

INDIAN ECONOMY

CRISIL Insights

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Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we take a close look at factors from where inflation is expected to spring in fiscal 2019

Inflation's not cycling up

Low consumer inflation has been one of the key highlights of the Narendra Modi-led National Democratic Alliance (NDA). Helped by fortuitous tailwinds from low crude prices and a sharp dip in food inflation, consumer price inflation fell to 3.6% in fiscal 2018 from a high of 9.9% in fiscal 2013.

That said, credit for the decline in inflation also goes to NDA's policy stance. A prudent fiscal policy has meant lower pressure on inflation. Restraint in raising minimum support prices (MSPs) for crops also contributed to lower food inflation. The government also adopted an inflation targeting framework, which meant sharper focus on inflation control from the Reserve Bank of India (RBI).

But the scenario is now changing and inflation is set to pick up this fiscal after declining continuously since fiscal 2014. We expect Consumer Price Index (CPI)-based inflation to average 4.6% this fiscal with a base effect-driven higher inflation in the first half versus the second half.

True, the economy is expected to grow faster at 7.5% in fiscal 2019, but that's not the reason for the inflation pick-up. Inflation will rather be driven by acyclical factors that are less dependent on a cyclical upturn in the economy:

Higher crude oil prices: Brent crude prices have risen sharply. With shrinking global oil surpluses accompanied by strong global recovery, sustainability of current trend and even an upside to the currently prevailing crude oil prices cannot be ignored. The government can neutralise the impact of rising global crude oil price by reversing the excise hike, which was effected when crude prices were falling, but not without an associated fiscal cost.

Rise in MSP: Food inflation could also move up as the government promises higher MSP, increase in its coverage, and a mechanism to ensure that farmers do not suffer price falls below MSP as it happened in the last fiscal. Market prices of crops could fall in a year when normal monsoons and record agricultural output is being predicted.

Weaker rupee: Weakening rupee, together with tariff increases in some sectors, will raise the imported cost.

Additionally, metal prices – steel, copper and aluminium – have all been firming up and this will raise input costs for corporates.

Money and Banking

Keeping the powder dry

Industrial Production

IIP growth slowed down on year end

Inflation

Inflation reverses trend

MONEY AND BANKING

- The RBI's Monetary Policy Committee (MPC) kept policy rates unchanged at its April review meeting, the decision based on uncertainty regarding the inflation trajectory
- Given the pressures, the MPC will stay vigilant on the evolving inflation scenario and take any rate action only after weighing the data
- Liquidity relocated to the surplus zone in April after staying in the deficit area for the previous two months
- Credit growth grew in double digits, to 12.6% in April from 10.3% in March
- CRISIL Research expects banking credit to grow 8-9% and 10-12% in fiscals 2018 and 2019, respectively, supported by improved economic growth and domestic demand

INDUSTRIAL PRODUCTION

- Industrial activity lost some steam, after having turned in a steady performance in past few months. The Index of Industrial Production (IIP) growth slowed down to 4.4% on-year in March, from 7.0% in February
- While manufacturing sector displayed mild improvement (growing by 4.5% over 4.4% in fiscal 2017), sharp decline in mining sector growth (to 2.3% from 5.3%) and a weaker electricity sector growth (to 5.4% from 5.8%) pulled down the overall IIP growth
- According to the use-based classification, capital goods sector was once again in red, growing by -1.8%
- For fiscal 2018 as a whole, IIP growth was down to 4.3%, from 4.6% in fiscal 2017

INFLATION

- CPI inflation rose to 4.6% in April, up from 4.3% in March, reversing a three-month trend
- Wholesale Price Index (WPI)-based inflation rose to 3.2%, from 2.5%
- For both the inflation measures, the pick-up was driven by a surge in fuel as well as core inflation
- Given improving domestic demand conditions, manufacturers are likely to pass on higher input prices to consumers, which will show up in core inflation
- Food inflation will have a softening bias going forward since it is likely to stay relatively low given the expectation of a normal monsoon
- However, aggressive implementation of the announced MSP measures could feed the numbers
- For fiscal 2019, therefore, CRISIL expects CPI inflation to perk up to 4.6% from 3.6% in fiscal 2018, but stay benign overall and within the MPC's projected trajectory. The expectation, however, is that inflation will significantly moderate in the second half

Interest Rate

Yields rebound once again

Rupee

Rupee slides to a one-year low

Trade

Gold blunts oil's pressure on imports

- Yield on the 10-year government security (G-sec) ended April at 7.77%, up 37 basis points (bps) from March-end
 - While yields got a breather with the RBI announcing various steps to calm bond markets, the impact was short lived and yields started moving northwards as states announced increased borrowings
 - Corporate bond yields rose in tandem, with yield on the 10-year paper moving up 39 bps on-month to 8.24% by April-end
 - CRISIL expects the 10-year G-sec yield to settle at 7.6-7.7% by March 2019, compared with 7.62% in March 2018
 - However, there could be upsides to this forecast if: a) oil prices escalate too rapidly, pushing up both inflation and the government's subsidy burden, b) the RBI decides to hike rates faster, should inflation test the upside, and c) there is a fiscal slippage, leading to higher-than-budgeted market borrowing
- Battling its way through a succession of external headwinds, the rupee weakened to one-year lows in April. Rupee averaged 65.7 per dollar in April, dropping 1% on-month and 1.8% on-year
 - A sharp rise in oil prices, along with the lower risk appetite of global investors affected capital flows, with foreign portfolio investors net-withdrawing \$2.4 billion
 - A stronger dollar on account of rising United States Treasury yields further weakened the rupee
 - The rupee will face pressure from the current account deficit (CAD), which is steadily widening owing to rising oil and commodity prices and improving domestic consumption demand
 - CRISIL expects the rupee to weaken to 66.5 per dollar by March 2019 from 65 in March 2018
- Merchandise exports grew 5.2% on-year, compared to 0.7% decline in the previous month. However, import growth slowed for third consecutive month to 4.6% in April from 7.1% in the previous month
 - Despite faster growth in exports relative to imports, trade deficit widened \$470 million on-year to \$13.7 billion in April. While surge in oil prices kept oil import growth in double digits, decline in imports of gold and other consumption-related goods helped moderate overall import growth
 - Nevertheless, with domestic consumption demand expected to improve this fiscal, non-oil imports will pick up, unless specific policy actions are taken to keep it in check. In addition, the sharp rise in oil prices remains a significant risk for import growth
 - We expect CAD to widen to 2.5% of GDP in fiscal 2019 from an estimated 1.9% of GDP in fiscal 2018, due to a wider merchandise trade deficit

INTEREST
RATE

RUPEE

TRADE

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