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IMA

The Operating Environment Assessment Paper

June 2022

*A quarterly update on politics and the Indian
economy*

Contents

Politics & Policy Review	1
A Macro-economic Review	2
High-frequency Indicators	
• <i>Summary table</i>	5
• <i>Charts</i>	6

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

The upcoming Presidential poll is the next big battle – for the BJP and the Opposition alike

The upcoming Presidential elections, coinciding with Parliament's Monsoon Session, are important both symbolically and practically. Having lost seats in the UP and Uttarakhand state polls, the BJP is short of the majority needed to secure an outright win. With its erstwhile allies drifting away, it must rely on 'friendly' regional parties such as the JD(U), YSRCP and BJD, to push through its candidate. For the Opposition – especially the beleaguered Congress, with its recent exodus of key leaders – it is an opportunity to slow down the BJP juggernaut. A strong rival candidate would be a good 'testing of the waters' ahead of end-2022 state polls and the 2024 General Elections.

The Prez elections, inflation, and controversial remarks by BJP spokespeople, will dominate politics in the near term

Together, the Presidential polls, the continued surge in inflation, and a diplomatic furore over remarks by two (now suspended) BJP spokespersons will dominate proceedings inside and outside Parliament. As many as 35 bills lie pending, including the much-delayed Personal Data Protection (PDP) bill. Reports suggest that, having been reformulated several times, the bill may require a full re-write, with a stronger focus on data governance and cybersecurity. The Centre will also be under pressure to announce fiscal measures to provide relief from inflation – a tough ask, given that growth (and therefore government revenue) could undershoot the budgetary targets.

A landmark ruling by the Supreme Court...

The Supreme Court's recent ruling that GST Council decisions are not binding on the states is highly consequential. By allowing states to possibly 'go their own way', and slowing the reforms process, it could erode the concept of 'one nation, one tax'. Elsewhere in the policy sphere, the Make in India programme received a boost with the announcement of 13 new textiles parks across 7 states. A severe coal shortage has forced the government to loosen the environmental-clearance rules for new coal-mining projects.

...and a few important policy announcements

India has taken a nuanced approach to the Ukraine-Russia conflict, and it has paid off – thus far

Four months into the Russia-Ukraine war, India continues to play a deft diplomatic balancing act. It has forcefully asserted its right to purchase discounted Russian oil while adopting a subtly pro-Moscow stance in forums such as the United Nations, perhaps in the hope of staving off a full-fledged Sino-Russian realignment. At the same time, it has reaffirmed its commitment to the Quad, a grouping of four key democratic nations spanning the Indo-Pacific. At its recent Tokyo Summit, the Quad reiterated its focus on 'a rules-based order' and an 'open and free' approach to regional trade.

Partly compensating for its absence from both the RCEP and the CPTPP, India has joined the new, US-led, 12-nation Indo-Pacific Economic Framework (IPEF). The IPEF will rest on four pillars: trade, supply chain resiliency, anti-corruption measures, and clean energy and decarbonisation. However, its mandate will also span issues around regional security and, specifically, measures designed to limit China's influence. It remains to be seen, however, whether India truly benefits from membership of IPEF, given its strong position against data localisation and its high standards on labour rules, environmental norms and decarbonisation.

A Macroeconomic Review

Growth weakened further in Q4...

From 20.3% in Q1, 8.5% in Q2 and 5.4% in Q3, India's GDP growth slowed further to 4.1% in Q4 (Jan-Mar) as the triple impact of Omicron, the Russia-Ukraine war and last year's high base effect weighed in. Full-year, FY22 growth came to 8.7% (compared to -6.6% in FY21), which was lower than the most recent, 8.9% official forecast. Nominal GDP grew by 19.5%, compared to -1.4% the previous year. Looking ahead, most forecasters have downgraded their FY23 growth estimates to ~6.9-7.2%. In our view, with strong inflationary pressures and supply-chain disruptions at play, growth could be lower still, falling in the 6.5-7% range.

...and full-year growth is likely to be 6.5-7%

Most sectors are back up above their pre-Covid output levels

In absolute terms, output in FY22 was above pre-pandemic (FY20) levels across sectors – barring the trade, transport, hotels and communication segment, where it was ~11% lower than in FY20. (However, quarterly output in this segment in Q4 surpassed the corresponding, two-year-ago figure.) Mining and quarrying grew by 11.5%, compared to -8.6% the previous year. Manufacturing grew by 9.9% after contracting mildly (-0.6%) in FY21, though it did record a marginal decline (-0.2%) in Q4. Also back in the black was construction, which expanded by 11.5% after dropping by 7.3% in FY21. Financial, real estate and other professional services continued to move up, growing by 4.2% on the back of 2.2% growth a year ago.

Agriculture remains a solid driver of growth, and is likely to stay that way in FY23

The farm sector remains growth supportive. It grew by 3% in FY22, and 4.1% in the fourth quarter, even after factoring in a heat wave that caused wheat yields to decline. Currently, the Meteorological Department is forecasting a fourth straight 'normal' monsoon, with rainfall estimated at ~103% of the long-term average. Crucially, rainfall is projected to be not just plentiful but also evenly spread, allowing it to replenish India's 81 major reservoirs, which support power generation, irrigation and drinking-water supplies. This makes it likely that agricultural output will continue to grow, supporting rural demand in general.

Most lead indicators are up, suggesting a continued growth recovery

For the immediate future, the lead indicators point to continued recovery. Monthly GST collections have remained above Rs 1.4 trillion for 4 straight months through May and touched an all-time high of Rs 1.67 trillion in April. Net new enrolments under the Employment Provident Fund Organisation (EPFO), an indication of new job creation in the formal sector, touched a new high of 1.53 million in March – a 19.5% increase over the previous month. The IHS Markit PMI indices remain strongly positive. In May, the Manufacturing index stood at 54.6 (marginally lower than April's 54.7) but Services touched an 11-year high of 58.9 (up 100 bps in a month). In April, IMA's Business Confidence and Performance Index (BCPI) survey moved up three points from its January levels, to a robust 69.6. (Values above 50 indicate net optimism/expansion, and those below 50 indicate the opposite.) Across segments – from passenger cars and 2-wheelers to commercial vehicles, tractors and 3-wheelers – auto sales are growing on a YoY basis. However, continued supply-side disruptions have meant that sales-growth figures appear

flat on a month-on-month basis, perhaps understating true demand. Bank credit, after languishing for years, has started to pick up, growing by 9.6% in FY22, up from 5.6% the previous year.

Indicators and forecasts at a glance

	FY20	FY21	FY22*	FY23*
<i>Economic growth (% , 2011-12 prices)</i>				
GDP	4.0	-7.3	8.7	6.5-7.0
Agriculture [^]	4.3	3.3	3.0	3.0-4.0
Manufacturing [^]	-2.4	-0.6	9.9	6.0-7.0
Services [^]	7.2	-7.8	8.4	7.5-8.0
<i>Inflation</i>				
CPI (% , average)	4.8	6.2	11.3	6.0-6.5
WPI (% , average)	1.7	1.3	9.0	8.5-9.0
<i>Public finance</i>				
Government borrowings, Rs tr	9.3	18.2	15.9**	16.6**
Receipts net of borrowings, Rs tr	17.5	16.9	21.8**	22.8**
Expenditure, Rs tr	26.9	35.1	37.7**	39.4**
Fiscal deficit (% of GDP)	4.6	9.2	6.9**	6.4**
<i>External sector</i>				
INR/USD (end of period)	75.4	73.5	75.8	81-83
Trade deficit USD bn	161.4	100.1	192.4	200-220
Current account balance (% of GDP)	(-) 0.9	(+) 1.0-1.5	(-) 1.0-1.5	(-) 2.5-3.0

*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.

Consumption growth shows signs of edging down

Weighing down on the growth outlook are three broad factors, two of which are interrelated. The first is consumption growth. As a share of GDP, private consumption fell significantly, from 61% in Q3 to 55.5% in Q4. (It was 56.7% in the corresponding year-ago quarter.) Even accounting for the usual post-festive-season dip, this is unusual. At least partly, this may reflect rising end-consumer prices. FMCG firms, for instance, report that their top-line is growing largely because of rising prices rather than volumes. According to the RBI's latest bi-monthly Consumer Confidence Survey, which was conducted in March, households have a positive outlook on spending but remain net-negative on most other parameters: employment, income, prices and the overall economic situation. This will constrain spending in the near-term.

Government spending has propped up growth for several quarters, but the investment cycle is yet to fully take off

Government spending and a slowly reviving capex cycle will only partly compensate for below-trend consumption. Public spending accounted for 11.3% of GDP in Q4, up from 9.3% the previous quarter, but for the full year, it fell from 11.3% to 10.7%. Similarly, capex accounted for 33.6% in Q4, and appears to be trending upwards. However, this, too, appears to be driven mainly by public-spending projects. A recent CMIE report indicates that private investment-intent in most sectors remains below pre-Covid levels, with the exception of those (such as pharmaceutical and electrical machinery) that stand to gain from the PLI scheme. Capacity-utilisation rates among

manufacturing firms, as measured by the RBI's Q3 OBICUS (Order Books, Inventories and Capacity Utilisation Survey), have crossed the 70% mark but still fall short of the 80% rate that is typically associated with a big investment revival.

Inflation remains the biggest risk factor...

The second major factor is inflation and – associated with that – rising interest rates. Retail inflation, led by high food and fuel prices, remained well above the upper-bound of the RBI's 2-6% 'comfort zone,' touching an 8-year high of 7.8% in April. WPI (wholesale) inflation, meanwhile, set a new record of 15.1%. Elevated global oil and other commodity prices are likely to persist for much of this year on account of the Ukraine war and other supply-side issues. Inflationary expectations have become deeply entrenched, as indicated by the RBI's bi-monthly surveys. (In April, over two-thirds of households said that prices would increase at an accelerating pace over the next 3 and 12 months.) A good monsoon should provide some relief in terms of food prices, as will the government's recent export restrictions. A high base effect will also start to pull down the headline inflation numbers. Consequently, inflation, both retail and wholesale, will be well above trend through late 2022. To counter this, in early May the RBI's Monetary Policy Committee announced an off-schedule 40 bps hike in the Repo rate, its first since 2018. In June, it hiked the Repo by another 50 bps, and is likely to effect combined hikes of another 100 bps through March 2023. This will have a huge bearing on both consumption and investment.

...and there are challenges to contend with on the external front

Third, there will be pressures to contend with on India's balance of payments, and in terms of exchange rates. As domestic economic activity recovers and commodity prices remain elevated, imports continue to outpace exports. India's trade deficit nearly doubled last year, from USD 103 billion to USD 192 billion, and is currently above USD 20 billion a month. The overall current account deficit also looks set to widen, from under 1.5% of GDP last year to 2.5-3% in FY23. Foreign portfolio investments (FPI) have reversed course as the US Fed has begun tightening monetary policy. Over January-May, India saw net outflows of USD 23.1 billion, compared to inflows of USD 7 billion in calendar 2021. Even accounting for steady FDI inflows, the two factors – a widening CAD and FPI outflows – will exert continuous downward pressure on the rupee, which recently touched new all-time lows below 77.5/USD. A falling currency will also feed into inflation by raising the landed (rupee) cost of imports. Finally, volatile financial markets – partly the result of portfolio outflows – will give rise to a negative wealth effect, impacting consumption, while at the same time affecting the fund-raising plans of corporates and the government (through the disinvestment route).

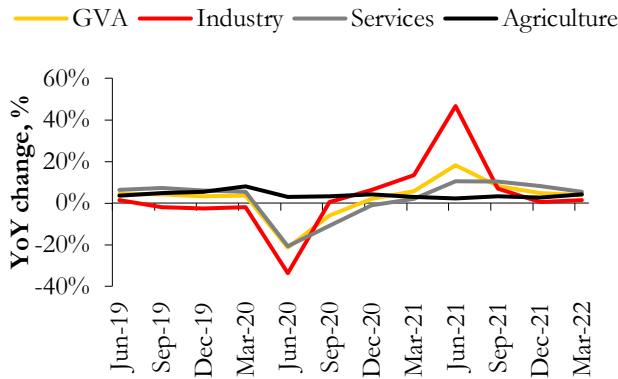
High-Frequency Indicators

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

	FY21	FY22	FY23 YTD#	Latest quarter#	Trend
Industrial/business performance					
The BCPI is up 3 points since January; Services PMI touched an 11-year high in May					
IIP index [^]	-8.5%	11.3%	NA	1.6% (Mar)	▲
IIP – capital goods [^]	-18.7%	16.8%	NA	1.4% (Mar)	▲
IIP – ‘core’ sector [^]	-7.0%	10.4%	NA	4.9% (Mar)	▲
Of which – Cement [^]	-11.9%	20.8%	NA	9.3% (Mar)	▲
IHS Markit Manufacturing PMI [§]	55.4	54.0	54.6 (May)	54.0 (Mar)	▲
IHS Markit Services PMI [§]	54.6	53.6	58.9 (May)	53.6 (Mar)	▲
IMA’s BCPI index [§]	73.0	66.4	69.6 (Apr)	66.4 (Jan)	▲
Naukri Job Speak (new job listings) [^]	23.5%	47.9%	17.5% (Apr)	47.9% (Mar)	▲
Banking, finance, monetary policy					
Inflation continues to rise, leading the RBI to hike the Repo and market rates to go up					
Non-food credit growth [^]	6.0%	7.2%	11.3% (Apr)	8.7% (Mar)	▲
CPI Inflation (Period avg)	6.2%	11.3%	7.8% (Apr)	6.3% (Mar)	▼
WPI Inflation (Period avg)	1.3%	9.0%	15.1% (Apr)	13.9% (Mar)	▼
Repo Rate [§]	4.0%	4.0%	4.9% (Jun)	4.0% (Mar)	▼
1-Year MCLR (Min/Max) [§]	7.00/9.43	7.00/9.08	7.20/9.23(May)	7.00/9.08 (Mar)	▼
10-Year Gov’t bond yield [§]	6.4%	6.9%	7.2% (Apr)	6.9% (Mar)	▼
External sector					
The trade deficit is widening, FII flows have reversed and the Rupee is dropping					
Exports (% change) [^]	-6.9%	43.0%	30.7% (Apr)	23.8% (Mar)	▲
Imports (% change) [^]	-17.4%	55.9%	31.0% (Apr)	28.5% (Mar)	▲
Trade balance USD bn [§]	-100.1	-194.3	-20.1 (Apr)	-194.3 (Mar)	▼
INR/USD (% change) [^]	-2.5%	-3.1%	-0.8% (Apr)	-2.0% (Mar)	▼
Net FII inflows (USD bn) [^]	30.3	-6.6	-4.7 (May)	-6.6 (Mar)	▼
Inbound FDI (USD bn) [^]	54.9	55.0	NA	16.0 (Mar)	◀▶
Foreign reserves net change [^] USD bn	94.5	4.0	-14.8(Apr)	-29.1 (Mar)	▼
Demand indicators					
Most markers of demand are up, with a spike in air traffic and tractor sales					
Car & utility vehicle sales [^]	-6.1%	-11.2%	NA	-5.7% (Mar)	◀▶
Two-wheeler sales [^]	-13.2%	-10.9%	15.4% (Apr)	-23.0% (Mar)	▲
Tractor sales [^]	27.6%	-6.4%	43.8% (May)	-25.7% (Mar)	▲
Domestic air traffic [^]	-61.7%	58.6%	87.8% (Apr)	6.8% (Mar)	▲
International air travel [^]	-84.8%	118.1%	155.6% (Apr)	80.8% (Mar)	▲
Credit card usage [^]	-14.1%	54.1%	NA	42.5% (Mar)	▲

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; * YoY growth rates for early FY22 are not comparable due to a lockdown-induced slump in the corresponding year-ago period; IMA’s BCPI (Business Confidence and Performance Index) is based on a quarterly survey of IMA’s Forum member companies

Gross Value Added (YoY change): 3.9% in Q4



Source: CSO

Growth slowed across most segments in Q4, pulled down by Omicron and the Ukraine war

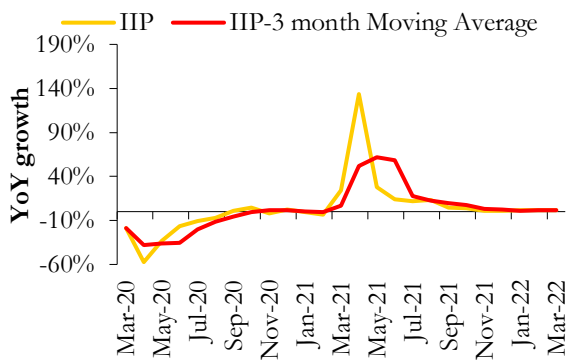
Merchandise trade: Robust growth



Source: Ministry of Commerce

India's inbound and outbound trade continue to grow strongly

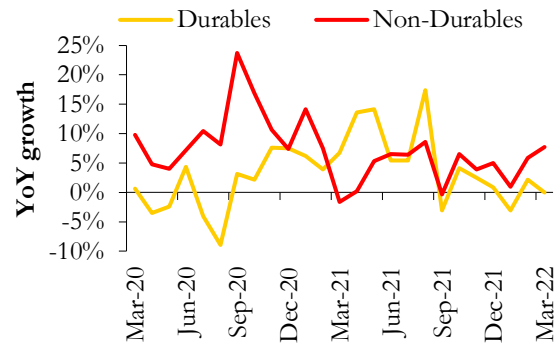
IIP (YoY change): Stabilising



Source: CSO

IIP growth was 1.85% in March on the back of a high base from last year

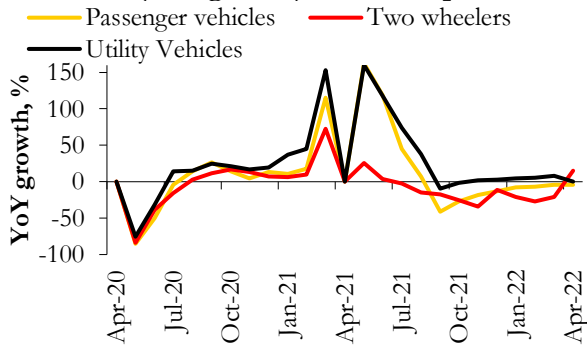
Consumer goods IIP: Non-durables rising



Source: CSO

Output-value of non-durable goods has gone up on account of rising end-consumer prices

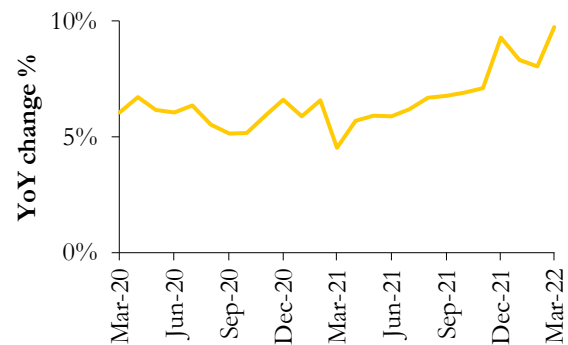
Auto sales (YoY growth): Headed upwards



Source: SLAM

2-wheelers and passenger car sales are rising on a YoY basis but are largely flat MoM

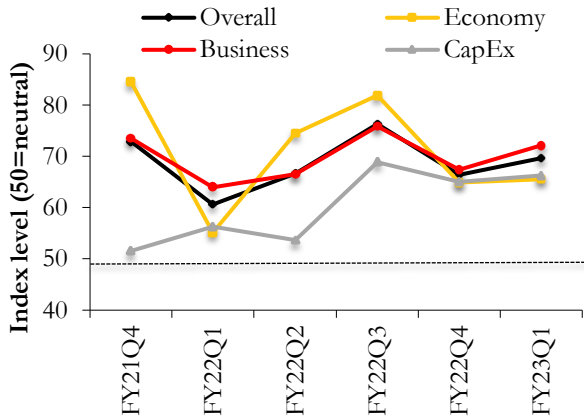
Non-food credit (YoY growth): Improving



Source: RBI

YoY credit growth continues to recover, and is now near the double-digit mark

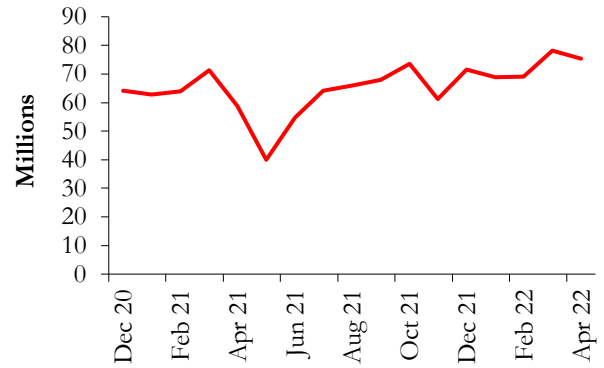
BCPI: Up 3 points in Q1FY23



Source: IMA India Research

After dipping 10 points in Q4, the BCPI has shown some recovery in Q1 of the new year

Monthly e-Way bill issuances: Steadily up

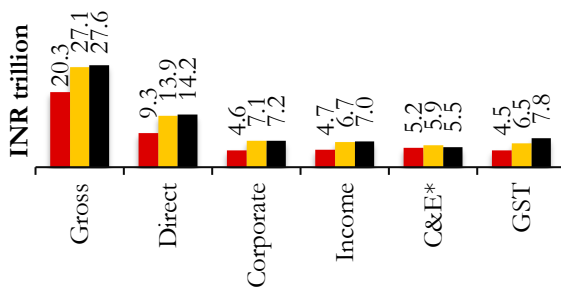


Source: GSTN

e-Way bill issuances set a new record of 78 million in March but declined slightly the next month

Tax revenues: Strongly up in Apr-Mar

■ Apr-Mar 2021 ■ Apr-Mar 2022 ■ Target FY23

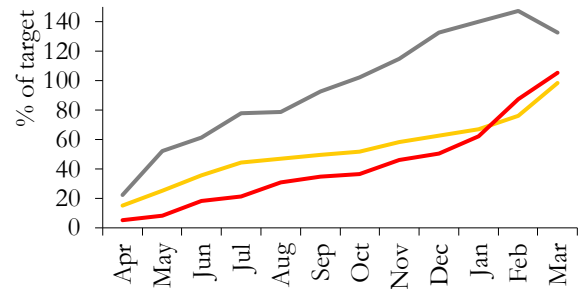


Source: Ministry of Finance *C&E - Customs & Excise

Tax revenues saw an upswing in FY22 and are projected to improve further in FY23.

Fiscal deficit (% of target): On track

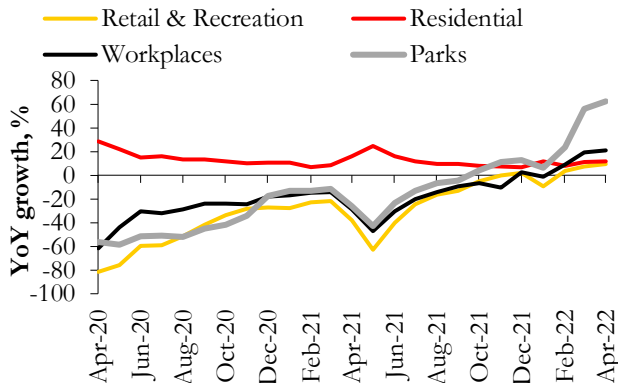
— 2019-20 — 2020-21 — 2021-22



Source: CSO, Ministry of Finance

The fiscal deficit remains well on track to stay within the revised target for the year

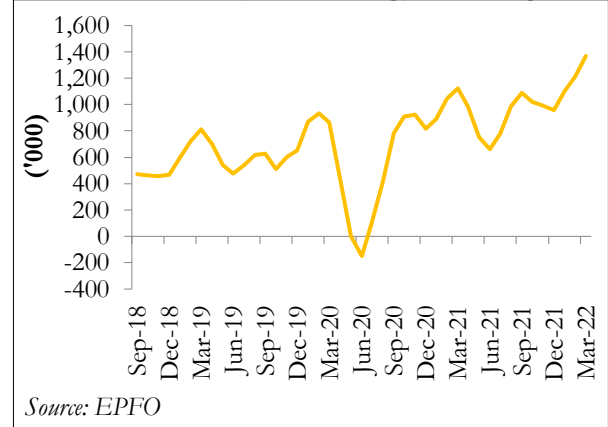
Google Mobility Index: Holding Up



Source: Google LLC

Mobility continues to improve after a small dip triggered by the third wave

EPFO enrolment (3-month avg): Upswing



Source: EPFO

Monthly enrolment in the EPFO is moving up, suggesting formal job creation remains strong