2020 in retrospect

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This year has been one typified by volatility with almost every economic indicator being influenced by the extent of lockdown, the unlock process and the actions taken by the policy makers. We look at how various indicators look at the end of calendar 2020.

Agriculture has been the leading sector this year with promise of a higher kharif harvest this season. The first advance estimate indicates that foodgrains production will be higher at 144.5 mn tonnes as against 143.38 mn tonnes last year. With the exception of coarse cereals where production is expected to be lower, growth is expected to be better in case of pulses, oilseeds, cotton, and sugarcane this kharif season. This would be a support factor for sustaining demand especially in the post festival season as the money earned through sale of crop which ends by December can be spent in early 2021.

The **industrial production** curve has begun leaning upwards. After negative growth rates starting in March which troughed the most in April by -57.3% turned positive in September at 0.2% and improved to 3.6% in October. The question is whether or not this will be sustained post December when the pent-up demand in consumption could end. We clearly need the other engines on investment goods to fire.

Investment ratio as defined by gross fixed capital formation to GDP rate has been declining this year to 19.5% in Q1 and recovered to 25.7% in Q2. A push from the government is required to keep this ratio steady in the upward direction in the next two quarters. Private investment has not been forthcoming in significant numbers. CMIE data on new investment of projects announced indicate that for the first 2 quarters, it was Rs 1.81 lkh crore as against Rs 4.95 lkh crore last year. RBI data on capacity utilization available till Q1-FY21 shows a low of 47.3%.

The **core sector** industries which give us an idea of how infrastructure is faring has been a bit volatile. Quite expectedly growth started off on a negative note in April at -37.9% and remained so till August. A near positive number of +0.1% was achieved in September raising hopes of a revival, which was not maintained in October when growth fell by 2.5%. Fertilizers is the only segment to witness continuously positive growth which was linked to the farm sector.

The **PMI indices** are probably the early signals of what is happening in the economy. The Manufacturing PMI crossed the positive zone of above 50 in August to reach 56.3 in November. In case of services the turning point was October and the index touched 53.7 in November. Quite clearly on a month-on-month basis there is improvement in both the segments as revealed by these Surveys.

How about **GDP growth**? Here the forecasts have been quite volatile, and it does appear now that growth will be negative for sure with our estimate being –7.7-7.9%. Sequentially there has been some improvement in the negative zone from -23.9% in Q1 to -7.5% in Q2. Technically we are still in recession with two quarters of negative growth. We do expect growth to be marginally negative in Q3 and turn positive in Q4. In Q2, 3 of the 8 broad sectors witnessed positive growth – manufacturing, agriculture and electricity. The anomaly in industrial production being negative and manufacturing-GDP being positive can be explained by the growth in profits in this quarter notwithstanding the decline in sales.

Corporate performance was lacklustre with a difference in the first two quarters. Our studies on the performance of a sample of 1435 non-banking/finance companies in Q1 showed a decline in sales of 34.5% and operating profit by 28.0%. In Q2 for a sample of 1686 non-bank/finance companies net sales declined by 7.5% but operating profit increased by 5.2%. This change in trend was mainly due to cost-cutting by corporates to protect profit as turnover fell.

Sectors that are in the driving seat are metals, fertilizers, pharma exports, IT, telecom, e-commerce. The sectors that have shown signs of pick-up are cars, 2W, CVs, Durable, FMCG, residential real estate, cement, pharma, healthcare, retail trade, ports, aviation and roads. There is still no clarity on whether these trends can be sustained, and the recovery was due to the pent-up demand. Those still to get their bearings are commercial real estate, hotels, restaurants, tourism, entertainment.

Inflation has been a nagging issue which though coming in the way of the cost of living of the people has not affected monetary policy decision as the MPC has focused on growth. CPI inflation has been above the 6% mark in all the months of the year and shown a slight dip to 6.9% in November. The food and beverages segment has caused inflation to be high so far, and the moderation in prices of food products such as vegetables witnessed in the last week or so should help to moderate inflation. WPI inflation has been low through the year so far and been negative till May before turning positive in a gentle manner to reach 1.6% in November. The good news for India Inc is that inflation of manufactured products has been increasing continuously albeit gradually from June onwards and has touched 3% in November indicating partly gain in pricing power in some sectors.

The **MPC** has been accommodative in monetary stance and the RBI has infused liquidity through the TLTROs, OMOs and CRR cut through the year. This has ensured that liquidity has been abundant with an average of around Rs 5 lkh crore of surplus liquidity being witnessed almost on a daily basis in the reverse repo operations. The CRR came down from 4% to 3% and repo rate from 5.15% to 4%. Over 12 months the MCLR came down from a range of 7.65-8% to 6.55-7.10%. The 10-year yield GSec yield came down from 6.74% as at end-December 2019 to 5.85-5.90% by 28th December 2020. Hence there has been a decline of almost 80 bps which has helped the government in its borrowing programme.

The **banking** sector has just recently witnessed some improvement in credit offtake. As of December 4, the growth in credit over March was 1.3% (1.7% last year) with the absolute increase being Rs 1.34 lkh crore (Rs 1.63 lkh crore). The excess liquidity in the system can be gauged by the comparable growth rates in deposits which was 7.5% (4.2%). In absolute terms deposits increased by Rs 10.24 lkh crore which was almost double that last year which was at Rs 5.32 lkh crore last year. The sector wise growth in credit shows an interesting picture for the period April-October. Growth in credit was -0.7% where there was negative growth in industry (-5.7%) and services (-0.7%) while it was positive for agriculture (5.3%) and retail (2.3%). This reflected both limited demand from corporates as well as crick-risk averseness of banks.

The government's **fiscal** pressures built up during the year due to a fall in tax revenue and maintenance of revenue expenditure due to the relief measures invoked. For the period April to October, the fiscal deficit was Rs 9.53 lkh crore which is around 120% of the budgeted number of Rs 7.96 lkh crore. Tax revenue was just 34.2% (46.2%) of the budgeted amount reflecting the shortfall. Non-tax revenue was also lower at 30.2% (71.6%). Non-debt receipts in the form of disinvestment were also lower as the programme has not taken off which put pressure on the total revenue numbers. Capex in the first 7 months was lower at 47.9% of the budgeted amount relative to 59.5% achievement last year.

Slippage in **fiscal deficit** is expected to be in the region of 5-5.5% resulting in a final number of 8.5-9% of GDP unless there are sharp cuts in expenditure and a major resurgence in tax revenue. The government's borrowing programme was to be Rs 7.8 lkh crore for the year which was revised to Rs 12 lkh crore due to the pandemic measures. Subsequently the programme was enhanced to Rs 13.1 lkh crore to take care of the states' compensation on account of GST. So far borrowings have been Rs 10.5 lkh crore. As liquidity has been in abundance this has not impacted the banking system and bond yields have been moving down due to the policies pursued by the RBI.

The **debt market** has been more buoyant partly due to the TLTRO operations and the extension of guarantee by the government on specific debt. Issuances through private placements for the first 8 months of the year were Rs 4.87 lkh crore relative to Rs 3.86 lkh crore in 2019.

The equity market was steady with the primary issuances being Rs 1.71 lkh crore for first 8 months which was marginally lower than Rs 1.78 lkh crore raised last year during this period. The secondary market however was more buoyant. For week ending December 27th, 2019 the Sensex was at 41575 and went down to 29816 by March 27th. After falling further in the following week, there have been significant gains with the index reaching 46974 in the week ending 25th December.

Foreign trade took a setback this year with exports declining by 17.8% during the first 8 months of the year and were valued at $ 174 bn. Imports decline at a sharper rate of 33.6% during this period and were at $ 216 bn. The trade deficit declined sharply from $ 113.4 bn to $ 42 bn. However, this situation may not be very comfortable for exports which are declining even though the deficit has come down sharply. Fall in imports reflects a weak industrial sector where demand for imported materials has come down.

For our **balance of payments,** the flows have been very positive. The lower trade deficit will get reflected in the current account which may be expected to be in surplus in Q2 and probably Q3 too. Cumulative FPI between April and December 18 was $ 26.1 bn (of which equity was $ 27.6 bn and debt negative). Gross FDI was $ 46.8 bn for first seven months of the year. This has helped to shore up forex reserves which have increased by around $ 103.3 bn in the current financial year between March and December 18 to reach $ 581.1 bn. The rupee has been largely stable. The rupee had moved from around Rs 75.50/$ in the beginning of April to Rs 73.73 in the week ending December 25th. In December 2019 it was around Rs 71.21/$. Hence while there was depreciation between December 2019 and March 2020, the rupee appreciated during the subsequent period due to strong fundamentals and weak dollar globally.

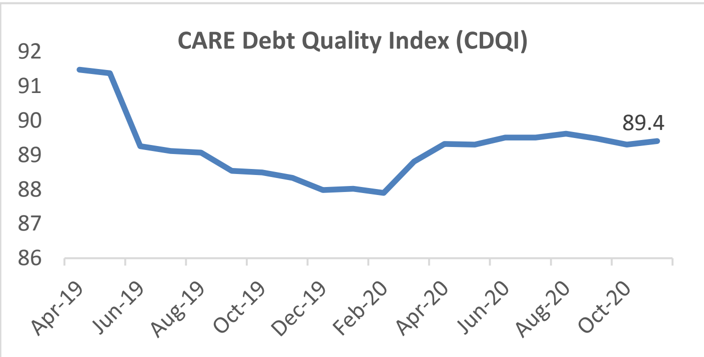
Therefore, the economic trends varied significantly across indicators. The external position was very strong leading to intervention by the RBI to ensure that the rupee does not become stronger. On the monetary side the mood was facilitative in all ways, yet banks were cautious with lending. Borrowing continued in the debt market but was restricted to finance companies and PSUs. The fiscal strains showed, and necessary action has been taken to ensure that slippages are controlled. There are limited signs of recovery in the real sector with some industries leading. But even here there is a bit of apprehension on whether the buoyancy witnessed during the festival season can be maintained. The same gets reflected in the corporate performance which has not been very convincing in the Q2 period. In this scenario investment revival looks challenging. Inflation in this environment has tended to be a concern from the consumer viewpoint but has not had an impact on monetary policy decisions.

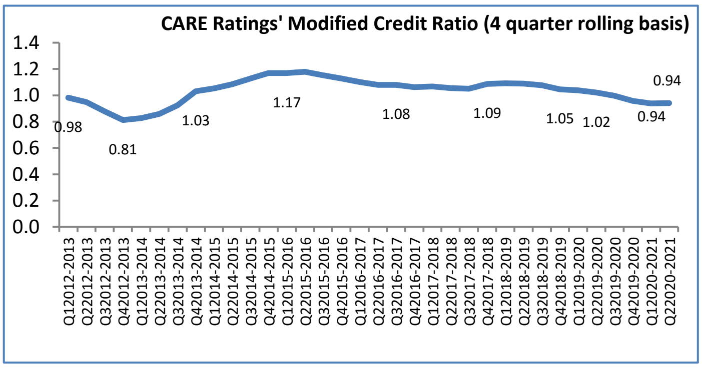
Hence the feeling one gets is that there have been several policy responses to a very unfavorable environment to steer the ship through turbulent seas. This has been commendable. However, the recovery process is more likely in the next fiscal year only.

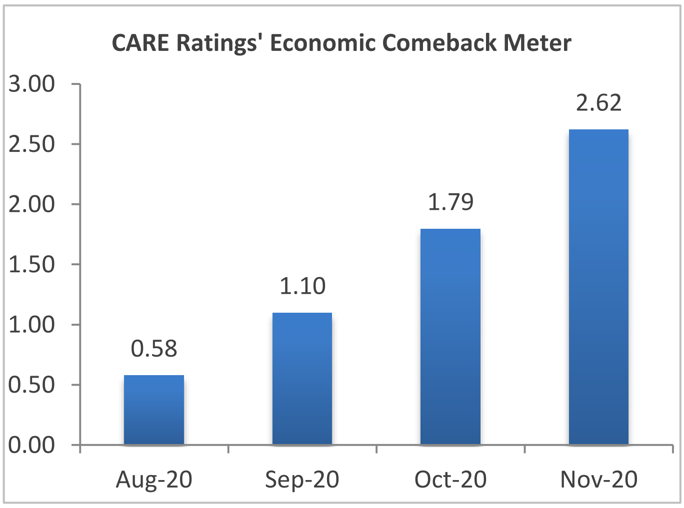
What do various CARE Indices show?

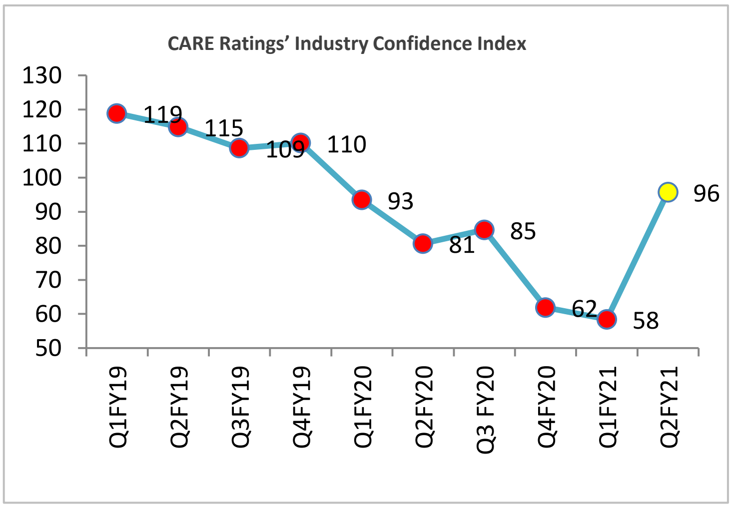
- CARE Debt Quality Index (CDQI) shows marginal improvement in the quality of debt over the year.
- CARE Ratings' MCR is still less than 1 as of September (rolling 4 quarters) indicating more downgrades relative to upgrades.
- CARE Ratings' Economic Comeback meter (CECM) shows that as of November there has been an improvement in the comeback meter, and we are on the road to comeback (up to score of 5). But we are far from a real comeback.
- CARE Ratings' Industry Confidence Index (CICI) indicates that after falling sharply in Q1-FY21, there was an improvement in Q2-FY21.

CARE Indices









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