Economics

India chart book

Holding out for a second half recovery

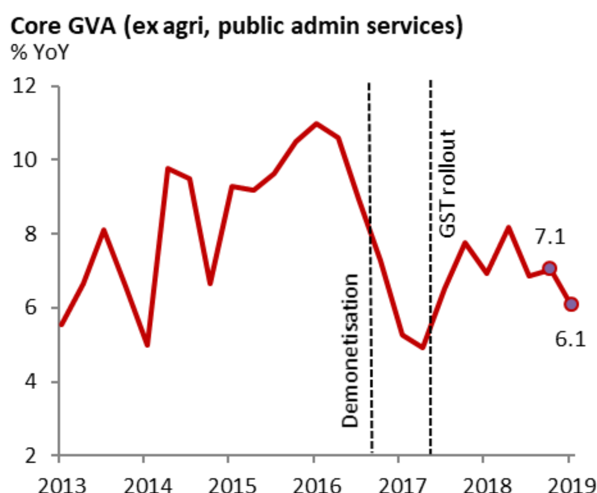
Group Research July 24, 2019

Radhika Rao
Economist

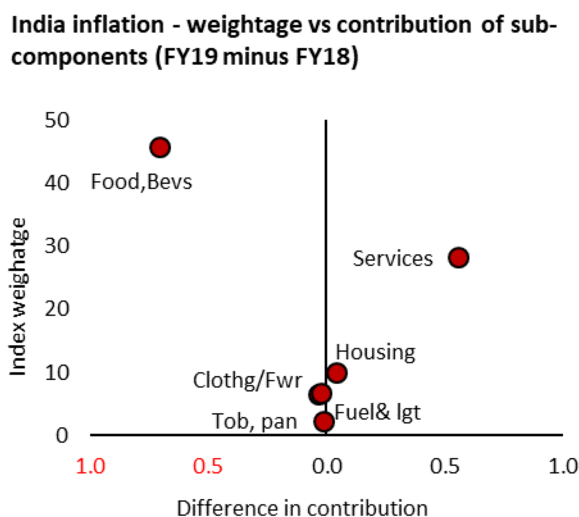
Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *FY20 growth is likely to be sub-7% for a second straight year. After hitting a speedbump in 1Q19, growth is likely to soften into 1HFY20. Favourable base effects and lower rates might help to lift activities in the 2H*
- *Inflation has been creeping up due to a weaker core. Monsoon strength and oil are under watch. We have revised down the FY20 inflation forecast.*
- *With fiscal consolidation a priority and inflation below target, monetary policy has adopted an accommodative hue*
- *Despite a proposed offshore sovereign bond issuance, reserves adequacy remains comfortable at this juncture*
- *After a sharp rally, INR bond yields are set to consolidate*
- *A supported US dollar and active reserves accumulation have kept the rupee under pressure. We look for USDINR to drift north by year-end with INR faring better than its export-reliant Asian peers*

Growth hits a speedbump

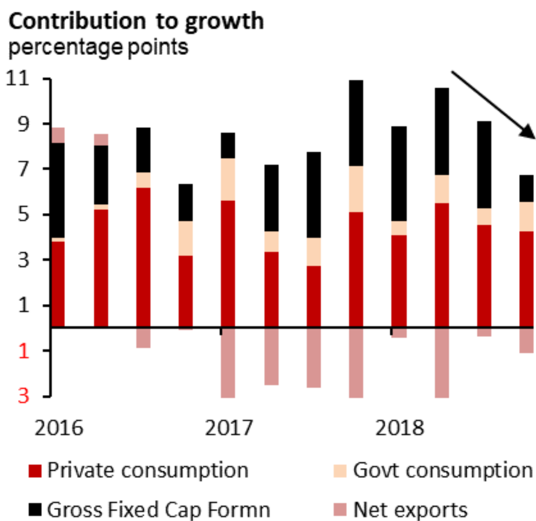


Inflation is better behaved

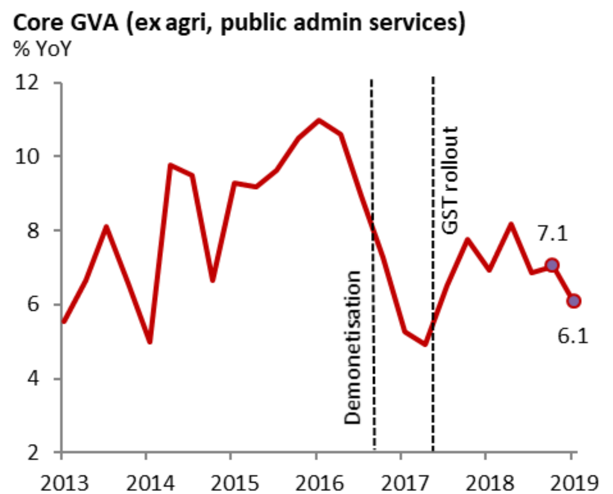


Growth indicators

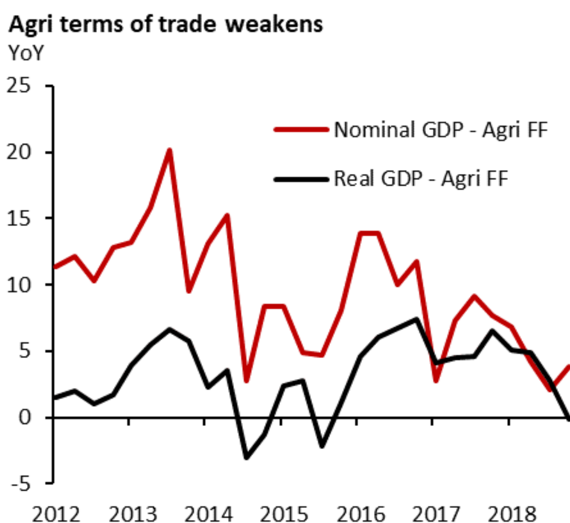
GDP growth for the first quarter of 2019 (4Q FY19) slowed to a five-year low at sub-6%. Incoming data and adverse base effects imply a subdued start for FY20. We, however, remained hopeful for a 2H recovery. DBSf FY20 GDP has been set at 6.8% with downside risks vs FY19's 6.8%.



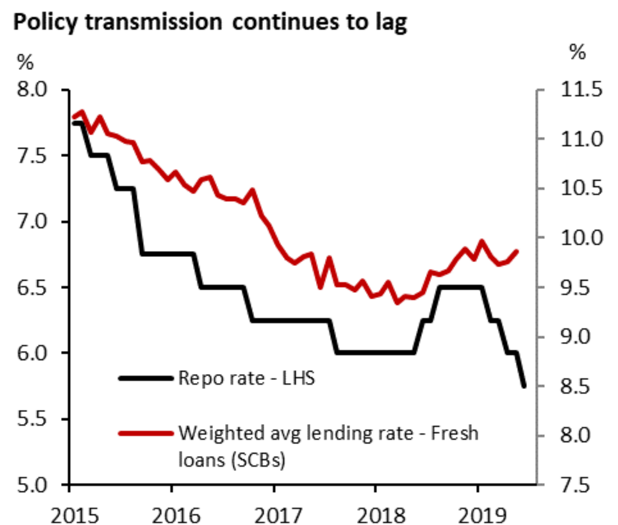
Public sector participation helped shore FY19 growth. Support is likely to extend into FY20 as election-related uncertainties ease. Private sector (core GVA) has been unable to pick the slack.



Rural output, incomes and consumption will be pressured by persistent negative terms of trade in the agricultural sector and a monsoon shortfall. Income transfer scheme announced in February's Budget is likely to help demand at the margin.



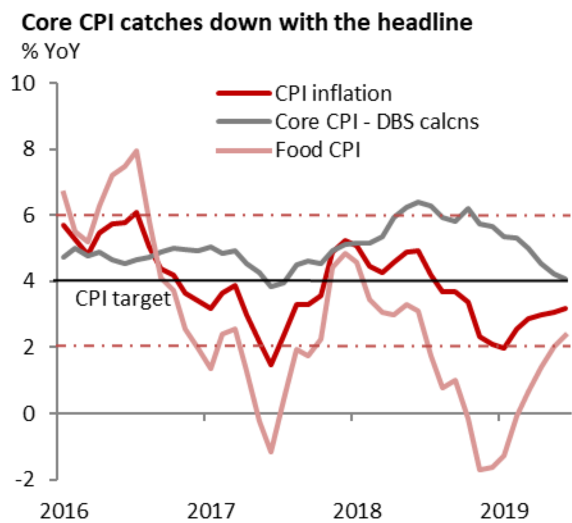
Monetary policy can be more growth-supportive, thanks to a fiscally conservative Budget and below-target inflation. The RBI's priority will be to improve the transmission of monetary policy i.e. ensure that rate cuts translate into lower lending rates.



Inflation grinds up, but below target

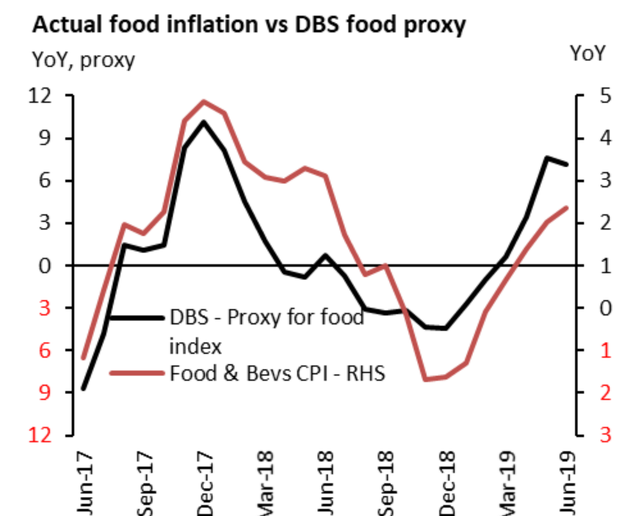
Headline inflation has inched up from its trough in January 2019. The lift from the end of food deflation has been offset by moderating core inflation. We have revised down the FY20 inflation forecast to 3.6% (vs 3.8% before).

Core CPI catches down with the headline



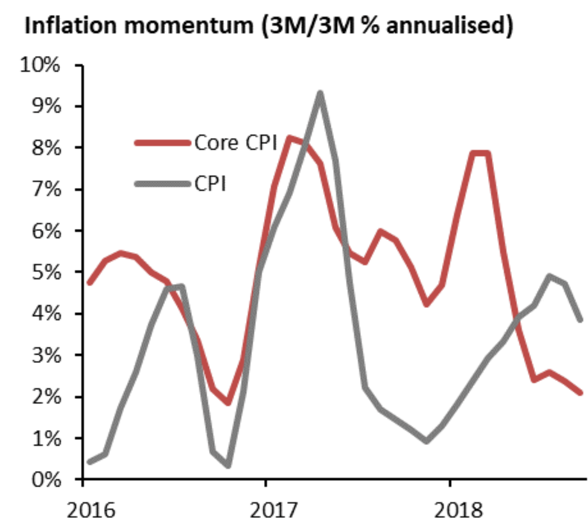
Our high-frequency food index, a proxy that closely tracks actual food inflation, has signaled a pick-up after the weak spell in late-2018 and early 2019. Heavily weighted in the basket, higher food prices will support the headline inflation.

Actual food inflation vs DBS food proxy



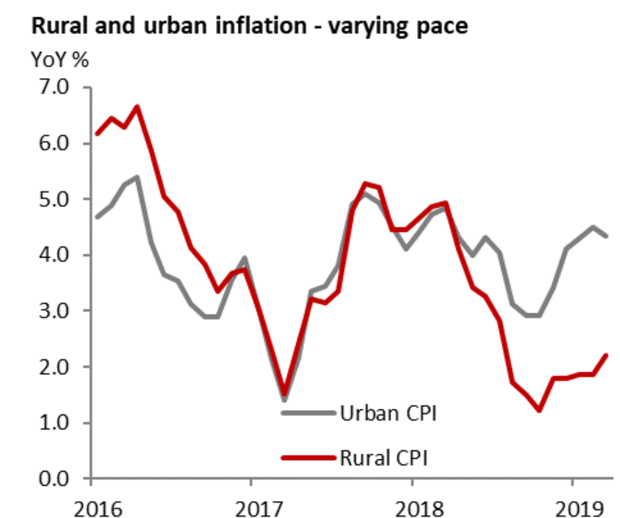
Outside of food, our momentum gauge has signaled 1) a deceleration in the core inflation; and 2) a levelling off in headline inflation to benign levels in the near-term.

Inflation momentum (3M/3M % annualised)



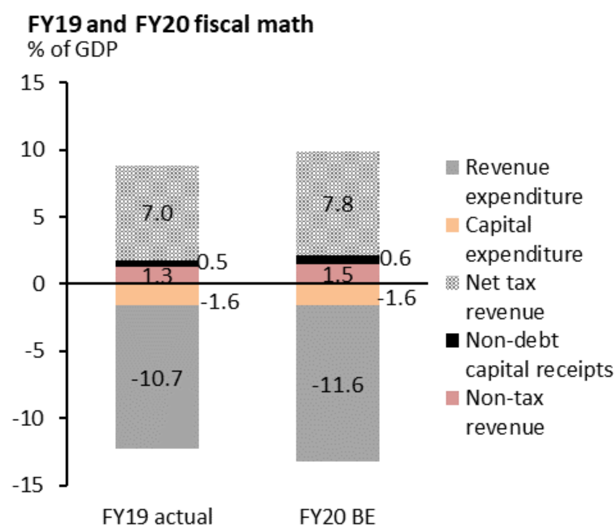
After a brief convergence, the urban-rural inflation gap has widened. While both have corrected in 2H18, rural inflation (primarily food) has risen by a smaller extent vs urban. Recent MSP increases have been modest, with prices of staples at sub-MSP levels, capping incomes.

Rural and urban inflation - varying pace

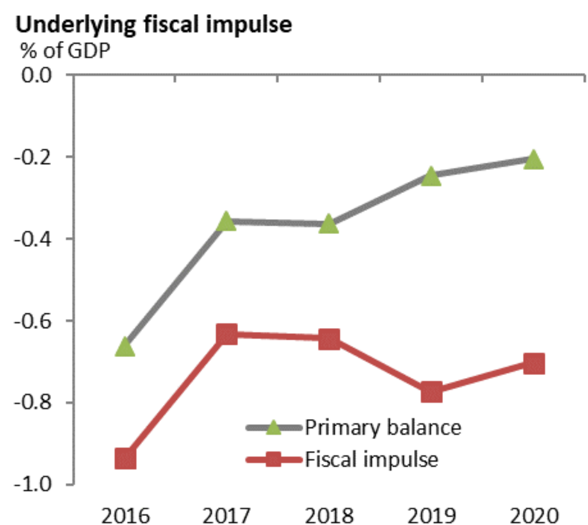


Fiscal balance prioritised, optimistic economic assumptions

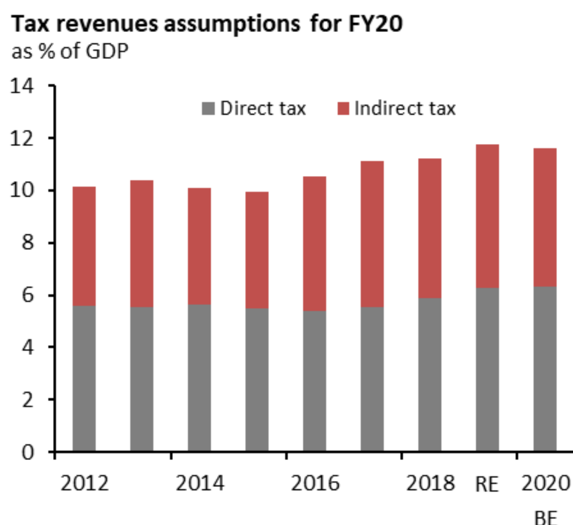
The government has prioritised fiscal conservatism over growth in FY20 and pegged the deficit target at -3.3% of GDP. The sharp increase in projected revenue has been assumed on higher tax and non-tax revenues.



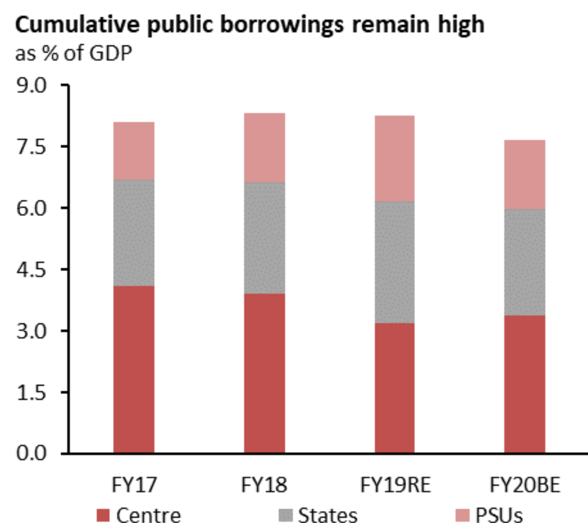
We have calculated two other indicators to gauge the underlying fiscal bias. Primary balance (fiscal balance minus interest payments) signals gradual consolidation in the past three years. In contrast, fiscal impulse i.e. primary deficit plus divestment receipts shows limited extent of fiscal restraint in the same period.



Proceeds from direct and indirect taxes ae expected to nearly equal (as % of GDP) in FY20. Tax revenues are expected to rise, as lower corporate tax collections from mid-tier companies will be compensated by higher income tax receipts from high-income individuals and non-corporate FPIs.

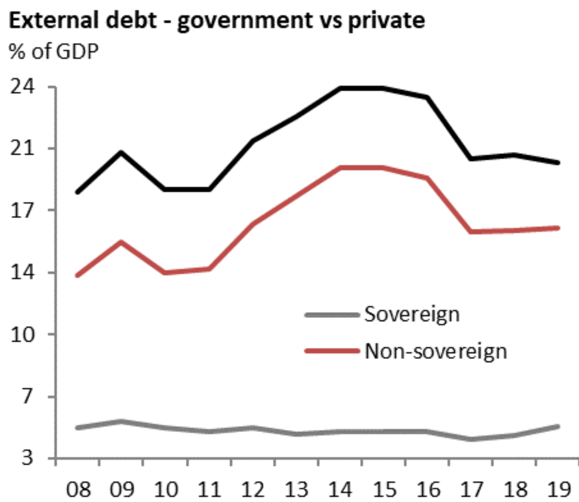


July's full-year Budget maintained the FY20 gross borrowings size at a record of INR7.1trn. When placed together with states' debt sales and PSU borrowings, is at a sizeable 7.5-8% of GDP, stoking crowding out effects for private sector debt.

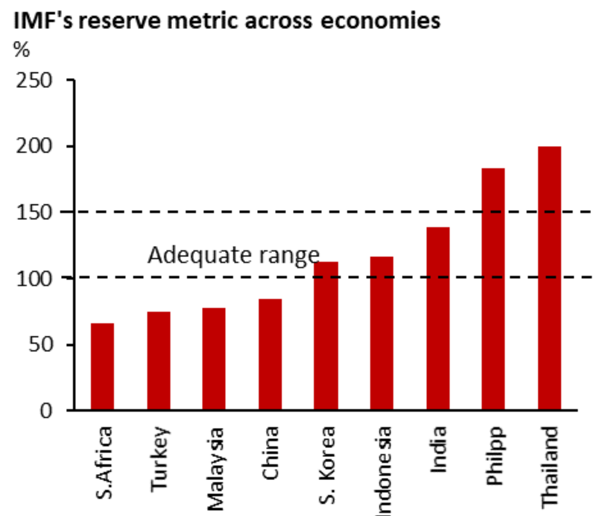


Sovereign bond issuance – focus on reserves adequacy

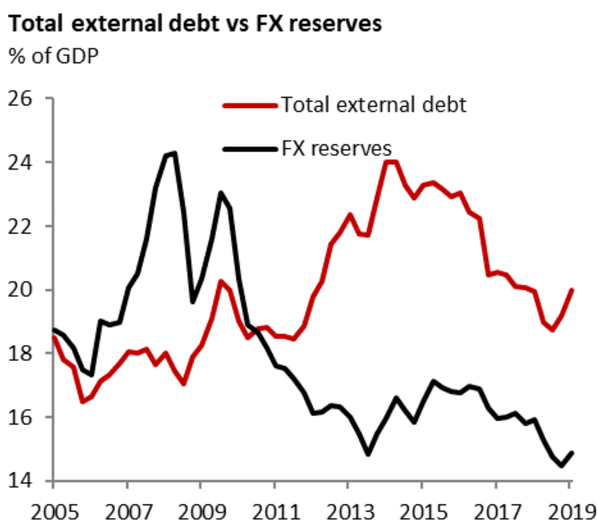
To shift part of the borrowings away from the domestic markets, the government has proposed a maiden offshore bond. This will help tap a new investor base, lighten domestic issuance, and take advantage of India's relatively lower government external debt to GDP ratio.



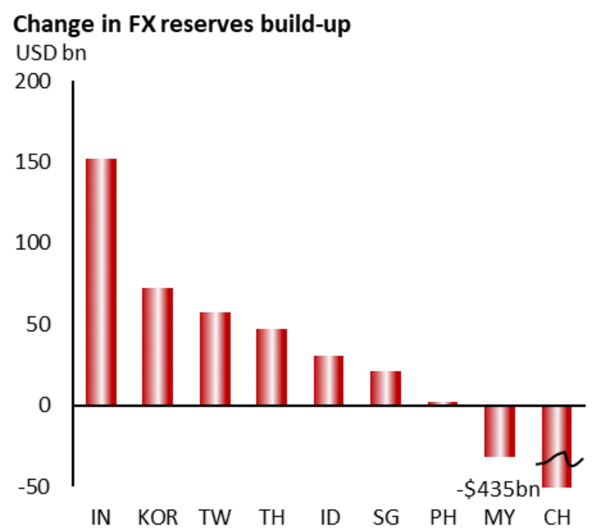
The proposed issuance has left market participants divided, with renewed focus on India's reserve adequacy. On most counts, the current stock is comfortable.



Yet there is need to continue building reserves: a) wide gap between total external debt vs reserves and b) rising proportion of portfolio flows into the economy, which keeps the math vulnerable in case of global volatility.



Hence, foreign reserves accumulation will be a priority for the authorities. Since the taper tantrums, the quantum of increase in India's reserves is amongst the highest vs the regional peers. This is set to continue.

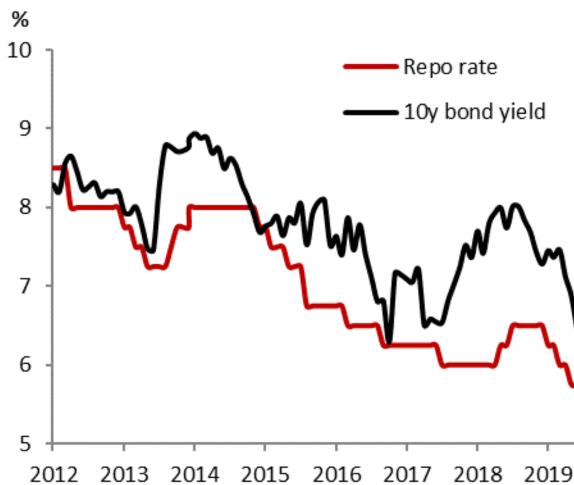


Monetary policy has been growth-supportive

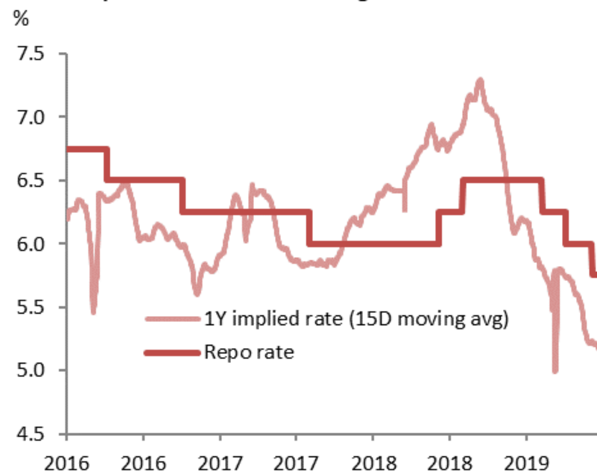
Sub-target inflation, fiscal consolidation and slowing growth saw the RBI adopting a growth-supportive role, with the committee voting for cuts totalling 75bp 2019 yet far and a change in the policy stance.

Markets are pricing in further rate cuts but have pared expectations on the recent cautious comments by RBI Governor Das. We still see odds of two more cuts, first of which might be in August.

Repo rate vs 10Y yields head lower



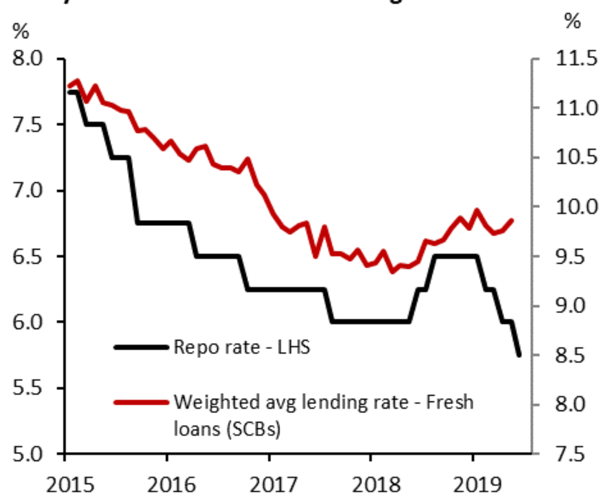
Markets price in further rate easing



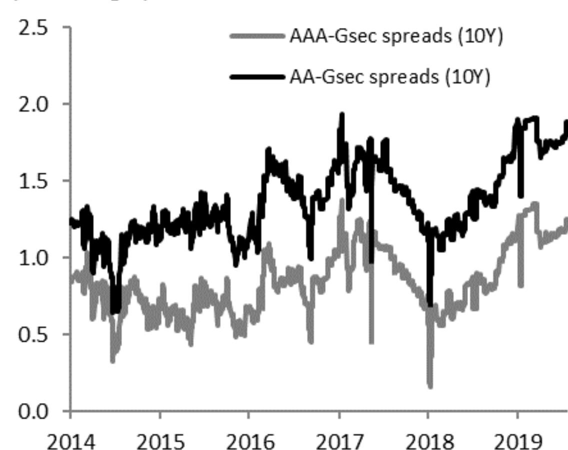
The transmission of the policy cuts has been lagged and measured. Banks with high NPAs (keen to recover cost of funds), operational costs and credit risks have been reluctant to lower lending rates. This fails to address the liquidity squeeze in certain selected sectors, including non-banks, autos etc.

Interest rates can be broken down into three parts – rates, spreads and term premia. While the first and third have been partly delivered, spreads are yet to narrow to meaningfully lower borrowing costs, particularly for selected stressed sectors. Hence transmission and stabilising non-bank related risks will be priorities.

Policy transmission continues to lag

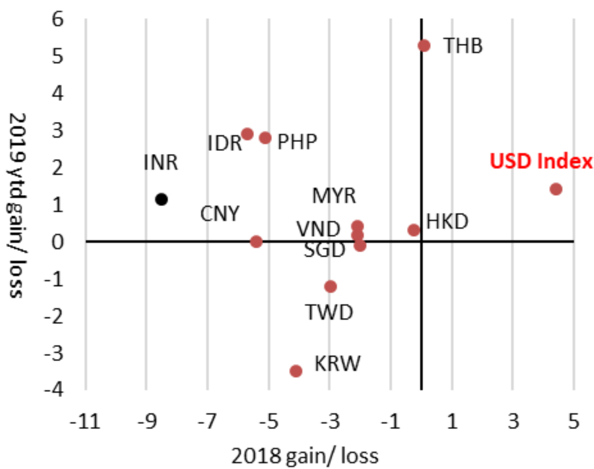


Borrowing costs remain at elevated levels
percentage points

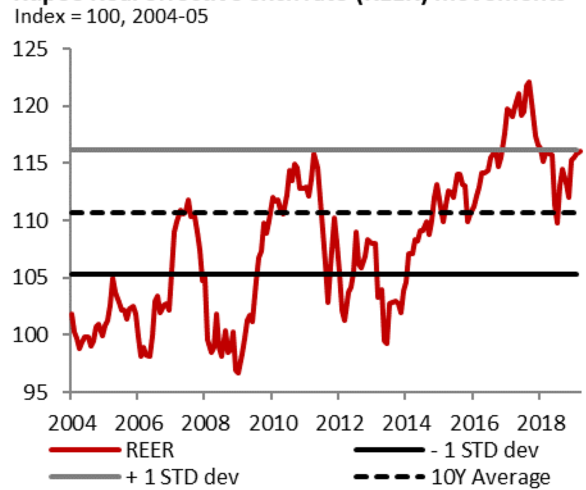


Financial markets

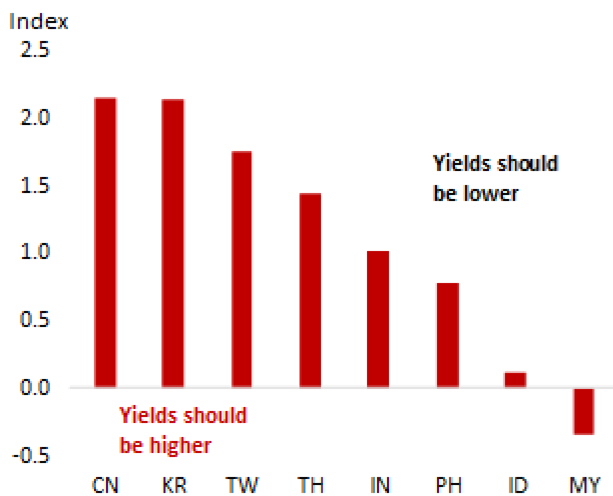
Amongst the regional currencies, export-reliant TWD and KRW have been the worst performers from trade conflicts. INR has eked out a small gain on YTD basis. But this remains a risk as USD stays supported and RBI continues to build reserves.



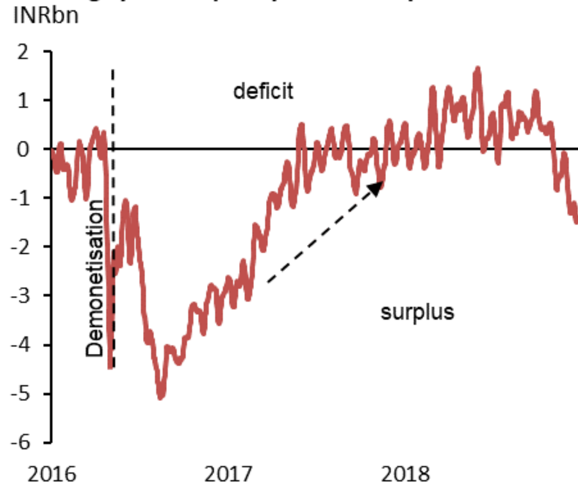
INR effective exchange rates have recovered from last year's slump. The rupee has gained ground not only against the USD but also its trading partners.



10Y bond yields have rallied sharply this year, down ~100bps since January and 30bp since July's Budget. Consolidation has set in and DBS Rates Strategist's model signals that the rally might be stretched. Odds of a cut in August have fallen, but given growth risks and benign inflation, likelihood of a rate cut cannot be fully dismissed.



Liquidity has improved post-elections as seasonal support and ad-hoc infusion measures helped. The central bank committee's report on the liquidity framework assessment might shed some light on the management of these conditions going forward.



Forecasts on major indicators

	GDP (YoY)				CPI inflation (YoY)			
	2017	2018	2019	2020f	2017	2018	2019	2020f
Annual change (%)	8.2	7.2	6.8	6.8	4.5	3.6	3.4	3.6

Exchange rate and interest rates forecasts									
		Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/INR	**eop**	69.2	69.0	71.0	71.5	71.0	70.5	70.0	69.5
Repo rate	**(%, eop)**	6.25	5.75	5.50	5.25	5.25	5.25	5.25	5.25
Government bond yields	**2Y (%, eop)**	6.88	6.30	6.00	6.10	6.20	6.30	6.30	6.30
	10Y (%, eop)	7.22	6.88	6.60	6.60	6.70	6.80	6.90	7.00

Group Research

Economics & Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Ma Tieying
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist - Eurozone & India
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Duncan Tan
FX & Rates Strategist - ASEAN
+65 6878-2140 duncantan@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg, IMF, and DBS Group Research (forecasts and transformations).

Disclaimer:

The information herein is published by DBS Bank Ltd (the "Company"). It is based on information obtained from sources believed to be reliable, but the Company does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Company & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified. DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.