CRISIL
An S&P Global Company

INDIAN ECONOMY

CRISIL Insights

October 2018

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we look at three broad aspects: performance of the monsoon this year; what it means for rural incomes; and outlook on food inflation.

After the hat-trick

The southwest monsoon 2018 wound up 9% short of the long period average, which is considered normal by the Indian Meteorological Department. That marked three straight years of adequate rains. That led to an average 4.7% growth in agriculture gross domestic product (GDP). Despite normal rains this season, there remain pockets of stress. Kharif production estimates are healthy, but crops such as groundnut, cotton, tur and jowar are under some stress. Further, farmer income, for one, has declined, and secondly, rainfall distribution has been patchy.

As of September-end, water storage at 91 major reservoirs stood at 76% of live storage capacity. In most states, reservoir storage is healthy barring Gujarat, West Bengal and Maharashtra, where it did not rain enough in the catchment areas. Deficient reservoirs raise some concerns about the rabi crops, because these three states together contribute 53% of the season's production of food grains and oilseeds. At an overall level, the fourth advance estimates of production released by the Ministry of Agriculture mirror the agricultural production prospects highlighted by CRISIL's DRIP (Deficient Rainfall Impact Parameter). These show a drop in the output of groundnut, tur, jowar and cotton. Lower acreage can also be attributed to several other reasons. For instance, pest attacks prevented farmers from sowing cotton, whereas fall in prices of some varieties of pulses last year, led farmers to sow less.

The good news is that the rural non-farm side is seeing better days compared with its other rural counterparts. Non-cultivation income accounts for almost 81% of average monthly rural household incomes. In agriculture year 2018 (July 2017 to June 2018), rural wages grew at a sluggish pace. While real agricultural wage growth slowed on-year, real non-agricultural wage has grown steadily. Non-agricultural wages benefited from the boost to construction activities, specifically roads and houses, under the Pradhan Mantri Gram Sadak Yojana and Mahatma Gandhi National Rural Employment Guarantee Scheme. The government's move to improve rural infrastructure and connectivity, coupled with waning impact of demonetization, is already propping up rural demand.

Also, given healthy agricultural production, food inflation might stay contained. Depending on the government's procurement efficacy, the higher minimum support prices (MSPs) announced could push food inflation up mildly. In July 2018, the government announced higher MSPs and an increase in the coverage of procured crops as per these MSPs. However, higher MSPs have done little to lift crop profitability so far. Mandi prices of all kharif crops have been trailing the revised MSP rates. For pulses and groundnut, profitability has even turned negative as prices remained below the cost of production since last year. This suggests that profitability of food grains might continue to be low this year. Even if higher MSPs translate into commensurate increase in retail prices, consumer inflation could go up by only by about 50 basis points (bps).

Money and Banking	Industrial Production	Inflation
Standing pat, changing	Core sector drag	Stable for now

MONEY AND BANKING

- The Monetary Policy Committee (MPC) stayed pat, opposed to the consensus view of rate hike in the market. The repo rate is paused at 6.50%, and the reverse repo and marginal standing facility rates at 6.25% and 6.75%, respectively
- Liquidity in the system moved into deficit around the middle of September. To support liquidity, the Reserve Bank of India (RBI) conducted open market operations worth Rs 200 billion in two instalments of Rs 100 billion each. It also allowed banks to have a higher carve out from the statutory liquidity ratio. This should support liquidity in the banking system going ahead
- The change in monetary policy stance from neutral to calibrated tightening means one can't expect a rate cut in the ongoing rate cycle
- The MPC took this decision in view of the ensuing risks to inflation in the future and in consonance with the objective of achieving the medium-term target for CPI inflation of 4%, within a band of ±2%
- Market interest rates trended up in anticipation of further rate hike by the MPC
- CRISIL believes the RBI can hike the policy rates by another 25 bps this fiscal

INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) growth slipped to 4.3% in August, from 6.5% in July and 6.9% in June. A sharp slowdown in manufacturing sector growth and a drop in mining sector dragged overall growth down, despite the electricity sector recording a pick-up in growth
- A sharp dip in core sector growth – to 4.2% in August, from 7.3% in July, was the primary reason for slower growth in overall IIP
- Core came down on the back of sluggishness in sectors such as coal, crude oil and refinery products, fertilizers and steel
- On average, IIP grew 5.2% between April and August this year, compared with 2.3% in the year-ago period

INFLATION

- Consumer Price Index (CPI)-based inflation measured 3.8% in September, marginally up from 3.7% in August and lower than the consensus estimate of ~4%, as the impact of rising global crude oil prices and depreciating rupee was balanced by subdued food inflation and some softening in household inflation
- With this, CPI inflation has remained below 4% for the second consecutive month, which should be comforting for the MPC as it held back from raising policy rates and lowered its inflation trajectory in the recently announced policy
- Core inflation softened marginally, but was still high at 5.3%
- As opposed to a modest 10 bps rise CPI inflation, the Wholesale Price Index (WPI)-based inflation rose 60 bps to 5.1% on-year in September from 4.5% in August. This was driven by the rise in inflation of certain food categories and high fuel inflation
- For fiscal 2019, CRISIL expects CPI inflation to rise to 4.8% from the 3.6% average seen in fiscal 2018

CRISIL
An S&P Global Company

Interest Rate	Rupee	Trade
Choppy waters	Plumbing depths	Deficit's import curb

INTEREST RATE

- Yield on the 10-year government security (G-sec) averaged 8.09% in September, 26 bps higher on-month and 150 bps higher on-year
- Benchmark yields on the shorter-end of the curve saw an even steeper rise
- Foreign portfolio investors (FPIs) are abandoning domestic bonds with alacrity, spurred on by attractive yields in the United States (US) and India's deteriorating rupee valuation and current account deficit (CAD)
- In addition, defaults by Infrastructure Leasing & Financial Services led to redemption pressures on mutual funds. This severely impacted liquidity in corporate bond markets, leading to a sharp rise in corporate bond yields
- However, open market operations by the RBI and reduction in market borrowing by the central government helped cool bond yields towards the end of the month. The 10-year G-sec yield, which peaked at 8.16% in mid-September, closed the month at 8.02%
- CRISIL expects the 10-year G-sec yield to settle at 7.9% by March 2019 compared with 7.62% in March 2018

RUPEE

- In September, the rupee breached the 72/$ mark, as FPIs turn net seller. Rupee averaged 72.2/$, and depreciated 3.8% on-month and 12.1% on-year
- FPIs net-withdrew $2.9 billion – $1.4 billion from the debt market and $1.5 billion from equities. Investors were already on edge owing to global uncertainties, ranging from the escalation in the tariff war between the US and China to surging crude prices
- A sharp appreciation in the value of dollar, which gained for eighth month in a row, further dragged the rupee down
- CRISIL expects the rupee to average 68.5/$ in March 2019, compared with 65/$ in March 2018

TRADE

- Merchandise trade deficit shrank to a six-month low of $14 billion in September, $3.4 billion lower on-month, but still $4.6 billion higher on-year
- The trade deficit fell owing to import growth slowing to 10.5% on-year in September compared with 25.4% in the previous month. The primary reason for the moderation was a plunge in core imports (i.e., non-oil non-gold imports)
- However, exports declined 2.2% on-year in September, compared with 19.2% growth in the previous month
- The decline in exports was broad-based, with 15 of the 30 principal export categories registering negative growth
- CRISIL expects CAD to average 2.6% of the GDP this fiscal compared with 1.9% of GDP in fiscal 2018

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Global Research & Analytics (GR&A)

CRISIL Global Research & Analytics (GR&A) is the world's largest and top-ranked provider of high-end research, risk and analytics services. We are the world's largest provider of equity and fixed-income research support to banks and buy-side firms. We are also the foremost provider of end-to-end risk and analytics services that include quantitative support, front and middle office support, and regulatory and business process change management support to trading, risk management, regulatory and CFO functions at world's leading financial institutions. We also provide extensive support to banks in financial crime and compliance analytics. We are leaders in research support, and risk and analytics support, providing it to more than 75 global banks, 50 buy-side firms covering hedge funds, private equity, and asset management firms. Our research support enables coverage of over 3,300 stocks and 3,400 corporates and financial institutions globally. We support more than 15 bank holding companies in their regulatory requirements and submissions. We operate from 7 research centers in Argentina, China, India, and Poland, and across several time zones and languages.

CRISIL Privacy

CRISIL respects your privacy. We may use your contact information, such as your name, address, and email id to fulfil your request and service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com.

Disclaimer

CRISIL has taken due care and caution in preparing this report. Information has been obtained by CRISIL from sources which it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information, and is not responsible for any errors in transmission; and especially states that it has no financial liability whatsoever to the subscribers / users/ transmitters/ distributors of this report.

Argentina | China | Hong Kong | **India** | Poland | Singapore | UK | USA | UAE

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

/company/crisil @CRISILLimited /CRISILLimited /user/CRISILLimited Follow us on @lifeatcrisil

CRISIL
A S&P Global Company