

## INDIAN ECONOMY

# CRISIL Insights

February 2018

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we evaluate the implications of budget proposals and present the macroeconomic outlook

## Through the budget lens, to drivers beyond

The Union Budget for fiscal 2019 had to perform a tightrope walk against the backdrop of a slowing economy and fiscal duress. The upshot was proposals only mildly supportive of economic growth. In all, gross domestic product's (GDP) northward sojourn next fiscal is expected to be driven by factors external to the budget. Fading impact of demonetization and the Goods and Services Tax (GST) implementation hurdles, and continuing global recovery in both GDP and trade are expected to provide the stimuli. The weak base of fiscal 2018, too, will give a statistical lift to growth.

While the budget relaxed near-term targets, its intention to accept the N K Singh Committee's recommendation of bringing down the fiscal deficit to 3% of GDP in fiscal 2021, should offer comfort on the medium-term fiscal trajectory. That said, fiscal slippage on part of the central government is not without repercussions for monetary policy, inflation, and bond markets. In its first monetary policy statement of 2018, the Reserve Bank of India (RBI) has already flagged concerns on fiscal slippage and the upside risk to inflation.

GDP growth is forecast to bounce back to 7.5% in fiscal 2019, from a low base of 6.5% in fiscal 2018. Growth will remain consumption-driven. Investment will improve gradually, aided by bank recapitalization and improved capacity utilization. Export growth stalled in fiscal 2018 owing to domestic disruptions is expected to recover, on the back of improving global trade and GDP growth. Consumer Price Index (CPI)-linked inflation is expected to pick up to 4.6% average in fiscal 2019, from a forecast of 4% in fiscal 2018, owing to rising consumption demand, impact of house rent allowance revisions on housing inflation, and higher global crude oil prices. Upside risks to inflation, however, arise from three factors: (i) fiscal actions (such as higher minimum support price (MSP) and higher pension outgo owing to the Seventh Pay Commission) that will exert higher influence on inflation; (ii) firmer global oil and metal prices that will compel manufacturers to raise prices given improving domestic demand conditions; and (iii) higher MSPs for farmers and higher import duties. Current account deficit (CAD) is expected to expand from 0.7% of GDP in fiscal 2017 to 1.7% of GDP in fiscal 2018 and further to 1.9% of GDP in fiscal 2019, owing to import growth exceeding export growth. Higher CAD will exert pressure on the rupee as well. Despite higher CAD in the first half of fiscal 2018 on-year, the rupee appreciated owing to a surge in foreign capital inflows. However, going forward, capital inflows face risks from tightening of global liquidity and adverse global financial developments.

The economic outlook for fiscal 2019 also faces risk from factors outside of the budget, including those related to global developments, such as risks to capital inflows from global financial developments such as corrections in asset prices, tightening of monetary policy by major central banks, rise in the US treasury yields; rising oil prices; lingering GST-related glitches; and below-normal monsoon.

## Money and Banking

Monetary policy maintains balanced tone, but path stays cautious

## Industrial Production

IIP registered high growth for the second consecutive month

## Inflation

Inflation eases led by food and fuel

### MONEY AND BANKING

- The Reserve Bank of India's (RBI), Monetary Policy Committee (MPC) left policy rates unchanged in its February meeting highlighting the nascent stage of domestic economic recovery that requires nurturing
- It maintained the repo rate at 6%, the reverse repo at 5.75%, and the marginal standing facility rate at 6.25%
- The MPC maintained its neutral monetary policy stance with a focus on maintaining medium-term inflation at 4%, while supporting growth. However, it will stay vigilant on the evolving inflation scenario
- Liquidity in the banking system stays in excess, sees marginal increase in January
- Credit growth touched double digits for the first time since September 2016, growing by 10.7% as of January 5, 2018
- CRISIL expects the repo rate to remain unchanged over the next six months unless significant upside risks to the MPC's inflation forecast materialize

### INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) registered second consecutive month of high growth
- IIP grew 7.1% on-year in December, after having clocked 8.8% (revised up from 8.4% earlier) growth in November
- Growth was on the back of 8.4% growth in manufacturing sector
- Mining and electricity – the other two components of IIP – continued their slow pace of growth. While mining grew 1.23% compared with 1.13% in November, electricity registered a growth of 4.43% compared with 3.85%
- According to the use-based classification, infrastructure and construction goods displayed strong buoyancy, growing by a healthy 6.7%

### INFLATION

- CPI inflation moderated to 5.1% in January from 5.2% in December, mildly pulling back the northward trajectory seen since July 2017
- A 30 basis point (bps) fall in food inflation on-month, aided by a 60 bps decline in fuel inflation, brought overall CPI inflation lower
- Inflation, however, continued to firm up in large parts of the services sectors such as housing (driven by the revision in house rent allowance payments), education and in recreation, amusement and personal care and effects (reflective of both, return of pent-up demand in the economy and impact of higher taxes on services due to GST implementation)
- Yet, core inflation (CPI excluding food, fuel and light, petrol and diesel), stayed broadly unchanged from the previous month, at around 5.1% in January
- Wholesale Price Index (WPI)-linked inflation dipped for the second month in a row, plummeting 70 bps on-month to 2.8% in January
- The steep fall was led by decline in food and fuel inflation. Within the CPI, inflation continued to firm in the services sectors, while in the WPI, core inflation somewhat eased reflecting weak pricing power of manufacturers

## Interest Rate

Yields charging up

## Rupee

Portfolio inflows, \$ weakness  
bolster rupee

## Trade

Trade deficit at a 5-year  
high

- Yield on the 10-year government security (G-sec) ended January at 7.43%, up 10 bps on-month
  - Yields edged higher in the run-up to the budget on fiscal slippage concerns
  - Corporate bond yields rose in tandem, with yield on the 10-year paper moving up 14 bps on-month to 7.86% by January-end
  - CRISIL expects the 10-year G-sec yield to settle at 7.5-7.55% by March 2018 and 7.5% (with an upward bias) by March 2019
  - There could, however, be some upside to this forecast if: (a) oil prices escalate too rapidly, (b) the RBI decides to hike rates if inflation tests the upside, and (c) there is a fiscal slippage, leading to higher market borrowing
- Rupee continued to appreciate in January, averaging 63.6 per dollar, 0.9% stronger on-month and 6.5% stronger on-year
  - Rise in foreign portfolio inflows and weaker dollar supported the rupee
  - However, rupee did not gain as much as currencies of key emerging market peers. Fears of fiscal slippage, rising inflation and crude oil prices may have capped the foreign capital inflows relative to other economies
  - The rupee will face depreciation pressures in the near term due to a higher CAD
  - CRISIL expects the rupee to settle at 65 per dollar by fiscal 2018-end, and 66.5 per dollar by end of next fiscal
- Merchandise trade deficit widened further in January 2018, testing levels not seen since May 2013
  - Trade deficit rose to \$16.3 billion from \$14.8 billion in the previous month
  - The fueling factor is burgeoning imports versus slow exports growth
  - Imports rose 26.1% on-year in January, almost thrice as fast as the 9.1% growth in exports
  - Import growth in January was 5.1 percentage points higher than the previous month, stoked by a 42.6% rise in oil imports, as crude oil prices rose 33.7% on-year on average in January and hovered around \$70 per barrel. Non-oil imports also rose 20.5%, driven by precious and semi-precious stones, and industrial and investment related goods
  - Export growth, on the other hand, slowed to 9.1% in January from 12.5% in the previous month, owing to sluggish growth in engineering goods and gems & jewelry, and negative growth in textiles
  - While export growth is slowly recovering from GST-related disruptions and moving in line with strengthening global growth, import growth is expected to be higher owing to rising oil prices and growth in domestic consumption demand

INTEREST  
RATE

RUPEE

TRADE

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**CRISIL Limited:** CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | [www.crisil.com](http://www.crisil.com)

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