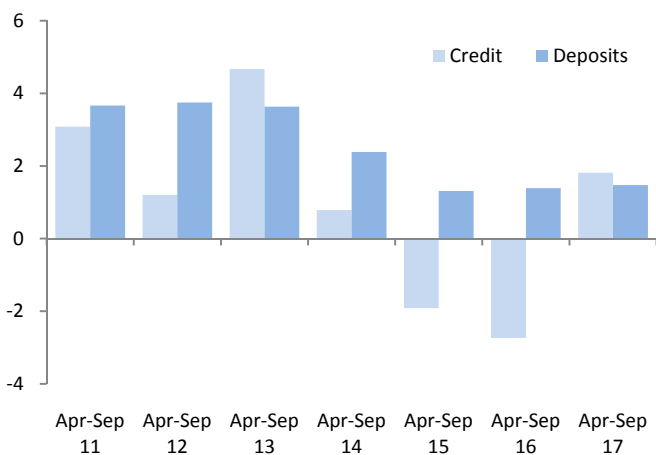
**Exports not accelerating as well as imports:** We have widened our FY18 CAD estimate to 1.9-2.4%, as imports growth is likely to surpass exports growth. Capital flows have been strong FYTD; some weakness is likely in the coming months. We expect a BoP surplus in FY18. The RBI has been consistently buying dollars (as flows are strong and to manage the pace of rupee appreciation), resulting in forex reserves of US\$ 403bn vs. US\$ 370bn in March 2017. While we expect rupee appreciation to continue in the medium-long term, near-term, some weakness is likely due to possible capital outflows/muted inflows (meaningful debt instruments ceiling limits are hit), dollar strength (possible announcement on tax reforms in the US), Indian fiscal slippage, and government/RBI's preference to support exports. Our FY18 dollar-rupee average is 64.0-64.5 (now at risk); FYTD average is 64.3. Our currency desk expects a range of 64.5-66.0 in Q3FY18 and 63.5-65.0 in Q4FY18.

## Credit growth: Muted

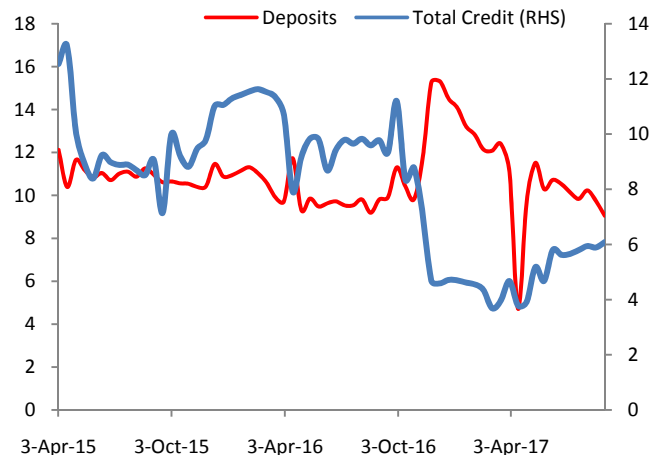
FYTD addition to banking credit is better at Rs 1,383bn vs. Rs 636bn last year; yoy growth at 6% vs. 10% last year.

- **Agri credit** picked up marginally due to sowing season (growth at 7% yoy)
- **Industry credit** pace has been declining (yoy growth marginally negative). However, its share in non-food credit has shrunk to 38% from 40% a year ago and its peak of 46%) primarily due to a drop in medium-large industry borrowing. Large-scale industries have mostly shifted to cheaper source of funding like CDs and CPs, while the drop in medium-sized industry borrowing would be due to weaker activity. CPs had reached a peak at Rs 4.7tn in May 2017, which has now come off to Rs 3.7tn. CPs' current RoI is at 6.05-11.25% (bottom range is quite stable, while peak rate has come off from 13-14%. Overall, industrial bank credit is quite stable for the last few months
- **Services credit** growth is at 5%. For many segments, the credit trend is stable, while it has increased for professional services and trade. There is reasonable improvement in personal loans – 15% growth but the maximum rise is in other personal loans (25-35% growth). Priority-sector credit have seen a marginal rise at 3-4%, with rise in credit to weaker sections, services, and agriculture even as education loans and micro-credit has reduced

**Credit and deposit growth rates (FYTD, %)**

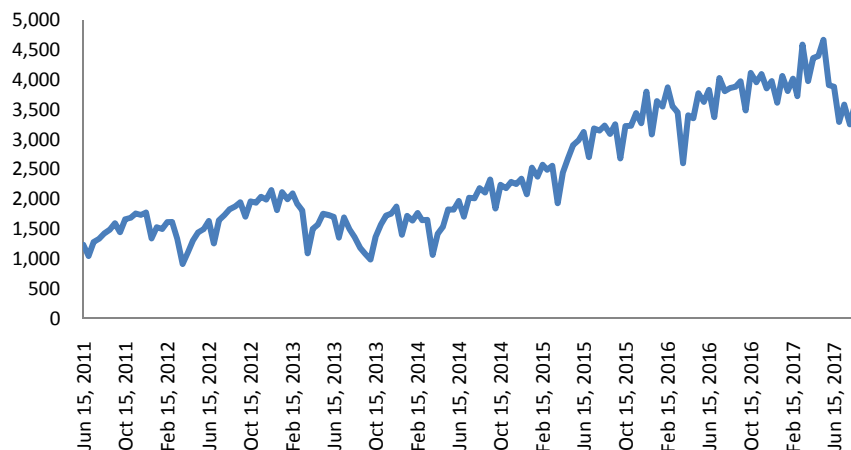


**Credit and deposit growth (yoy,%)**

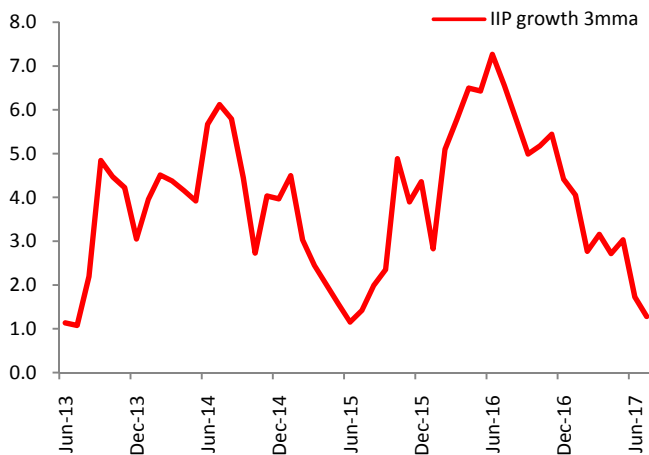
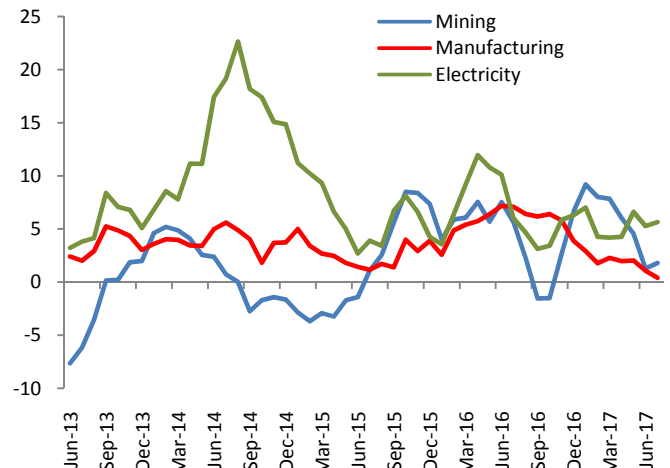


Source: RBI, Bloomberg, PhillipCapital India Research

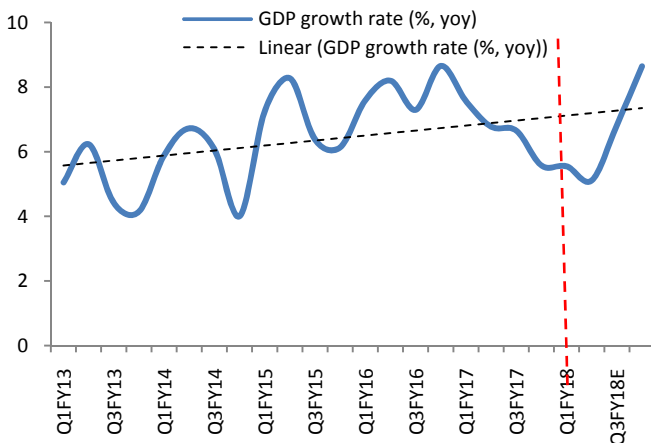
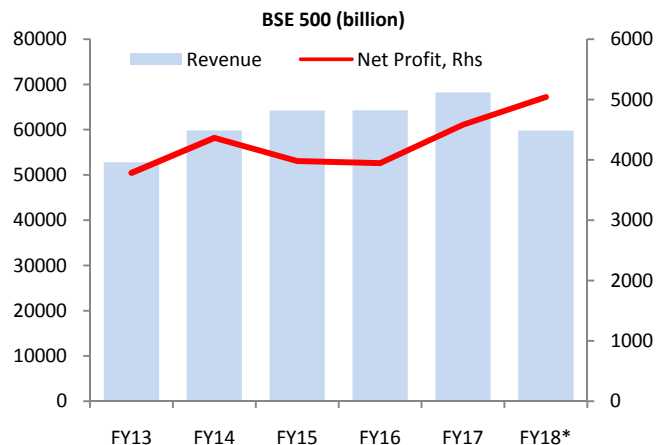
## Outstanding CP issuance (Rs Bn) – off from its peak



Source: RBI, Bloomberg, PhillipCapital India Research

**IIP growth falls back to 2013 levels despite index changes**

**Electricity output decent; mining, manufacturing sluggish**


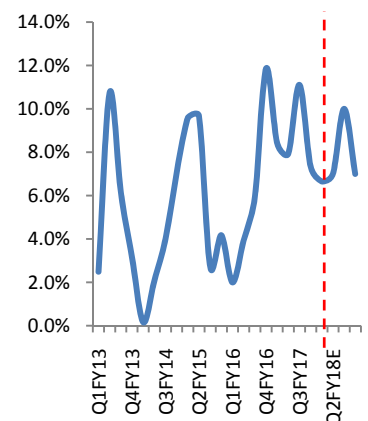
Source: PIB, CSO, PhillipCapital India Research

**GDP growth to dip in Q2 and pick up in Q4 due to base affect**

**Revenue and Net profitability of BSE 500 companies**


Source: RBI, CSO, PhillipCapital India Research

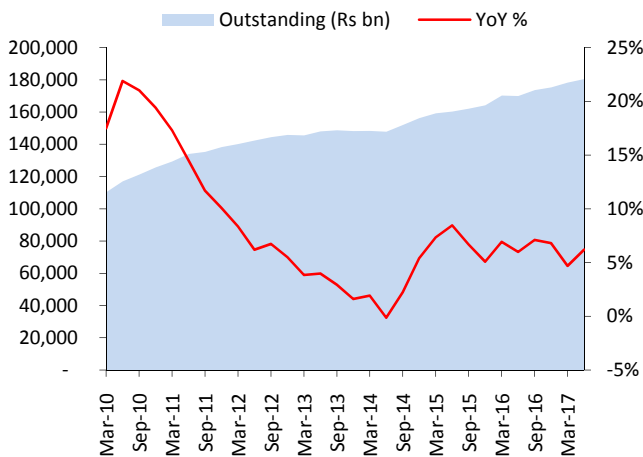
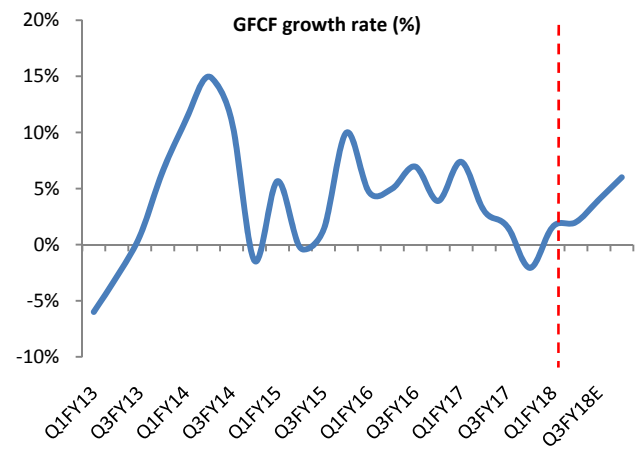
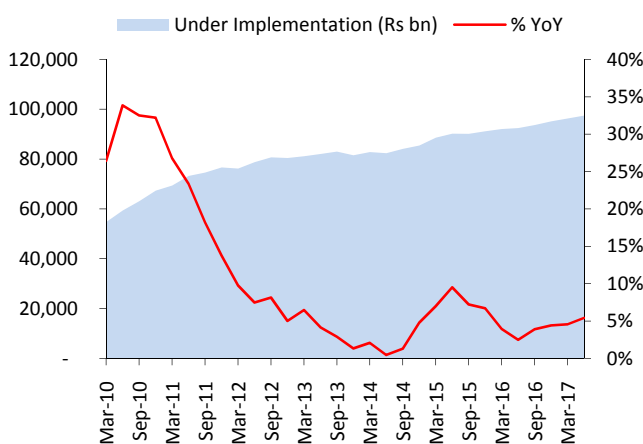
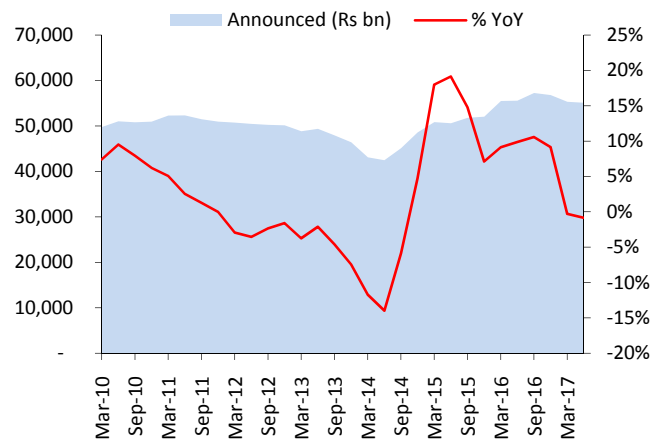
**Consumption – holding up well**

PFCE recorded reasonable growth of 6.7% in Q1FY18, led by sufficient monsoon (for two years), 7<sup>th</sup> PC, and government spending. Our FY18E PFCE growth estimate is at 7.5% vs. 8.7% in FY17. Other indicators such as FMCG and car purchases are at acceptable levels, however, white goods (consumer durables, paints) remain muted (possibly due to extensive pre-GST buying along with muted demand/incomes/cash). Our FMCG analysts' volume growth estimates for FY18/19 is 6.7%/7.9% vs. 3.8% in FY17 with new product launches supporting volume growth; they also anticipate a price rise due to higher input cost. Our channel checks suggest that FMCG volumes are better after GST, as prices have fallen (Q1FY18 volume growth had contracted by 4.3%). Automobiles grew by 14% in August 2017 (improvement in PVs and CVs was due to anticipation of higher prices after GST clarification). While we do not anticipate a surge in private consumption (as benefits of monsoon and PC will gradually fade impacting demand along with GST issues at the dealer/distributor levels impact supply), we expect it to hold around the current levels.

**Private final consumption expenditure YoY growth**


### Investment – CAPEX seems to be gradually improving

Q1FY18 GFCF growth inched into positive territory at +1.6% yoy vs. -2% last quarter. CMIE capex data (as on Q1FY18) also reflects improvement – projects outstanding (+6%, maintaining past trend) and new projects announced are marginally weak, but there is a reasonable progress in projects under implementation (+5%) while completed projects maintained decent pace. For FY18, we expect GFCF growth at 3-4% vs. 2.4% in FY17. Higher government spending on infrastructure (in case of fiscal slippage) will be a positive. So far, public capex spend has been progressing well, with focus on defence, roads, metros (urban development), and power (lagging behind).

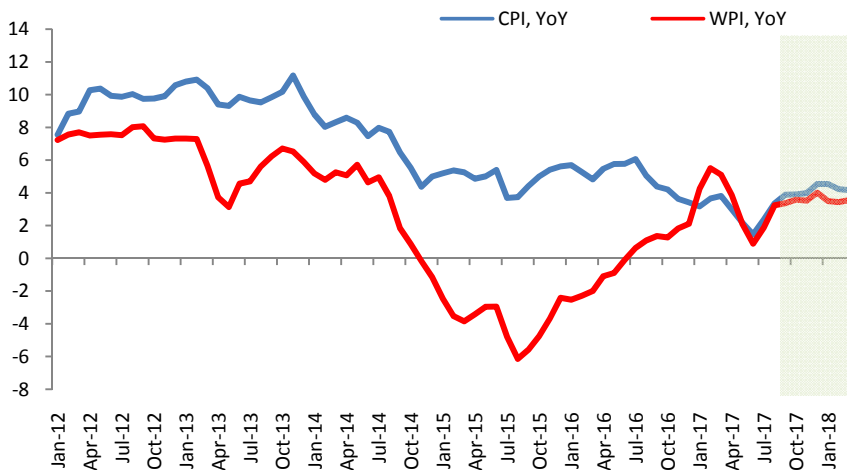
**Projects outstanding (CMIE)**

**Projects announced (CMIE)**


Source: CMIE, PhillipCapital India Research

### Inflation (to inch up), interest rates (higher bond yields), liquidity (to turn neutral in FY18)

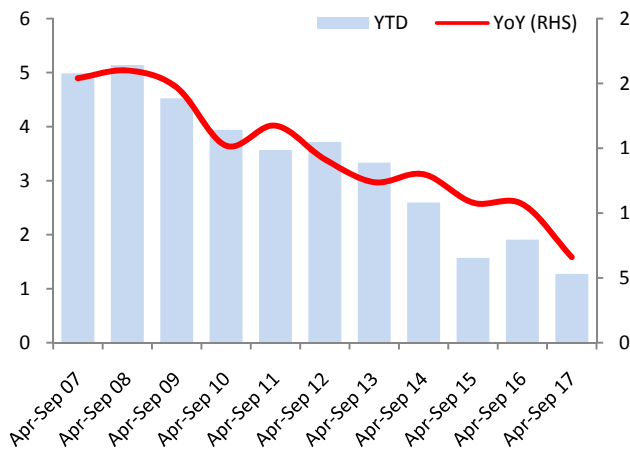
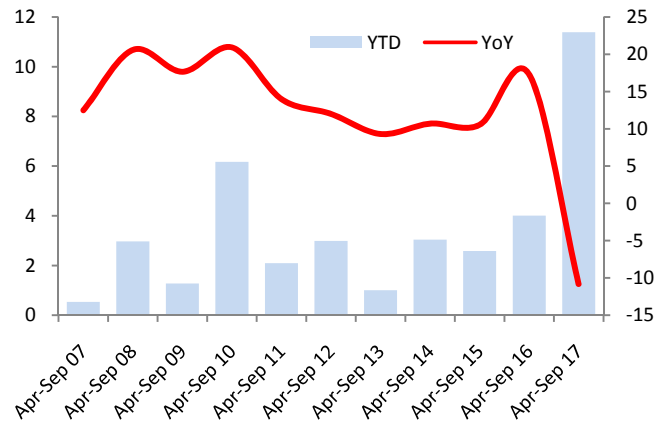
CPI is likely to inch up from current levels to 4.0-4.5% by March 2018, led by unfavourable base effect and stable prices; vegetable prices should fall from the high levels recorded until August. We are seeing the WPI-CPI inflation gap narrowing significantly, which is a reflection of likely corporate margin stress ahead vs. the benefits enjoyed for the last four years.

The future trajectory of currently elevated international oil prices needs to be tracked. Based on the assumption of likely dollar strength ahead, commodity prices are not likely to rise unless they are influenced by geopolitical or other fundamental factors. However, a weak rupee will make Indian imports expensive, adding to inflation. Based on this, we maintain that RBI will remain on hold, as its primary focus will remain inflation targeting, not growth.

**WPI, CPI inflation merging – implying lower corporate margins**


Source: PIB, CSO, PhillipCapital India Research

Banks' liquidity surplus has come down to Rs 1.7tn from Rs 2.5-3tn a fortnight ago. A new liquidity-management instrument called Standing Deposit Facility (SDF) is likely to be launched in the next two months, after which we expect liquidity to turn neutral, possibly by the end of FY18. For the festive season, CIC is likely to rise to Rs 16.5tn from current levels of Rs 15.6tn. There is a possibility of bond yields rising due to tighter domestic banking liquidity, higher inflation, higher fiscal deficit (borrowings), and higher global yields.

**Money supply (FYTD and yoy)**

**Currency with public (FYTD and yoy)**


Source: RBI, Bloomberg, PhillipCapital India Research

**Fiscal account under stress due to lower revenues**

FY18BE fiscal estimate is 3.2% of GDP – there is talk of this slipping to 3.7% because of higher expenditure on bank recapitalisation, housing, and power. April-July fiscal deficit is already 92% of BE.

We are extending this argument and attributing a possible slippage in fiscal estimate (no confirmation yet) to a drop in revenues due to lower disinvestment, GST, lower RBI dividend, and lower revenue from telecom auctions. In the past few years and even as a general trend, the government has been making sure that it gets closer to its target fiscal range by lowering capex – we would have expected the same this year as revenue collections are weaker. A change in the erstwhile trend to now allowing fiscal slippage of 0.5% of GDP (Rs 500bn), has contributed to currency weakness and a rise in bond yields by 20bps (currently at 6.67%). We are in favour of fiscal

expansion, but only by way of quality spending to boost economic growth, which is currently tepid and unable to recover due to various policy changes underway.

FY18 disinvestment target is Rs 725bn with Rs 192bn achieved so far. Due to weak equity market sentiment, aggressive disinvestment in the coming months will be challenging – thus, a reasonable slippage on this account is likely. In addition, RBI's dividend to the government at Rs 307bn is not even half of the total budgeted amount of Rs 750bn, because of printing cost of new currency after demonetisation, rupee appreciation, and muted returns on higher forex reserves. However, gross tax revenue until July 2017 is faring well at +17% vs. the budgeted estimate of +12%. According to the government, GST collections have not been as anticipated, which may dent the future tax-revenue trajectory for the centre and states (the central government will have to compensate states for this, an added expense).

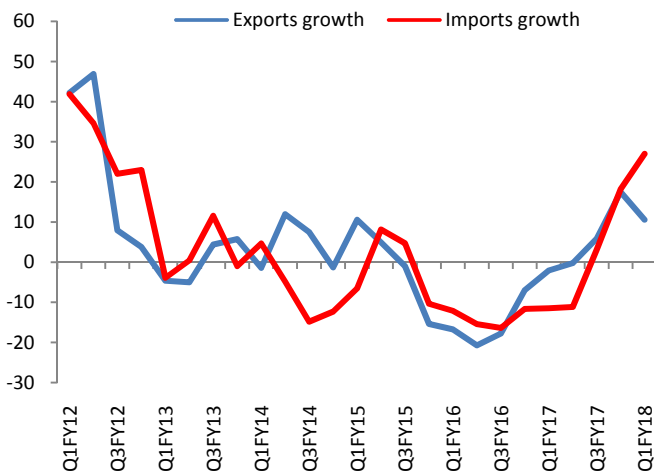
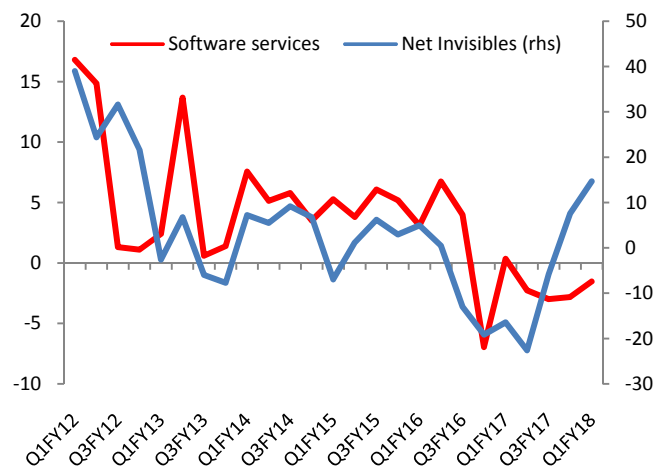
Lower international oil prices and higher excise duty on petroleum products has been a boon for government revenues and subsidy. Any reversal on these fronts, along with a weak rupee, will add to fiscal pressure and the government's ability to spend. Since many fuel products are now linked to market prices, a rise in international crude-oil prices (along with weak currency) will add to inflation, unless managed by lowering of excise/VAT on fuel products.

### **Imports outpace exports; CAD to rise to 2%; Currency weakness to persist**

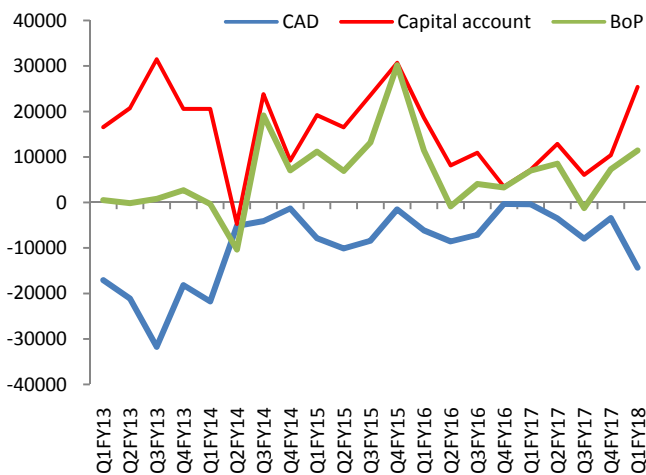
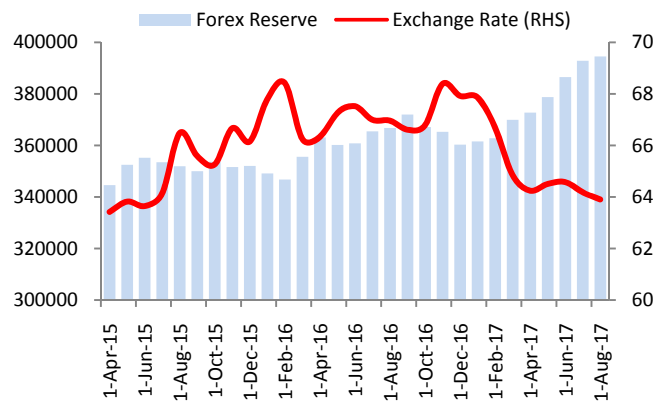
Imports have outpaced exports growth, which inched higher in August 2017. For the next few months, GST-related issues could dent exports. For FY18, we expect imports to stay elevated while exports should follow last year's trend of 5% growth (vs. the general expectation of an uptick). This will lead to higher CAD; our FY18 estimate is 1.9-2.4%, assuming marginal improvement in invisibles. Capital flows are likely to be stable in FY18 (possibly lower than Q1), adding to forex reserves – but this is unlikely to be as fast as seen lately. Current forex reserves are US\$ 403bn (FYTD addition of US\$ 33bn).

Dollar-rupee, after remaining reasonably stable at 63.80-64.50 for the last five months, weakened recently due to FII outflows, dollar strength, and worries about India's economic health. This drop is as expected ([click here](#) for our take on impact on Indian financial assets post Fed policy). Our FY18 dollar-rupee average is 64.0-64.5 (now at risk), while the FYTD average is 64.3. Our currency desk expects a range of 64.5-66.0 in Q3FY18 and 63.5-65.0 in Q4FY18. While we expect rupee appreciation to persist in the medium-to-long term, assuming reasonable Indian economic health, in the near-term, some weakness is likely due to possible capital outflows/muted inflows (meaningful debt instruments ceiling limits are hit), dollar strength (possible announcement on tax reforms in the US), Indian fiscal slippage, and government/RBI's preference to support exports.

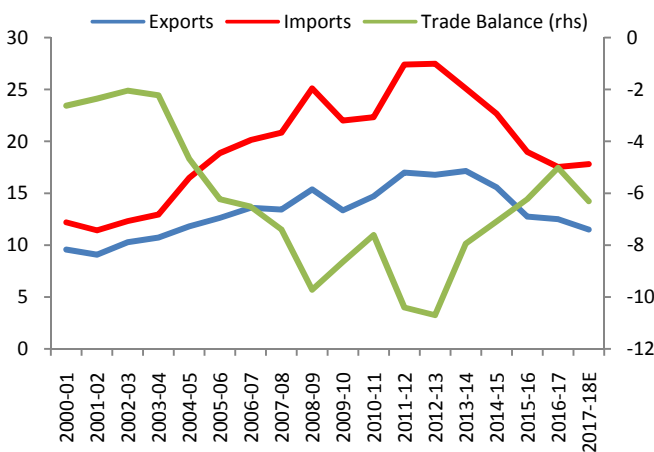
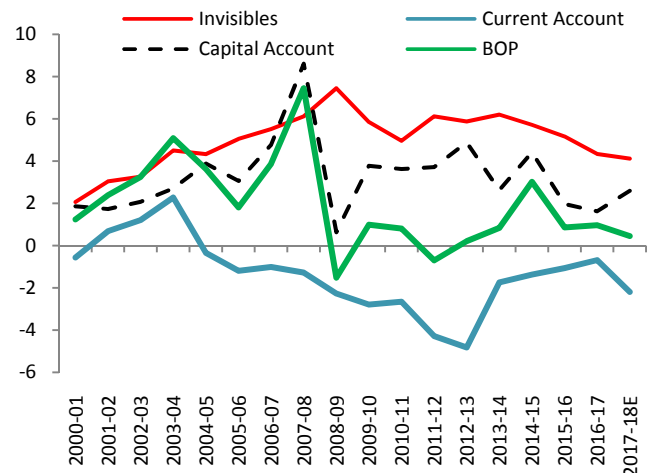
So far, global liquidity remains at ease, except for Fed's BS reversal starting October 2017, which is expected to absorb US\$ 300bn over the next year, and US\$ 600bn over the next two years. Currently, this does not seem substantial, as other central bankers are keeping liquidity easy. Thus, we expect rupee to return to appreciation bias, assuming Indian economic strength returns in FY19.

**Imports growth outpace exports lately**

**Net invisibles improve gradually – led by software and remittances**


Source: RBI, Ministry of Commerce, PhillipCapital India Research

**CAD increased in Q1FY18 led by higher imports**

**Forex Reserves and Dollar-Rupee**


Source: RBI, Ministry of Commerce, Bloomberg, PhillipCapital India Research

**Exports, imports, trade (% of GDP)**

**CAD and BoP (% of GDP)**


Source: RBI, Ministry of Commerce, CSO, PhillipCapital India Research



### Commodity-wise exports

**Higher:** Engineering goods, Petroleum products, organic and inorganic chemicals, Rice, Spices

**Stable:** Leather and leather products, Electronic goods, Cotton yarn

**Lower:** Drugs and Pharmaceuticals, Gems and jewellery, tobacco, Oilseeds

### Commodity-wise imports

**Higher:** Petroleum and crude, electronic goods, pearls and precious stones, Machinery Electrical and Non-electrical, Iron and steel, Artificial Resins and plastic materials.

**Stable:** Transport equipments, Leather and Leather products

**Lower:** Fertilisers, Medicinal and Pharma products, Sulphur & Unroasted Iron Pyrts

### Country-wise exports

**Higher:** USA, Hong Kong, China, Singapore, Germany, Italy, Korea RP, Malaysia, Japan

**Stable:** UK, Belgium, Saudi Arab

**Lower:** UAE, Vietnam, Nepal, Turkey, Netherland

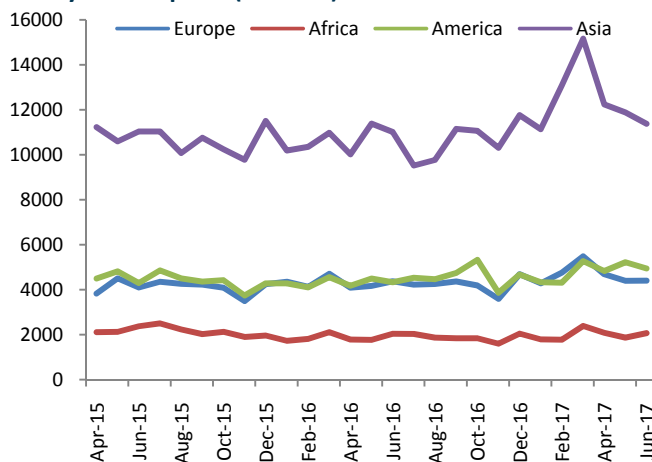
### Country-wise imports

**Higher:** China, Switzerland, USA, UAE, Saudi Arab, Indonesia, Korea. HongKong, Australia, Germany, Japan

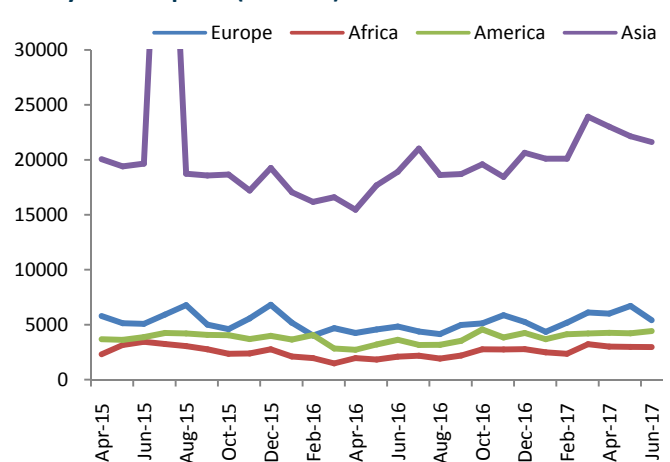
**Stable:** France, Malaysia

**Lower:** Vietnam, Turkey, Argentina, Netherlands, Turkey

**Country-wise exports (USD mn)**



**Country-wise imports (USD mn)**



Source: RBI, Ministry of Commerce, PhillipCapital India Research



**Revenue growth of BSE 500 companies**

Sector	2014					2015					2016					2017					2018	2018E
	Q1	Q2	Q3	Q4	Y	Q1	Q2	Q3	Q4	Y	Q1	Q2	Q3	Q4	Y	Q1	Q2	Q3	Q4	Y	Q1	Rs Mn
Industrials	17.9%	8.7%	22.0%	13.1%	5.1%	33.4%	37.2%	47.8%	53.7%	8.8%	-11.3%	-12.1%	-11.3%	10.2%	-1.1%	-5.1%	-3.4%	-11.6%	-9.0%	-0.8%	44.0%	712449
Energy	-6.1%	7.4%	1.9%	2.5%	7.5%	562.6%	587.3%	463.9%	326.8%	-2.9%	-12.4%	-30.3%	-17.8%	-17.5%	-20.5%	-22.7%	4.6%	28.7%	33.2%	5.7%	22.6%	939164
Cons Disc	16.0%	28.8%	31.7%	26.6%	15.2%	36.7%	18.0%	18.2%	11.1%	14.2%	0.0%	22.6%	24.4%	36.0%	17.3%	40.0%	19.1%	8.5%	1.5%	11.4%	-2.6%	2534827
Materials	1.2%	42.5%	36.9%	41.2%	26.4%	38.3%	7.8%	6.4%	-1.4%	6.7%	-7.8%	-8.7%	-10.6%	-4.3%	-7.9%	3.4%	16.9%	8.9%	12.9%	4.0%	17.0%	1438349
Utilities	38.7%	20.4%	2.8%	17.0%	18.3%	10.1%	5.2%	18.0%	-6.9%	4.1%	7.8%	20.2%	9.2%	23.6%	6.2%	-0.9%	-7.3%	-10.8%	-10.6%	2.0%	30.9%	286562
Health Care	28.1%	34.7%	32.2%	24.7%	21.8%	24.4%	21.9%	16.8%	19.1%	20.1%	15.6%	14.8%	21.1%	19.6%	12.4%	19.0%	16.8%	10.3%	0.1%	6.7%	1.0%	444875
Financials	8.0%	3.7%	13.5%	15.4%	13.6%	12.7%	11.0%	8.6%	16.2%	16.4%	2.8%	3.1%	16.4%	9.6%	7.8%	39.1%	22.3%	-3.8%	16.0%	8.5%	3.5%	1632764
IT	16.9%	23.0%	24.7%	24.5%	20.6%	20.8%	17.5%	18.7%	0.7%	0.8%	13.3%	12.2%	9.4%	30.3%	28.5%	16.0%	11.4%	11.7%	8.5%	8.5%	2.1%	1066797
Cons Staple	13.3%	8.1%	1.1%	29.5%	12.0%	31.6%	28.4%	37.9%	30.0%	19.3%	15.1%	16.5%	7.8%	12.8%	4.0%	13.4%	7.5%	-2.4%	-12.4%	-1.2%	-23.3%	219548
Telecom	10.4%	9.5%	12.2%	13.0%	11.3%	11.7%	7.3%	7.7%	5.4%	9.3%	1.6%	0.4%	-0.2%	2.9%	0.7%	5.1%	5.8%	-2.8%	-11.1%	-2.5%	-12.3%	462043
Real Estate	17.8%	10.5%	12.2%	15.9%	16.2%	25.8%	12.4%	28.4%	-1.9%	10.0%	12.7%	45.2%	30.7%	36.0%	14.2%	-1.9%	-17.9%	-17.9%	-17.3%	-13.3%	3.8%	66805
<b>BSE500</b>	<b>12.1%</b>	<b>20.3%</b>	<b>22.8%</b>	<b>22.8%</b>	<b>13.3%</b>	<b>43.7%</b>	<b>32.1%</b>	<b>30.3%</b>	<b>22.0%</b>	<b>7.3%</b>	<b>-1.0%</b>	<b>1.0%</b>	<b>5.2%</b>	<b>12.8%</b>	<b>0.1%</b>	<b>14.9%</b>	<b>12.7%</b>	<b>5.5%</b>	<b>6.4%</b>	<b>6.1%</b>	<b>7.2%</b>	<b>9804183</b>

Source: Bloomberg, PhillipCapital India Research

**PAT growth of BSE 500 companies**

Sector	2014					2015					2016					2017					2018	2018E
	Q1	Q2	Q3	Q4	Y	Q1	Q2	Q3	Q4	Y	Q1	Q2	Q3	Q4	Y	Q1	Q2	Q3	Q4	Y	Q1	Rs Mn
Industrials	-108%	-101%	-27%	509%	-37%	-2068%	-16569%	-1317%	-34%	-31%	100%	65%	-184%	48%	178%	-2%	40%	54%	39%	-13%	25%	43612
Energy	-17%	-3%	-11%	-15%	9%	155%	158%	117%	136%	-14%	6%	46%	26%	0%	25%	-7%	-37%	1%	-9%	20%	11%	79003
Cons Disc	-8%	43%	137%	4%	25%	129%	6%	-20%	-41%	-3%	7%	-107%	1%	123%	10%	-39%	-953%	-44%	12%	1%	37%	57478
Materials	-18%	32%	111%	-729%	59%	71%	69%	3%	-401%	-65%	-47%	19%	-76%	-35%	-62%	-7%	-37%	521%	-167%	563%	195%	73516
Utilities	-525%	-103%	-39%	297%	3%	-302%	-935%	239%	-46%	-3%	69%	427%	95%	-25%	5%	7%	43%	-26%	-397%	-3%	38%	14966
Health Care	-71%	70%	43%	26%	9%	839%	9%	-30%	-1%	33%	-26%	29%	62%	12%	8%	22%	21%	13%	-12%	7%	-60%	68340
Financials	2%	-4%	-7%	13%	-1%	6%	2%	2%	8%	10%	-1%	-1%	-45%	-54%	-42%	-29%	-18%	64%	-28%	18%	10%	114378
IT	19%	28%	36%	50%	32%	22%	17%	7%	-22%	-5%	6%	10%	8%	47%	29%	12%	7%	9%	5%	5%	0%	170266
Cons Staple	28%	-3%	10%	15%	7%	32%	21%	33%	37%	7%	14%	19%	21%	-19%	9%	4%	19%	-3%	39%	13%	-15%	23089
Telecom	39%	92%	144%	47%-1782%		41%	43%	85%	36%	-46%	45%	12%	-11%	-17%	15%	-26%	-48%	-39%	-124%	-68%	-164%	16617
Real Estate	-14%	-25%	-46%	556%	-2%	8%	0%	44%	-46%	-8%	-43%	61%	64%	-54%	-24%	125%	10%	-45%	123%	38%	-22%	7859
<b>BSE500</b>	<b>-7%</b>	<b>14%</b>	<b>31%</b>	<b>52%</b>	<b>15%</b>	<b>69%</b>	<b>30%</b>	<b>1%</b>	<b>-42%</b>	<b>-9%</b>	<b>1%</b>	<b>2%</b>	<b>6%</b>	<b>28%</b>	<b>-1%</b>	<b>-11%</b>	<b>-3%</b>	<b>16%</b>	<b>28%</b>	<b>16%</b>	<b>6%</b>	<b>669125</b>

Source: Bloomberg, PhillipCapital India Research

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