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The Operating Environment Assessment Paper

December 2023

A quarterly update on politics and the Indian economy

Contents

This report provides an assessment of the operating environment in India. It examines the political scenario and the state of the Indian economy.

The information in the following pages is intended to provide an indication of the way things are likely to evolve in the medium term. Whilst we have made efforts to ensure that the information contained in the following pages is accurate to the best of our knowledge and belief, IMA India cannot assume any liability or responsibility for the outcome of decisions taken as a result of this study. Moreover, the information may not be used to form the basis of strategic decisions that concern investments or any other commitments.

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Politics & Policy: A Near-Term Review

BJP's 3-state win sends a strong signal leading up to the national polls

With the last set of state Assembly elections wrapped up, preparations for the 2024 general elections can begin in earnest. The BJP stands at a clear advantage, especially after its convincing wins in 3 key 'Hindi heartland' states. While Rajasthan, which traditionally alternates between the two national parties, was expected to go its way, the scale of victory in MP (163/230 seats) and Chhattisgarh (54/90) has tilted the odds heavily in its favour. Meanwhile, the Congress managed to unseat the ruling BRS in Telangana. Many have explained this way as a case of anti-incumbency, made worse by recent corruption scandals, but it is also indicative of the relative edge the INC enjoys in Southern India. However, the BRS' loss may ironically push it closer to the NDA, thereby bolstering the ruling alliance. The INC's lacklustre performance will also hamper its position within the INDIA alliance, which must battle both a loss of momentum and Narendra Modi's undimmed popularity to pose a credible challenge to the BJP nationwide in 2024.

The Winter Session will see crucial legislative action…

The ongoing Winter Session of Parliament will effectively be the last opportunity for the government to pass key legislation before the Lok Sabha polls. (As is typical before general elections, a shorter Budget Session with an Interim rather than a Full budget is expected in February.) This session is set to consider up to 19 bills, and the key legislation passed so far includes bills concerning the composition of the Jammu & Kashmir Assembly and granting reservations to certain minorities. Together with the Supreme Court's recent affirmation of the Centre's decision to abrogate Article 370, this signals that a restoration of J&K's statehood (and fresh Assembly elections) could happen in the short term.

…and the government may be tempted to enact some populist measures

Other crucial agenda items include a set of hallmark bills overhauling India's criminal laws, one (already passed) overhauling 76 redundant laws, and the Chief Election Commissioner (CEC) bill, which seeks to change the status and service conditions of ECs. By changing the composition of the selection committee for appointing ECs – replacing the Chief Justice of India with a Cabinet minister – it possibly exposes the electoral process to greater influence from the Centre. Despite some controversy over the terminology and coverage of these bills, the BJP's stock of political capital may provide the boost needed to push them through. Elsewhere on the policy front, a big jump in tax revenues provides an ideal fiscal buffer for the government to try and enact populist measures, shoring up support for the party ahead of polls.

India must navigate diplomatic challenges with its key allies

Internationally, the Israel-Hamas conflict leaves the future of the Middle East region as well as the fate of the proposed India-Middle East-Europe Economic Corridor (IMEC) uncertain. Ongoing India-UK FTA discussions face roadblocks on immigration, market access and other key issues with negotiators aiming to finalise the agreement before the general elections. India-Canada, and more recently, US-India diplomatic relations have grown increasingly fraught over allegations that India was responsible for the assassination of a Sikh leader on Canadian-soil and the attempted assassination of another in the United States. A delayed resolution will hinder the growing goodwill between India and the US and escalation must be avoided to ensure economic cooperation.

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A Macroeconomic Review

GDP growth in Q2 was higher than anticipated at 7.6%

At 7.6%, India's Q2 (Jul-Sep) GDP growth was better than expected and stronger than a year ago (6.2%). Coming on top of 7.8% growth in Q1 (Apr-Jun), this took growth in the first half of the fiscal (H1 FY24) to 7.7%, compared to 9.5% a year ago. Buoyed by these numbers, most market estimates of FY24 growth have been revised up, with the RBI now expecting 7%, up from its earlier forecast of 6.5%. A surge in manufacturing and construction, a pick-up in investment and rising government spending in the run-up to elections are the main drivers of growth today. Countering this are several risks: a slowing global economy, geopolitical tensions, inflationary stress and weak agricultural sector performance domestically. Taking all these factors into account, we are revising our FY24 projection marginally up to 6.5-7%, from the previous forecast of 6-6.5%.

Manufacturing accelerated, while agriculture and services slowed in Q2

Q2 growth was driven by a 13.2% expansion in the industrial economy, with all four segments showing strong performance. Manufacturing expanded by 13.9%, a nine-quarter high (though on a low base of (-) 3.8% in Q2 FY23), and construction grew at a similar pace (13.3%), a five-quarter high. Also robust were mining and quarrying (10%) and electricity and utilities (10.1%). Services sector growth, on the other hand, moderated to 5.8%, down from 9.4% a year ago. This was due to well-below-par growth in the trade, hotels, transport and communication services (4.3%, compared to an untenable 15.6% in the year-ago quarter) and in the financial, real estate and professional services segment, which grew by 6% compared to 7.1% a year ago. Public administration, defence and other services, an indicator of government spending, was a relatively better performer at 7.6% (up from 5.6% a year ago). Meanwhile, agriculture experienced an 18-quarter-low of 1.2% in Q2, compared to an already low 2.5% a year ago. The advance estimates from the Ministry of Agriculture peg *kharif* (summer) foodgrain production at 4.6% *below* last year's level, primarily due to erratic and deficient monsoon rainfall, which could pull down agriculture growth to its lowest levels since the pandemic.

The lead indicators present a mixed outlook

The S&P Purchasing Managers Index (PMI) for manufacturing stood at 56 in November. While better than October's eight-month low of 55.5, the index remains well below the 57.2-58.7 range seen over April-September. Non-food credit growth has been ~20% in the four months through October, led by credit to the services sector and personal loans, while credit to the manufacturing sector remains relatively subdued. Further, the S&P PMI for services fell to 56.9 in November, from 58.4 in October – and its lowest in 2023. The slowdown was attributed mainly to a drop in new orders. IMA India's quarterly BCPI (Business Confidence and Performance Index) fell by 6 points in October, signalling that business sentiment is weakening. On the other hand, GST collections in October were the second highest ever, next only to April 2023, at Rs 1.7 trillion (an increase of 13%). Meanwhile, e-Way bill issuances set a new record of 100.3 million in October, up from the previous high of 93.4 million in August, but dropped to 87.57 million in November. Automotive sales – a key marker of demand – grew by 6.6% overall in the Apr-Nov period, led by commercial vehicles (13.5%), and followed by two-wheelers (6.5%) and passenger vehicles (5.1%). However commercial vehicles saw a dip in monthly YoY growth from double digits in the last several months to 2.9% in November. The two-wheeler segment saw an uptick to 21%, led by festive/marriage season demand, though it remains to be seen if this can be sustained in the face of weaknesses in the farm sector.

Indicators and forecasts at a glance

	FY22	FY23	FY24*	FY25*
Economic growth (%, 2011-12 prices)				
GDP	9.1	7.2	6.5-7.0	6.0-6.5
Agriculture^	3.5	4.0	1.5-2.0	3.0-3.5
Manufacturing^	11.1	1.3	5.0-5.5	5.5-6.0
Services ^	8.8	9.5	7.5-8.0	7.0-7.5
Inflation				
CPI (%, average)	5.5	6.7	5.0-5.5	4.5-5.0
WPI (%, average)	13.0	9.6	(-) 0.5-1.5	3.5-4.0
Public finance				
Government borrowings, Rs tr	15.8	14.2	17.9**	NA
Receipts net of borrowings, Rs tr	22.1	27.6	27.2**	NA
Expenditure, Rs tr	37.9	41.8	45.0**	NA
Fiscal deficit (% of GDP)	6.7	6.4	5.9**	5.0-5.4
External sector				
INR/USD (end of period)	75.8	82.2	83.0-85.0	84.0-86.0
Trade deficit USD bn	100.1	263.6	250-270	240-260
Current account balance (% of GDP)	(-) 0.9	(-) 2.0	(-) 1.5-1.8	(-) 1.4-1.7

**IMA India forecasts unless otherwise indicated; **Government estimates; ^ GVA at basic prices (2011-12 base)*

Source: *CSO, RBI, DGCI&S, Ministry of Finance and CEIC*

Investment, an important driver of growth, is seeing moderate gains

The share of gross fixed capital formation (GFCF), in GDP, a bellwether of investment, stood at 35.3% in Q2, compared to 34.7% in Q1 and 34.2% in the year-ago quarter. This moderate increase comes on the back of the Centre's rising capex spend, which grew 43% YoY to Rs 4.9 trillion through Q2. However, the RBI's most recent quarterly OBICUS survey (Q1 FY24) recorded an economy-wide capacity utilisation rate of 73.6%, lower than the 76.3% recorded in the previous quarter but above Q1's 72.4%. Further, IMA's BCPI survey finds a downswing in investment sentiment – ~55% of our members plan to make investments in Q3, down from 73% in Q2.

Consumption remains a weak link

Government final consumption expenditure (GFCE) stood at 9.5% of GDP in H1, down from 9.8% a year ago. On a sequential basis, it fell from 10.1% in Q1 to 8.9% in Q2. Going forward, this share may rise as the government focuses on current (as opposed to capital) spending as elections approach. Meanwhile, the share of private final consumption expenditure (PFCE), a proxy for household consumption, fell from 59.3% a year ago to 56.8% in Q2. Worryingly, the growth in PFCE halved from 6% in Q1 to 3.1% in Q2, partly due to weakening rural demand. Cumulatively, H1 recorded a figure of 57%, down from 58.8% a year ago. The next quarter may see a pickup in urban demand as indicated by various high-frequency growth indicators, such as passenger vehicle sales, personal loan growth and FMCG sales. However, the outlook for rural demand is mixed given the hit to agricultural production and its impact on farmer incomes.

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Uncertain outlook for inflation

After averaging 7.1 % in July and August 2023, retail (CPI) inflation eased to 5% in September, and further to a 4-month low of 4.9% in October. However, food inflation, which accounts for 45% of the overall consumer price basket, rose 6.6% in both September and October. Wholesale price (WPI) inflation, meanwhile, remained in the deflationary zone for the seventh consecutive month, at (-) 0.52% in October compared to (-) 0.26% in September. Going forward, the WPI inflation figures may be pushed up due to the base effect – it averaged just 4.2% in Nov-Mar 2022-23, compared to 13.4% in Apr-Oct 2022. Consequently, in early December, the RBI held the Repo rate steady at 6.5% for the 5th consecutive time on concerns around food prices and projections that CPI inflation will remain well above its 4% medium-term target. On the other hand, crude oil prices have softened – the average price of an imported 'basket' of crude stands at USD 75/bbl, down from ~USD 91/bbl in September – on expectations that output cuts announced by OPEC will only partially offset rising supply from countries such as the US and Russia. Yet, the price advantage India enjoys on discounted Russian crude (~34% of its total oil imports in October) may dissipate if, as reported, Russia withdraws these discounts. Given the interplay of these factors, India's central bank has retained its projected consumer inflation at 5.4% for 2023-24.

Risks in the external environment

The global goods trade remains subdued in the face of geopolitical tensions – especially the recent developments in West Asia – and a stagnant eurozone. According to the WTO's latest (October) estimate, global trade volumes will rise by 0.8% in 2023 – a downward revision from the 1.7% figure predicted in April. According to the IMF, global growth will slow from 3.5% in 2022 to 3.0% this year and 2.9% in 2024. The US economy is expected to slow as the effects of monetary policy tightening make themselves felt, while the eurozone already faces stagflation. There is also a high likelihood of a deepening Chinese property sector crisis and intensifying geopolitical tensions further denting trade and investment flows globally, but especially to emerging markets.

India's exports rose 6.2% in October, but on a low base of 11.5% de-growth. Cumulatively, exports in Apr-Oct were 7% lower than a year ago. Imports too de-grew in this period, by 8.9%, but they saw a revival in October (12.3%, compared to 8% a year ago), indicating a possible uptick in domestic demand. While India's current account deficit (CAD) widened on a quarter-on-quarter basis to USD 9.2 billion (1.1% of GDP) in Q1 on the back of a widening trade deficit, it was lower than a year ago (USD 17.9 billion, or 2.1% of GDP). India also saw net FII inflows in November after two months of outflow. Cumulatively, net FII inflows stood at USD 21.6 billion in the first eight months of the current fiscal, compared to *outflows* of USD 3.6 billion a year ago. This is expected to continue due to greater political certainty after the BJP's election wins in three key Assembly elections and expectations of US Fed rate cuts next year. The recent pause in the Fed's rate hike cycle has helped slow the rupee's fall (currently, it is at ~83.4/USD levels, down from ~82 at the start of FY24), and continued capital inflows should help stabilise the currency over the next 3-4 months.

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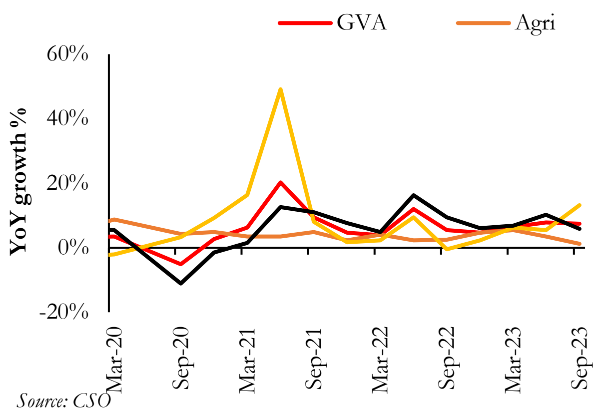
High-Frequency Indicators

▲ = demand rising/stress falling; ▼ = demand falling/stress rising; ◀ ▶ = steady

	FY22	FY23	FY24 YTD#	Latest quarter#	Trend
Industrial/business performance					
The BCPI fell by ~6 points in Oct and the PMI indices have plateaued					
IIP index^	17.9%	5.4%	6.1% (Sep)	7.4 % (Sep)	▲
IIP – capital goods^	98.5%	14.1%	6.7% (Sep)	8.3% (Sep)	▲
IIP – 'core' sector^	62.0%	8.2%	8.6% (Oct)	9.4% (Sep)	▲
Of which – Cement^	12.4%	9.5%	12.2% (Oct)	10.2% (Sep)	▲
S&P Manufacturing PMI$	54.0	56.4	56.0 (Nov)	57.5 (Sep)	◀ ▶
S&P Services PMI$	53.6	57.8	56.9 (Nov)	61.0 (Sep)	◀ ▶
IMA's BCPI index$	66.4	62.1	60.5 (Oct)	66.0 (Jul)	◀ ▶
Naukri Job Speak (new job listings) ^	65.7%	15.7%	-0.4% (Oct)	-11.1% (Sep)	▼
Banking, finance, monetary policy					
Inflation has started to ebb and interest rates are close to peaking					
Non-food credit growth^	7.0%	14.6%	19.8% (Oct)	19.9% (Sep)	▲
CPI Inflation (Period avg)	5.5%	6.7%	5.4% (Oct)	6.4% (Sep)	▲
WPI Inflation (Period avg)	13.0%	9.6%	-1.6% (Oct)	-0.7% (Sep)	▲
Repo Rate$	4.0%	6.5%	6.5% (Nov)	6.5% (Sep)	◀ ▶
1-Year MCLR (Min/Max)$	6.4/7.0	7.5/8.4	8.0/8.5 (Nov)	8.4/8.0 (Sep)	◀ ▶
10-Year Gov't bond yield$	6.9%	7.4%	7.3% (Nov)	7.2% (Sep)	◀ ▶
External sector					
The trade deficit continues to narrow, FII flows have recovered, as has the rupee					
Exports (% change)^	44.6%	6.7%	-7.0% (Oct)	-3.1% (Sep)	▼
Imports (% change)^	55.4%	16.5%	-8.9% (Oct)	-11.7% (Sep)	▼
Trade balance USD bn$	-191.0	-263.3	-147.1 (Oct)	-59.6 (Sep)	▲
INR/USD (% change)^	-3.1%	-8.5%	-1.4% (Nov)	-1.2% (Sep)	◀ ▶
Net FII inflows (USD bn)^	-16.0	-5.5	7.6 (Nov)	5.4 (Sep)	▲
Inbound FDI (USD bn)^	84.8	70.8	32.9 (Sep)	15.3 (Sep)	▼
Foreign reserves net change^ USD bn	38.4	-39.2	7.7 (Oct)	-8.1 (Sep)	▲
Demand indicators					
Measured by several key indicators, demand remains strong					
Passenger vehicle sales^	10.5%	17.9%	5.1% (Nov)	8.2% (Sep)	▲
Two-wheeler sales^	1.9%	18.5%	6.5% (Nov)	12.1% (Sep)	▲
Tractor sales^	-6.4%	12.2%	-3.8% (Oct)	-5.8% (Sep)	▲
Domestic air traffic^	58.5%	62.1%	19.4% (Oct)	23.0% (Sep)	▲
International air travel^	118.1%	157.8%	26.2% (Oct)	21.6% (Sep)	▲
Credit card usage^	54.1%	47.4%	27.0% (Oct)	16.6% (Sep)	▲

 # Dates in parentheses refer to the month/quarter for which data is reported; ^ YoY for FY18 and FY19 and absolute returns/change/amount over the period for fiscal YTD, latest month, and latest quarter; $ refer to end points; IMA's BCPI (Business Confidence and Performance Index) is based on a quarterly survey of IMA's Forum member companies

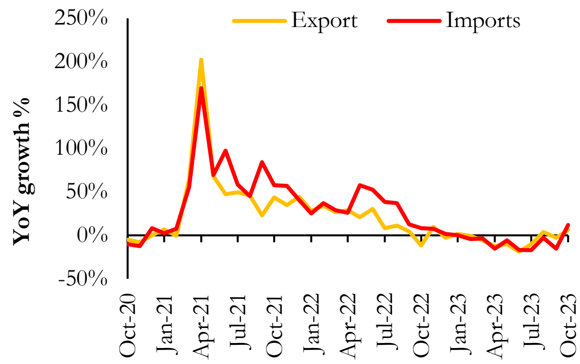
GVA (YoY change): 7.4% in Q2



Source: CSO

Industry has surged while agri and services have dipped

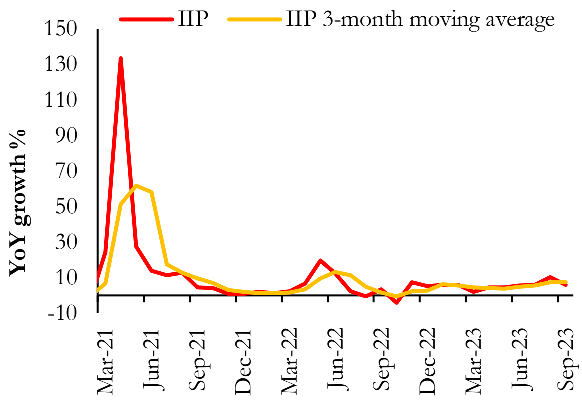
Merchandise trade: Bottoming out?



Source: Ministry of Commerce and Industry

Imports and exports are growing again, albeit slowly

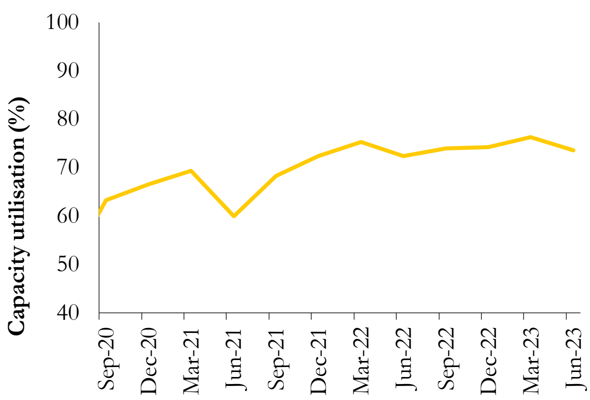
IIP (YoY change): Stabilising



Source: CSO

Across segments, IIP growth has perked up recently

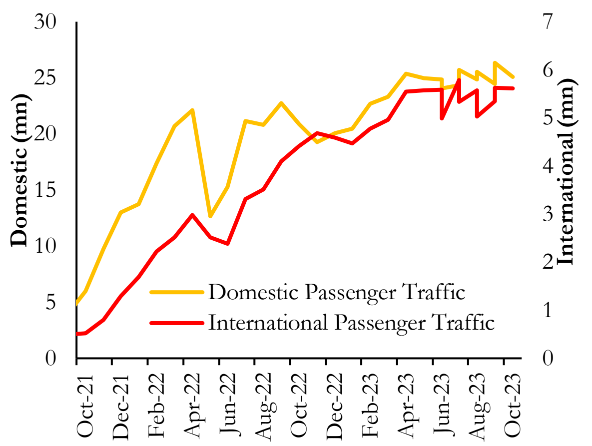
Capacity utilisation rates: Down in Q1



Source: OBICUS Survey, RBI

Utilisation rates dipped slightly in June

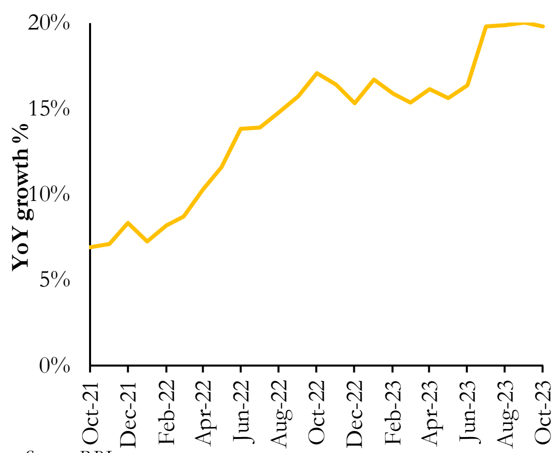
Air Passenger Traffic: Rising



Source: Airport Authority of India

Foreign and domestic air traffic are rising strongly, and have surpassed pre-Covid levels

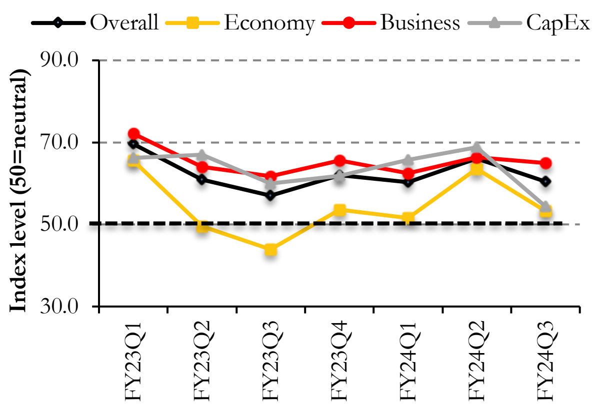
Non-food credit (YoY growth): Strongly rising



Source: RBI

Overall non-food credit growth is at ~20% rates today, led by the services sector

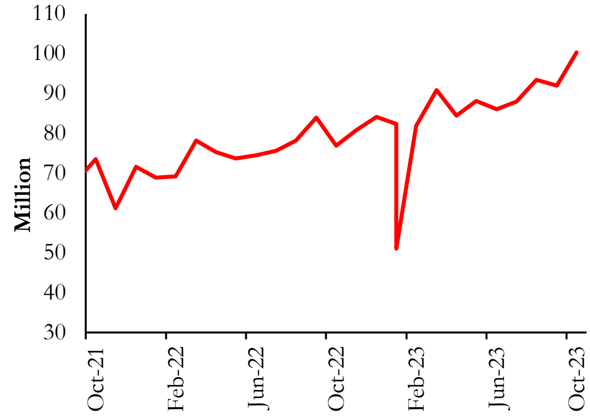
BCPI: Dipping in Q3



Source: IMA India's Q3 FY24 BCPI Survey

The BCPI index fell by 6 points in Q3, with all of the sub-indices slipping, especially macro and capex

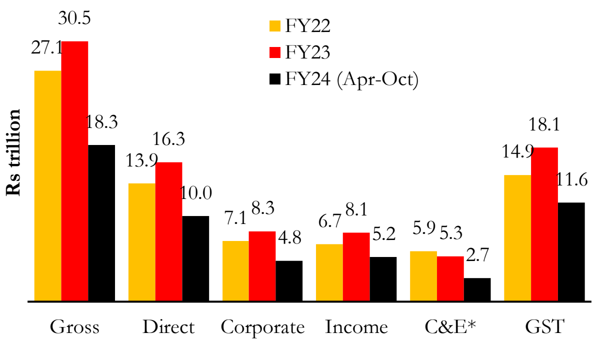
Monthly e-Way bill issuances: Climbing



Source: Goods and Services tax Network

e-Way bill issuances have steadily risen, crossing the 100 million mark for the first time in October

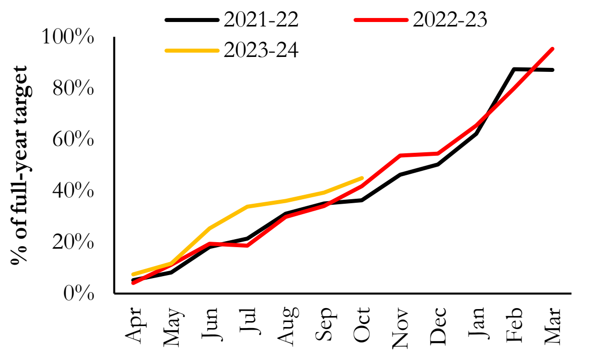
Tax revenues: On target



*Source: CAG, GSTN; * Customs & excise*

Tax revenues continue to grow strongly and are on course to easily surpass last year's levels

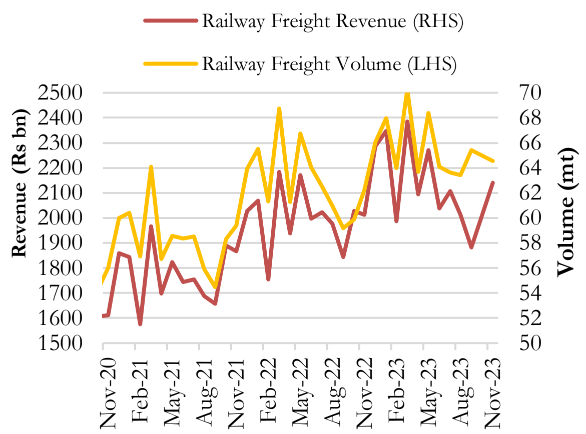
Fiscal deficit (% of target): On track



Source: Ministry of Finance

The fiscal deficit stood at ~45% of the FY24 estimate in October and should stay within target for the year

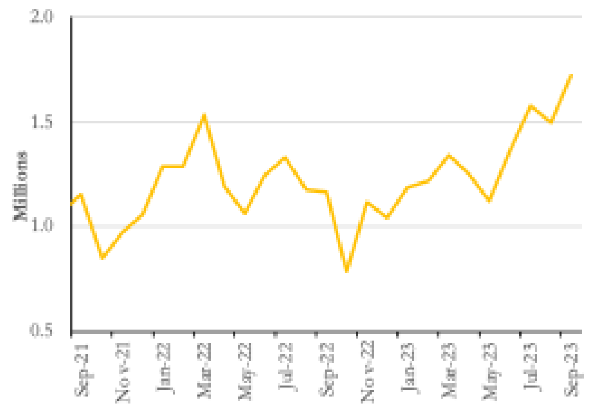
Freight Volume and Revenue: Rising



Source: Indian Railways

Freight volumes and value remain on a rising trend

EPFO enrolment (3-month avg): Rising



Source: EPFO

Monthly EPFO enrolment crossed 17m in September

