

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 evaluate possible implications of AI for the Indian economy

Rise of the machines

Artificial intelligence (AI) is beginning to have a profound impact on all walks of life. AI focusses on developing cognitive abilities of machines and is therefore materially different from technological advancements of the past that were focused on augmenting computing power. Today, the term 'AI' generates both fascination and fear in equal quantities. Fascination, because replicating human intelligence means augmenting human capabilities and well-being. Fear, because AI continues to replace cognitive tasks and could one day take over humans.

While robots and machine learning have begun to pervade our lives much closer and deeper than we probably realize, the verdict is still not out on whether AI comes with benefits unlimited. For India, specifically, it's widely regarded a mixed blessing. Despite the productivity gains it can bring to the economy, it also raises concerns on jobs and inequality.

- **Productivity:** Over time, productivity has got a lift from technological advancement and innovation. This has been the case with India as well when technology and reforms came together to give a substantial boost to productivity and growth in the decade of 2000. However, given the long lags with which technology reflects in productivity statistics as well as inability to appropriately measure productivity, technology/AI may take time to show up in total factor productivity growth.
- **Jobs:** AI raises concerns of job losses with job displacement/ disruptions expected at a faster pace, given the exponential growth of AI. However, while AI will gobble a number of existing jobs, it will also create new ones in complementary areas. This would in turn increase the need for large-scale reskilling. For developing countries such as India, low labor cost will prevent swift substitution of labor by machines in the medium run, but over the long run, disruption looks inevitable.
- **Inequality:** Inequality is set to rise as the return on capital will increase compared with the return on labor. This will continue to concentrate wealth in a few hands, can be socially disruptive and pose a major policy challenge for a country like India, which already has high inequality and is set to add millions to the workforce in the coming years.

All that leaves policy makers in a cleft stick. While they cannot afford not to promote AI, they also need to prepare for disruptions arising out of it by writing an efforts algorithm, as it were, comprising reskilling, continuous learning approach to education, and last but not the least, redistribution of income.

Money and Banking

Second strike & after

Industrial Production

IIP charges up

Inflation

Softer core, food inflation

MONEY AND BANKING

- The Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) went in for a second straight rate hike, raising policy rates by 25 basis points (bps) in August
- With this, the repo rate stands at 6.50%, the reverse repo at 6.25%, and the marginal standing facility rate at 6.75%
- The rate hike was largely pre-emptive, in anticipation of the upside risks to inflation
- Liquidity tightened in July even as RBI infused money through open market operations
- The double-digit run-up in banking credit continues, with growth printing at 12.4% on-year as of July 20
- Market interest rates continued to firm up amid the rate hike cycle
- CRISIL Research expects moderation in slippages, better recoveries from non-performing assets (NPAs), and improved provision coverage in fiscal 2019. We project the systemic gross NPA ratio will peak in the second half of fiscal 2019, at ~12%, and then start reducing

INDUSTRIAL PRODUCTION

- The Index of Industrial Production (IIP) jumped 7% on-year in June, compared with 3.9% in May. There were two things at play in June: broad-based gains, which is salutary, and a low-base effect
- The jump was driven by a pick-up across categories, but led by manufacturing and electricity sectors. In manufacturing, growth picked up to 6.9% from 3.7%, while electricity output grew 8.5% compared with 4.2%
- Within use-based categories, production of consumer durables, capital goods and primary goods took the lead, with output growing 13.1%, 9.6% and 9.3%, respectively
- Core sector growth rose to 6.7% in June from 4.3% in May. Growth was driven by steel (4.4% from 0.7%) and refinery products (12% from 4.9%), and supported by coal and electricity sectors
- On average, the first quarter of fiscal 2018 (April to June) saw IIP grow 5.2%, compared with 1.9% in the same period last fiscal

INFLATION

- Consumer Price Index (CPI)-based inflation fell 70 bps to 4.2% in July compared with June
- That came despite a 110 bps surge in fuel inflation to 9.7%. A steep 160 bps plunge in food inflation, and a 40 bps drop in core inflation led to decline in overall inflation
- On the other hand, food and core inflation dropped by 160 bps and 40 bps cumulatively
- Wholesale Price Index (WPI)-based inflation, too, declined in July to 5.1%, from a 54-month high of 5.8% seen in June
- Even as most categories showed higher inflation, what pulled down overall WPI inflation was the on-year decline in food prices. Food inflation stood at -0.8%, largely led by the sharp fall in prices of pulses and fruits and vegetables
- For fiscal 2019, CRISIL expects CPI inflation to rise to 4.7% from the 3.6% average seen in fiscal 2018. Other than higher fuel and core inflation, a likely uptick in food inflation (due to upward revision in minimum support prices) should drive the headline number higher

Interest Rate

Yields skid on oil

Rupee

Rupee on a slippery slope

Trade

Imports on a tear

- After rising for the past three months, benchmark 10-year bond yields took a breather in July. Yield on the 10-year government security (G-sec) averaged 7.82%, 7 bps lower on-month, but 134 bps higher on-year
 - 10-year G-sec yields declined after oil prices fell and open market operations by the RBI
 - Foreign portfolio investor (FPI) inflows net-brought \$6 million to the debt market in July, after net-withdrawing \$1.6 billion in the previous month. This is the first month of net FPI inflows after five months
 - However, the rupee depreciated to its all-time low against the US dollar, denting investor sentiment. These especially affected yields at the shorter end of the curve
 - Yield on the one-year G-sec increased an average 16 bps on-month to 7.22%, in contrast with the fall in the 10-year G-sec. This led to slight flattening of the yield curve
 - Corporate bond yields also fell in July, reversing the rise seen in the previous three months
 - CRISIL expects the 10-year G-sec to remain under pressure and average at 7.7% by March 2019 compared with 7.62% in March 2018
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- There was no respite for the rupee in July as foreign inflows failed to provide heft to the currency owing to combined pressure from domestic and global cues
 - The domestic currency weakened against the United States (US) dollar to average 68.7 in July, depreciating 1.3% on-month (6.6% on-year)
 - On a month-end basis, the rupee was almost unchanged at 68.6 per dollar, down 5 bps
 - Despite the net inflow of foreign investor funds, the rupee lost on wider trade deficit, which is at the highest level since May 2013, and a stronger dollar
 - Most of the major global currencies weakened on-month against the dollar in July, with the Chinese yuan taking the biggest hit
 - CRISIL expects the rupee to weaken, averaging 67 per dollar by March 2019 from 65 in March 2018
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- Merchandise exports growth slowed 370 bps to 14.3% on-year in July, compared with 18% in June
 - On the other hand, growth in imports galloped 930 bps to 28.8% in July
 - Merchandise trade deficit increased to \$18 billion in July, the highest since May 2013
 - Services exports grow in double-digits for the eighth consecutive month in June
 - While crude oil remained the primary reason for faster growth in imports, strong recovery in gold imports after five months of decline put additional pressure
 - Due to steady increase in merchandise trade deficit, we see India's current account deficit (CAD) increasing to 2.6% of GDP in fiscal 2019 from 1.9% in fiscal 2018
 - Imports will continue to face pressure from higher crude oil prices, which we expect to average \$70-72 per barrel in 2018 compared with \$54 in 2017

INTEREST
RATE

RUPEE

TRADE

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