In, On and For Emerging Markets

A CEIC Insights Report

India Economy in a Snapshot Q4 2020

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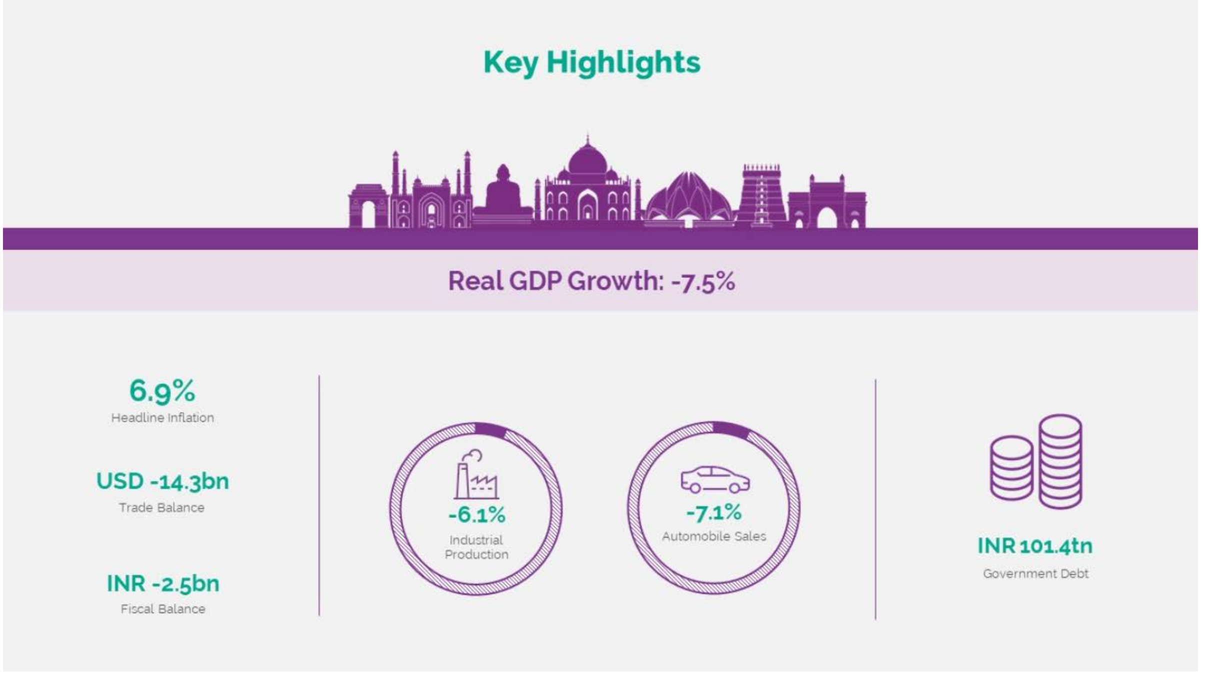
Executive Summary

India Economy in a Snapshot is a quarterly publication produced by the CEIC Macroeconomic Research Team. The report is designed to provide a comprehensive, albeit concise overview of the current economic and financial developments. The India Economy in a Snapshot report is produced using data from CEIC's India Premium Database.



In, On and For Emerging Markets

Summary

The latest GDP figures confirm the Indian economy was in recession between April and September 2020, with real GDP contracting by 7.5% y/y in Q3 of calendar year 2020, corresponding to the second quarter of India's fiscal year to end-March 2021. This follows a huge fall of 23.9% y/y in Q2 2020 caused by the COVID-19 induced stringent lockdown effect on domestic demand, coupled with the collapse in external demand.

In October 2020, inflation measured by the consumer price index (CPI) accelerated to 7.6% y/y from 7.3% y/y in September and it remained above the Reserve Bank of India's (RBI's, central bank's) tolerance band of 4% +/-2% for an eighth consecutive month. Core inflation, which excludes food and fuel prices, rose marginally to 5.8% y/y in October from 5.7% y/y in September.

High inflation, partly driven by supply chain disruptions, is preventing the RBI from lowering its key policy interest rate, despite the marked economic slump. As a result, the RBI maintained an unchanged monetary policy in October 2020, with its key policy interest rate, the repurchase or repo rate, remaining at 4% since it was last lowered in May 2020. Since the outbreak of the pandemic, the RBI has reduced its repo rate by 115 bp in total.

India's fiscal stimulus package of INR 20tn, equivalent to 10% of GDP, has not been effective because only a fraction has been implemented through the budget. The government announced a further stimulus of INR 0.73tn in October, and another in early November worth USD 27bn over five years to support ten areas in manufacturing.

In October, India's merchandise (goods) exports contracted by 5.1% y/y to USD 24.9bn and imports declined by 11.5% y/y to USD 33.6bn. This led to the trade deficit narrowing to USD 8.7bn in October 2020 from USD 12.7bn in the corresponding period of the previous year.

Foreign direct investment (FDI) inflows surged by 16% y/y between April and August 2020. Total FDI inflows during this period were USD 35.73bn.

Economic Outlook

Economic activity gained momentum in Q3 2020 through into Q4, with the smoothed CEIC Leading Indicator rising for a fifth consecutive month in October, to 112.2, from 104.45 in September, after having fallen to an all-time low of 79.1 in May 2020. While the Indian economy is showing visible signs of economic revival, economic activity remains subdued given the ongoing crisis caused by the spread of the pandemic, weak fiscal policy implementation, the lack of sufficient credit demand and a slump in private investment. As a result, it is expected that the Indian economy will contract in FY2021 (to end-March 2021) after it grew by 4.2% in FY2020.

According to the IMF, the Indian economy will contract in real terms by 10.3% in FY2021 and grow by 8.8% in FY2022. It will be difficult for the Indian economy to get back on track given that the economy was already weak prior to the pandemic and GDP growth had been decelerating sequentially since Q4 of FY2018. Weak fiscal stimulus and the lack of fiscal space - i.e. the government's borrowing plan of INR 12tn for FY2021 will mostly take care of the shortfall in budget revenue, but will actually leave very little space for additional fiscal stimulus - amid rising COVID-19 cases are unlikely to reverse the economic contraction in Q4 2020 and Q1 2021 i.e. the two remaining quarters of this fiscal year.

The amount of fiscal stimulus to bolster demand is considered underwhelming. According to Nomura's chief economist for India and Asia, ex-Japan, Sonal Varma, and India economist Aurodeep Nandi, as reported on CNBC, India's total fiscal support (on budget) is about 1.2% of GDP, which is small compared with other countries and given the seriousness of the economic downturn and public health crisis caused by COVID-19. It also reflects the lack of fiscal space for a large stimulus to prop up GDP growth. What India requires is income support, according to Jahangir Aziz, head of emerging markets economics at J.P. Morgan, so that when the restrictions are removed, consumers and firms would have the financial stability to borrow and invest.

The stimulus until now has largely been in the form of liquidity injections from the central bank, rather than fiscal expenditure. As a result, aggregate demand is unlikely to get much of a boost over the coming quarters and therefore India requires more public spending, which means an expansion of the fiscal deficit. According to The Wire, massive investments, income transfers and the creation of additional purchasing power are required to get the economy back on track.

Despite this, high frequency indicators such as the IHS Markit manufacturing purchasing managers' index (PMI), power demand, exports and fuel consumption, among others, seem to suggest that the Indian economy is witnessing a very gradual, yet tentative economic recovery from the deep slump in Q2 2020 when real GDP plunged by 23.9% y/y. This was confirmed with the Q3 2020 GDP data and if this momentum is maintained the Indian economy is likely to contract by even less in Q4 2020.

New project investments in India have fallen markedly in each fiscal year from FY2016 to FY2020, which suggests a weak investment climate. Excessive sovereign bond yields, among the highest in the world, are hurting investments. Unless there is an investment revival, it is unlikely that India can witness a sustained growth path.

As for inflation, Focus Economics Consensus Forecast panellists project India's headline inflation rate will average 5.1% in FY2021 and 4.3% in FY2022. Food inflation is primarily keeping the headline inflation rate elevated.

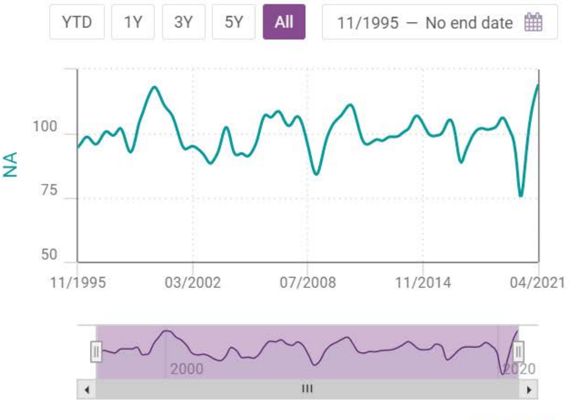
India Economy: Statistics at a Glance

1Y 3Y 5Y All 03/2019 – 12/2020

Name	03/2019	06/2019	09/2019	12/2019	03/2020	06/2020	09/2020	12/2020
Real GDP; % y/y change	5.84	5.39	4.61	3.28	3.01	-24.38	-7.35	0.41
Fixed Investment; % y/y change	4.44	13.26	3.90	2.43	2.54	-46.44	-6.77	2.56
Industrial Production Index; % y/y change	1.52	2.97	-0.42	-1.40	-4.26	-35.56	-5.70	1.65
Consumer Price Index; % y/y change	2.46	3.07	3.47	5.83	6.67	6.57	6.90	6.36
Core CPI; % y/y change	5.22	4.29	4.18	3.57	4.06	5.06	5.70	5.75
Wholesale Price Index; % y/y change	2.93	2.68	0.89	1.10	2.06	-2.25	0.49	1.85
Policy Rate; % pa	6.25	5.75	5.40	5.15	4.40	4.00	4.00	4.00
10 Year Government Securities Yield; % pa	7.37	6.93	6.83	6.92	6.73	5.98	6.10	5.98
Exports; % y/y change	6.69	-1.39	-3.92	-1.92	-12.68	-36.32	-5.27	-4.29
Imports; % y/y change	0.30	1.10	-11.25	-11.16	-9.21	-52.89	-25.19	-4.80
Trade Balance; USD mn	-35,742.16	-49,188.40	-39,744.24	-37,050.78	-35,438.15	-9,768.27	-14,149.42	-34,868.50
Government Debt; % of GDP	44.84	45.63	46.40	47.11	46.50	52.68	56.24	56.59
Current Account Balance; USD mn	-4,628.37	-14,976.55	-7,553.33	-2,604.62	584.38	19,022.34	15,123.73	-1,723.59
Automobile Sales; % y/y change	-6.10	-10.89	-18.47	-9.75	-22.31	-74.11	-7.09	6.86

CEIC Leading Indicator
Main

CEIC Leading Indicator
Smoothed



Real Sector

Real Sector

The Indian economy slipped into recession between April and September 2020, with real GDP contracting by 7.5% y/y in Q3 of calendar year 2020, corresponding to the second quarter of India's current fiscal year to end-March 2021. This follows a huge fall of 23.9% y/y in Q2 2020 caused by the COVID-19 induced stringent lockdown effect on domestic demand, coupled with the collapse in external demand.

Private consumption contracted at a reduced pace of 11.3% y/y, and gross fixed capital formation (investment) by 7.4% y/y, which compare with larger respective declines of 26.7% y/y and 47.1% y/y previously. Government expenditure has been consistently propping up the Indian economy until now, growing most recently by 16.4% y/y in Q2 2020, but in Q3 2020 it declined by 22.2% y/y. Meanwhile, external demand remains subdued, with goods and services exports volume contracting by 1.5% y/y, although imports were down by 17.2% providing a boost to GDP from the foreign balance (net exports).

In terms of gross valued added (GVA), the agriculture, forestry and fishing sector grew by 3.4% y/y in Q3 2020, after increasing by the same amount in Q2 2020. The mining and quarrying sector contracted by 9.1% y/y in Q3 2020, after declining by 23.3% in Q2 2020 and the construction sector declined by 8.6% y/y after previously contracting by 50.3% y/y. However, the utilities sector GVA increased by 4.4% y/y in Q3 2020, after declining by 7% y/y in Q2 2020 and manufacturing showed an improvement of 0.6% y/y after declining by 39.3%.

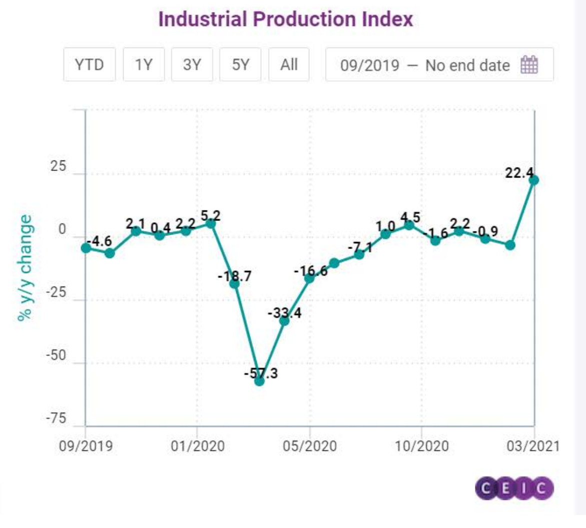
The infrastructure industries index, which accounts for around 40% of the industrial production index and constitutes eight core industries, contracted by 0.8% y/y in September, after declining by 7.4% and 8% in August and July, respectively. The rate of decline in September was the lowest since March 2020, but in October it accelerated to 2.5% y/y. During the April-September 2020 period, this core sector output index contracted by 14.9% y/y compared with growth of 1.3% y/y in the corresponding period of 2019.

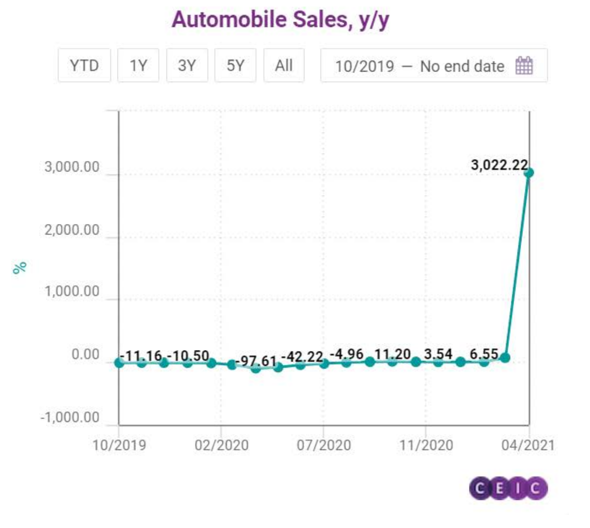
Industrial production grew by a meager 0.24% y/y in September 2020, after declining by 7.4% and 10.8% in August and July, respectively. Output of capital goods, a barometer of investment, continued to fall in September, by 3.3% y/y, although it was at a reduced pace compared with the 14.8% y/y drop in August. Despite the monetary and fiscal stimulus, private investment was still declining, and consequently the sustainability of the economic recovery will remain a challenge.

The IHS Markit Manufacturing purchasing managers' index (PMI) surged to a seasonally adjusted 58.9 in October, from 56.8 and 52.0 in September and August, respectively. The PMI reading for October was the highest since mid-2008. According to IHS Markit, levels of new orders and output continued to recover from the pandemic-induced slump earlier this year, and companies in October were convinced the resurgence in sales would be maintained in the coming months.

Services sector activity also expanded in October, ending eight months of consecutive contraction, with the IHS Markit India Services PMI rising to a seasonally adjusted 54.1, from 49.8 and 41.8 in September and August, respectively. This upturn in services activity is important for the Indian economy as this sector accounts for around 55% of India's GDP and approximately one-third of total employment. Given the surge in manufacturing activity, signs of improvement in services sector activity will provide some relief to policymakers eying the fact business conditions in India are gradually returning to normal. However, it is too early to be optimistic given that the recovery in the manufacturing and services sectors has followed a marked slump in previous months. Moreover, after India's four month festive season ends in November, i.e. after Diwali, activity in both sectors is likely to decelerate.

Proposed investments plummeted from INR 2.04tn in January 2020 to INR 108.25 bn in August. Burdened by excess capacity, and in an uncertain economic environment, there is little incentive for the corporate sector to invest, highlighting the policy challenges of economic revival and job creation in India.





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Monetary & Financial Sector

Monetary and Financial Sector

Inflation, according to the consumer price index (CPI), surged to 7.6% y/y in October 2020 from 7.3% in September and 6.7% in August. This was the seventh consecutive month in which inflation was above the Reserve Bank of India's (RBI's, central bank's) medium-term inflation target of 2%-6%. This makes the task of reviving the economy more complex for the RBI, as a surge in inflation is preventing it from further lowering its key policy interest rate. Inflation has surged, despite the contraction in GDP, mainly due to the spike in food price inflation, which accounts for around 60% of the CPI basket. Food price inflation rose to 11.1% in October, from 10.7% and 9.05% in September and August, respectively, despite a good agricultural harvest. Supply chain disruptions and a hike in minimum support prices (MSPs) for certain agricultural produce have resulted in a marked increase in food price inflation.

The core consumer price inflation measure, which excludes food and beverages as well as fuel and light prices, increased marginally to 5.8% y/y in October 2020 from 5.7% in September 2020, but was back up to the same level it was at in August 2020.

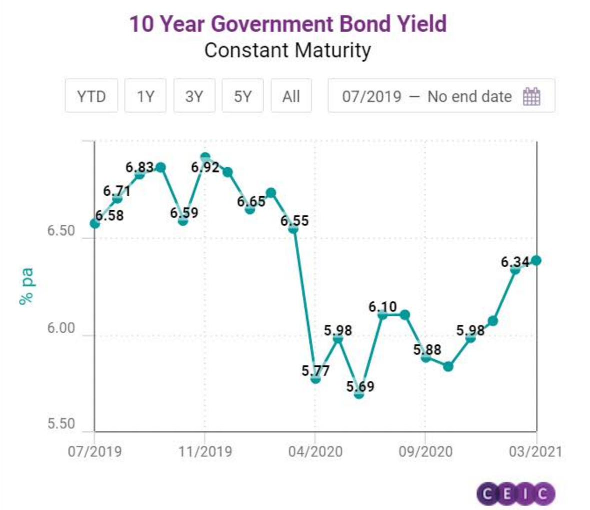
The RBI kept its monetary policy accommodative to help the Indian economy come out of its worst slump in four decades. At its monetary policy meeting on October 9, 2020, the RBI unveiled several measures to reduce or constrain borrowing costs - such as new Targeted Long Term Repo Operations (TLTROs) of INR 1tn that will enable banks to borrow at low cost and lend to the corporate sector to revive the Indian economy. The RBI also doubled the size of its open-market bond purchases to USD 2.7bn and offered to buy the debt of state governments, but kept its repo rate, the key lending rate, unchanged at 4% and the reverse repo rate, the key borrowing rate, unchanged at 3.35%. The underlying reason for the status quo on policy rates in October was that inflation remained above the RBI's medium-term target range of 2%-6% for a fifth consecutive month in August, at 6.7% y/y.

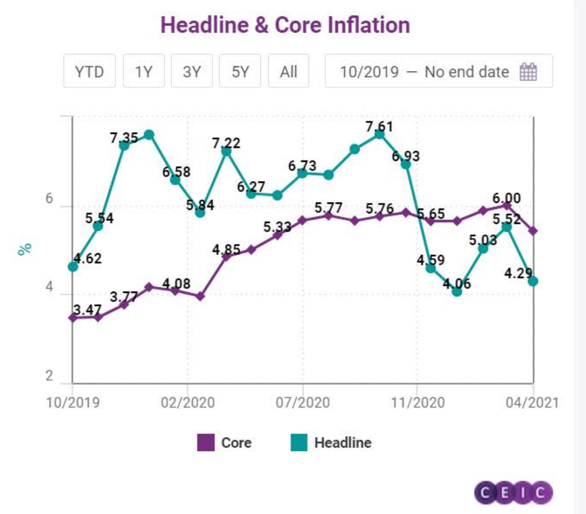
The commercial banking sector's non-performing assets (NPAs) have been a major factor behind the country's economic slowdown over recent years, as it has adversely affected the demand for and supply of credit, which in turn has put private investment on a declining trend over the past decade. According to Alok Sheel, RBI Chair Professor in Macroeconomics at the Indian Council for Research on International Economic Relations (ICRIER), a fresh capital crisis is looming in India's banking sector.

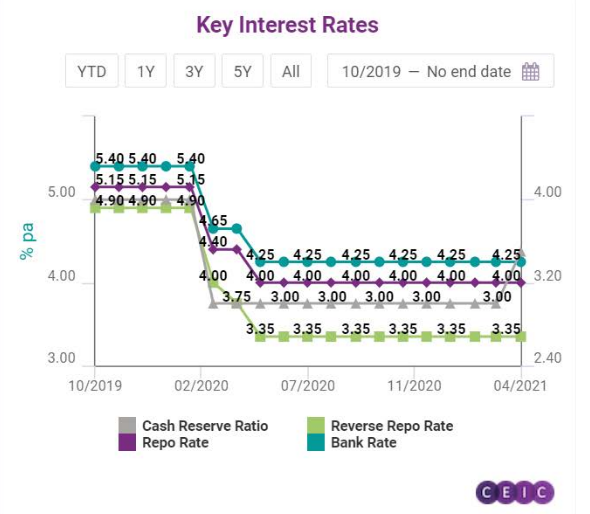
The RBI's latest Financial Stability Report states that the average NPA ratio is forecast to rise to 12.5% in FY2021 (to end-March 2021) and to 14.7% if the pandemic escalates further and results in more bankruptcies. This compares with an NPA ratio of 8.5% at the end of FY2020. There is a renewed danger that India's public sector banks, which account for approximately 70% of India's banking system, might witness their entire capital erased. If this happens it might entail an even larger recapitalisation of these banks via the Union Budget to maintain their mandated capital reserves. The amount of INR 3.8tn has been injected into 18 public sector banks over the past decade so they can maintain their mandated capital-to-risk weighted asset ratios.

The stock market capitalisation of all listed firms on the Bombay Stock Exchange (BSE) touched a record high of INR 157.9tn in October 2020, as several macroeconomic indicators and earnings optimism boosted equities. However, on a global level, India remains in 10th spot in terms of its market capitalisation with India's share of global market capitalisation only 2.3%.

The BSE market-weighted benchmark index of 30 companies, known as the Sensex, crossed the 40,000 mark to 40,182.67 on October 8, 2020 for the first time since February 24, 2020 when it hit 40,363.2. The surge in global liquidity, balance sheet expansion by central banks, expectations of a quick corporate earnings revival and hopes of another government stimulus ahead of India's festive season in November boosted stock markets.







Fiscal Sector

Fiscal Sector

India's fiscal response to the pandemic has been limited by the parlous state of the government's finances. According to a report by Motilal Oswal Financial Services, India's fiscal deficit may rise substantially to INR 146mn, i.e. 7.6% of GDP in FY2021 (to end-March 2021) as a result of the pandemic-induced fall in revenues and rising government expenditure. The firm also stated that government spending is expected to be highly skewed towards more current rather than capital expenditure. Consequently, capital spending could fall, which does not augur well for economic recovery.

The government's economic stimulus package of INR 20tn, equivalent to 10% of GDP announced on May 12, 2020, to revive the Indian economy has not been very successful moderating the blow to economic activity due to the stringent lockdown. This is because the fiscal stimulus involved little actual government spending and focused on providing liquidity and collateral-free credit for small firms. It also left out adversely affected sectors, such as tourism, aviation and hospitality. To foster economic recovery, the government announced a long-awaited demand stimulus of INR 730bn on October 12, 2020, that focused on boosting consumer spending and capital expenditure. This stimulus package will neither fan inflation in the future, nor put government debt on an unsustainable path.

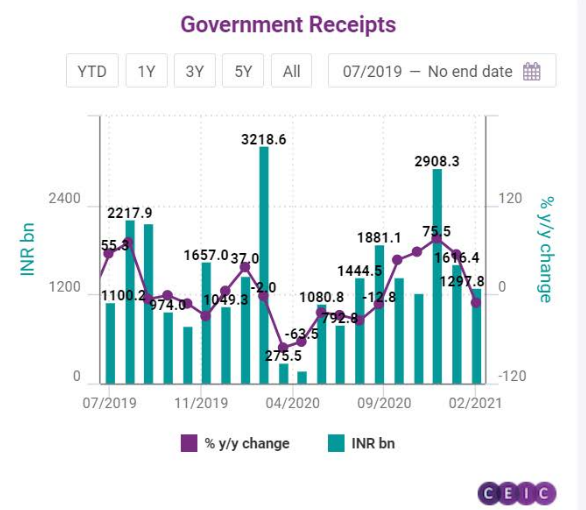
Notable in this stimulus plan is the announcement of a INR 120bn interest-free 50-year loan to state governments for spending on capital projects in a bid to boost the economy, while central government will allocate an additional INR 25bn towards capital expenditure on roads, defence, infrastructure, water supply and urban development. Given that the central government is hamstrung by budgetary constraints, it has also asked 13 public sector oil companies to double their capital expenditure in FY2021 to INR 2tn, from the initial target of INR 1tn, and scale this up further to INR 3tn in FY2022.

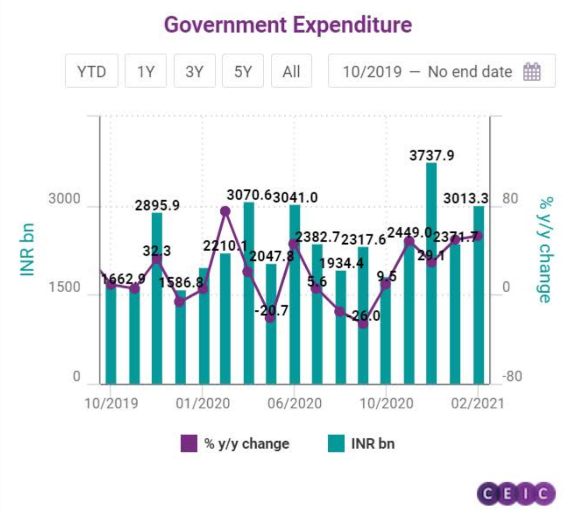
The stimulus plan also includes the Leave Travel Concession (LTC) cash scheme for government employees and those who opt for it can buy goods and services in lieu of the tax-exempt portion of this Concession. Another stimulus package was approved by the cabinet in early November 2020 which involves production-linked incentives worth USD 27bn over five years for manufacturers across ten sectors.

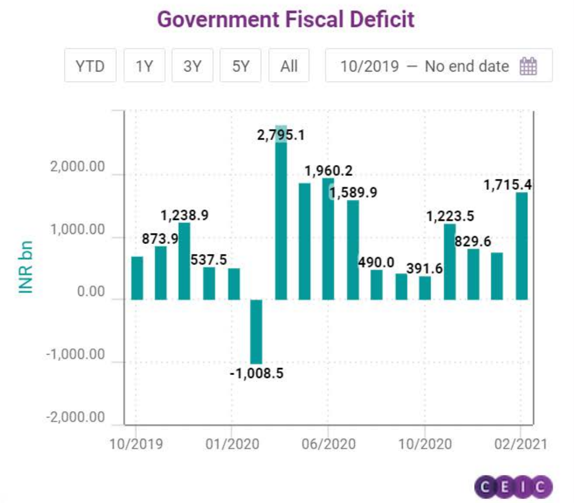
India's fiscal deficit surged to 6.6% of GDP in Q2 2020 from 4.6% in the previous quarter and it reached 114.8% of the fiscal year target in the first six months of FY2021, mainly as a result of poor revenue realisation. However, the government has stuck to its INR 12tn borrowing plan for the current fiscal year. It borrowed INR 7.66tn in the first half of FY2021 and plans to borrow the remaining INR 4.34tn between October 2020 and January 2021, according to the economic affairs secretary, Tarun Bajaj, who stated that government borrowing has been contracted on a weighted average yield of 5.82%, which is the lowest rate at which the government has borrowed in 15 years.

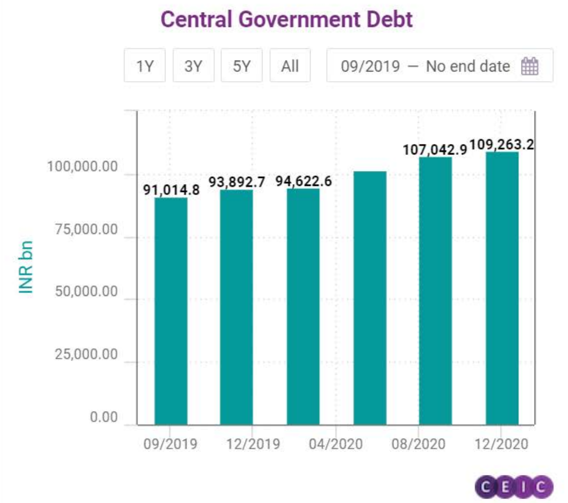
Goods and Services Tax (GST) revenues increased in October to INR 1.05tn, a 10.25% y/y rise, after rising by 3.8% y/y to INR 954.8bn September, reflecting a pick-up in domestic demand. In October 2020, GST collections were the highest since February 2020, crossing the INR 1tn mark for the first time in this fiscal year. GST receipts had previously contracted y/y each month between April and August 2020. The marked y/y rise in GST collections in October is predominantly the result of households purchasing smartphones, automobiles and other consumer durables during India's festive season. However, this should not be taken as indicative of a sustainable economic recovery. The pick-up in economic activity is a combination of pent-up demand, restocking of inventory and the fact these tax collections have spiked in the middle of India's festive season.

Gross tax collections declined by 16.2% y/y in September 2020, after growing by 2.05% y/y in August. Disconcertingly, corporate income tax revenues fell on a y/y basis by 37.9%, 51.8% and 108.2% in September, August and July 2020, respectively. Income tax revenues, however, rose by 2.6% y/y in September, after contracting markedly by 27.9% y/y and 8.5% y/y in August and July, respectively. In terms of the first six months of the current fiscal year (i.e. April - September 2020), gross tax collections declined by 21.6% y/y to INR 7.21tn, which is a reflection of the severity of India's economic downturn. Corporate and income tax collections declined by 39.7% y/y and 21.8% y/y respectively during this period.









External Sector

External Sector

Merchandise (goods) exports rose sharply in March 2021 at their fastest pace in three years, as a result of an increase in global demand and more specifically due to the marked rise in Chinese demand for Japanese products, including plastics and raw materials, such as copper. Japanese exports to the EU also increased sharply in March 2021, while exports to the US rose more moderately. Imports rose for the second consecutive month in March 2021.

Merchandise exports surged by 16.1% y/y in March 2021 after contracting by 4.45% y/y in February but rose by 6.39% y/y in January. Prior to that, exports had risen on an annual basis for the first time in December 2020, by 1.98% y/y, as external demand picked up. Japanese exports to China, the EU and US rose by 37.2% y/y, 12.8% y/y and 4.9% y/y, respectively, in March 2021. Japan's exports to China rose for the ninth consecutive month in March 2021.

Merchandise imports rose by 5.7% y/y in March 2021 after increasing by 11.83% y/y in February, but contracting by 9.45% y/y in January. Imports had risen for the first time in 22 months in February 2021 and continued to rise in March due to the pick-up in domestic demand.

Japan's trade surplus rose to JPY 663.7bn in March 2021 from JPY 215.86bn in February 2021, while in January there was a trade deficit of JPY 327.16bn.

Foreign direct investment (FDI) as a percentage of nominal GDP increased to 1.31% in 2020 from 0.78% in 2019. FDI inflows into Japan remain low compared to other developed economies and relatively unstable. According to Santander Trade, the potential barriers to FDI in Japan are essentially demographic, cultural and linguistic, although Japan does remain a key investment destination. FDI in Japan is mainly directed into the finance and insurance, electric machinery, equipment related to transport production, pharmaceutical and chemicals industries.

According to JETRO's latest survey of overseas affiliates in Japan, more than 60% of overseas companies state that the current market size and growth of relevant industries is what makes Japan an attractive investment destination. Japan is a leader in advanced technology, and research & development, and it is actively opening its doors for foreign companies to invest and is aiming to create the best possible investor environment. In the World Bank's 2020 Doing Business Report, Japan's position at 29 out of 190 countries represented a rise of 10 places compared with 2019.

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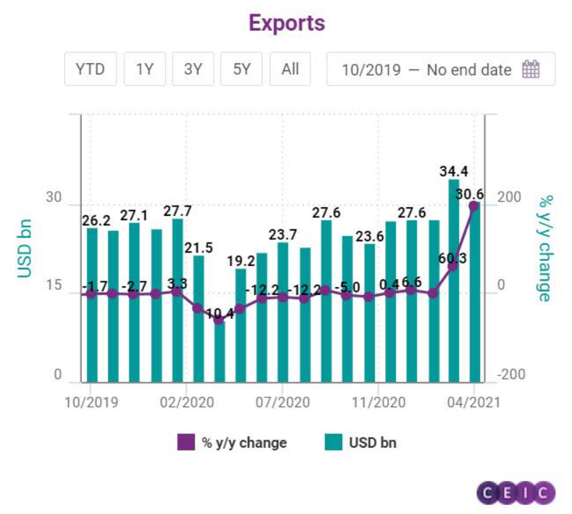

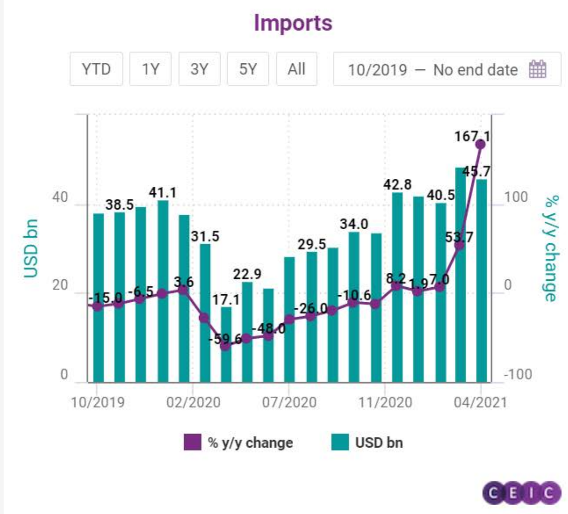

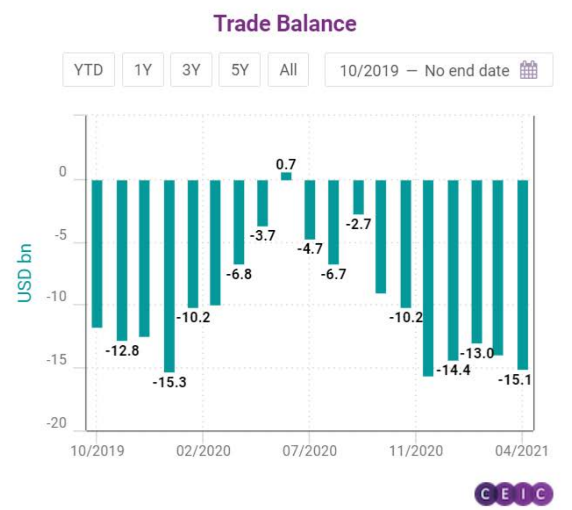

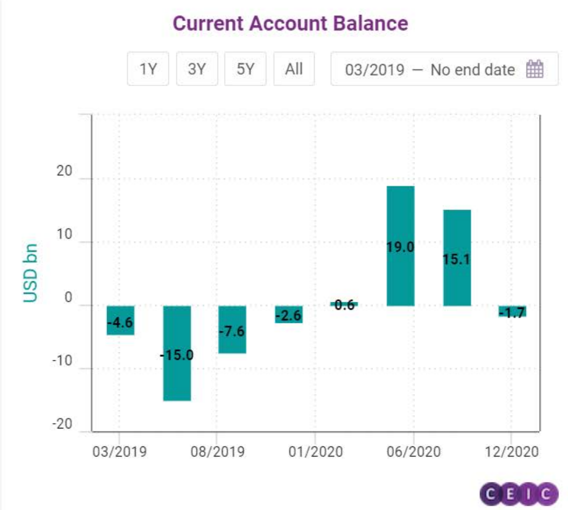

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