20 July 2021

India's economic recovery starts to gain traction after a temporary hit in Q1 FY22; however, risk of a third COVID wave continues to lurk

- Global economic recovery continues to move ahead, although the disparity between advanced and developing nations widens, reflecting differences in policy support and unequal access to vaccines.
- In India, the impact of the second COVID wave was felt mainly in Q1 FY22, and it was lower compared to the first wave last year, in line with our expectations.
- India's economic recovery is starting to gain traction in early Q2 FY22, as indicated by ultra-high frequency indicators such as Google mobility and electricity usage numbers.
- Corporate financial results in Q4 FY21 were strong but also showed widening of the gap in performance of larger firms compared to smaller firms, underscoring the need for targeted policy support for vulnerable segments.
- The government announced an economic package in late June to provide relief to pandemic-impacted segments, enhance health infrastructure, revive tourism, boost exports, and aid overall economic recovery.
- Meanwhile, like other major central banks, the Reserve Bank of India (RBI) is trying to balance the need to support economic revival amidst rising inflation pressures.
- The RBI continues to lean towards supporting economic revival while viewing recent inflationary pressures as largely transient and supply-side driven.
- The key risk to economic outlook continues to stem from a possible third COVID wave. While daily COVID cases have fallen to ~10% of the peak from the second wave, the pace of further improvement has slowed.
- In addition to timely virus containment measures, efforts to further ramp up vaccination pace are needed to prevent a third COVID wave or at least limit its intensity if it were to occur.

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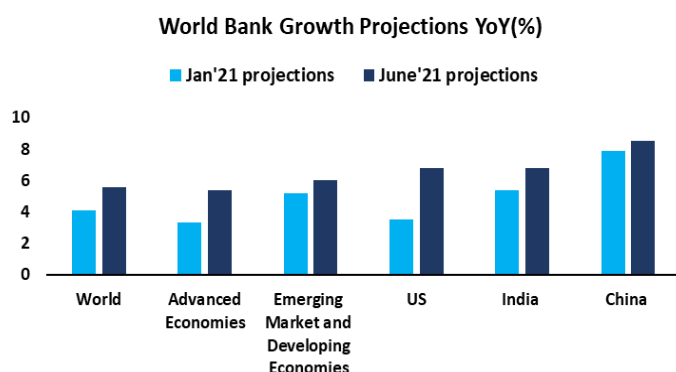
Global growth outlook remains optimistic; downside risks persist due to new COVID variants and inflationary pressures

Amidst easing restrictions and progress on the vaccination front, the global economic recovery continues to move ahead, although it remains unequal. High-frequency indicators such as Global Purchase Managers' Index (PMI) surveys (both manufacturing and services) indicated slight moderation in the month of June; nonetheless, they stayed in the expansionary zone as new orders and employment continued to grow. Sectoral PMI further suggests that contact intensive services such as the tourist and recreational sector gained traction. World trade also continues to strengthen, posting a sequential recovery in the June quarter. Accordingly, in its Global Economic Prospects June'21 edition, the World Bank revised the global growth forecast from 4.1% YoY to 5.6% YoY for 2021. However, the growth forecast highlights the disparity between advanced and developing nations due to differences in policy support and unequal access to vaccines. Advanced economies led the upward revision in the growth forecast (increase by 2.1 percentage points from January). The change in growth prospects for emerging and developing economies remain relatively moderate (with a smaller upward revision by 0.8 percentage points from January). The growth forecast is in alignment with the disparity observed in vaccination rates. At present, the vaccine coverage of high-income countries stands at 91.3% (capacity to cover population for a single shot), whereas developing countries lag far behind, with vaccine coverage at 37.6% (data as of July 15, 2021).

World bank foresees higher global growth in 2021; however, disparity persists among nations



Source: Global Economic Prospects – World Bank

Even though global growth prospects look optimistic in the current environment with a pick-up in economic activities, one cannot ignore economic recovery uncertainties. After witnessing a decline in COVID cases, the world has found itself grappling against new mutations of the virus, such as Delta and Lambda variants. Given the uncertainty about the severity of these variants, accelerating the pace of the vaccination drive is of utmost importance. Hospitalization and fatality rates are found to be lower in regions with higher percentages of vaccinated populations. Another downside risk to the economic outlook emanates from the upward swing in commodity prices and inflationary pressures. Energy prices continued on an upward trend in June, rising by 9.4% MoM, whereas non-energy commodities witnessed slight moderation of -1.4% from the prior month. Rising inflation pressures are leading to concerns that they may force policymakers' hands into reversing the policy stance of ultra-accommodation sooner than they have previously committed. Central banks have to strike a balance between preventing inflation from becoming entrenched beyond temporary spikes while ensuring that policy stimulus is not withdrawn in haste when economic recovery is still fragile and the output gap persists. In this context, it is worth noting that global output is projected (by the World Bank) to remain at about 2% below pre-pandemic projections by 2022. So far, major central banks have either renewed their commitment to stay accommodative or planned to undertake policy normalization gradually to nurture economic recovery while overlooking inflationary concerns in the short term.

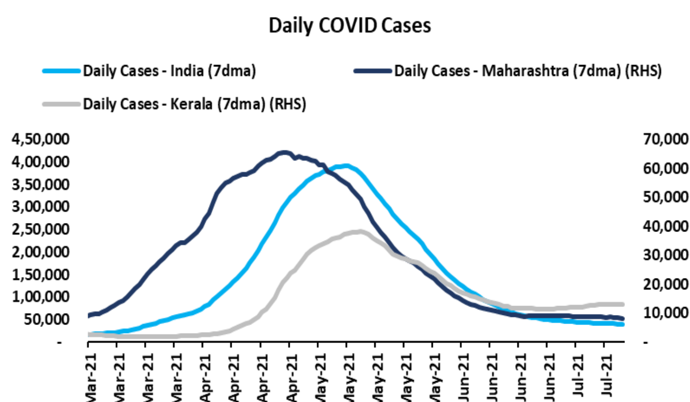
After a sharp improvement, further decline in India's COVID cases slowed recently; the potential risk of resurgence of cases persists

India's second COVID wave has ebbed after significant improvement since its peak in early May. The 7-day moving average (7-dma) of daily cases has fallen to 39.1 thousand on July 15, which is ~10% of its peak levels of 3.92 lakhs as of May 8. Further, the number of recoveries continues to outweigh the number of daily cases, leading to a drop in active caseloads from 37.5 lakhs in early May to 4.3 lakhs at present. India is also witnessing a drop in fatalities, which have declined to below 1000 in the past week. However, the COVID situation shows early signs of bottoming in recent weeks, with daily cases appearing to have settled at higher levels of around 40,000. This creates a potential for reversal of the downward trajectory of daily cases, especially if social distancing norms are not followed properly, as being reported by media in several cities.

The slower pace of improvement in daily COVID cases in recent weeks seems mainly due to the limited progress in Kerala and Maharashtra in bringing down infection numbers further, along with the rise in cases in the northeastern region. Daily cases in states like Maharashtra and Kerala seem to be fluctuating at relatively higher levels and contribute to over 50% of India's total COVID cases, as per data until July 15. Meanwhile, states like Tamil Nadu, Andhra Pradesh, Karnataka, and Odisha have seen their

daily cases dropping by 70-88% from the first week of June to the second week of July. Reports of the virus's new variant, Delta Plus, have also raised concerns. Interestingly, ~80% of the nation's daily cases are presently concentrated in six states (Kerala, Maharashtra, Tamil Nadu, Andhra Pradesh, Karnataka, and Odisha) which coincidentally have also identified cases of Delta Plus. Even though not much is known about the transmissibility and severity of the new mutation, the risk of a third wave persists as mobility rises amidst patchy adherence to COVID-appropriate behavior and emerging new variants, which could pose downside risks to economic recovery.

COVID situation has improved significantly; however, daily cases appear to be bottoming at a higher base



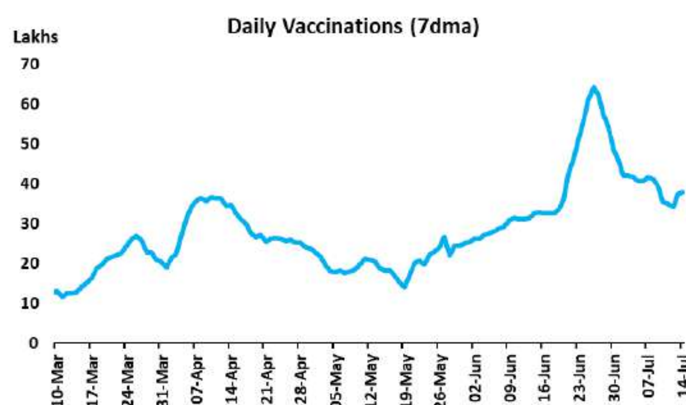
Source: CMIE; COVID19india.org

Pace of vaccination accelerated in June but slowed in early July; measures to address vaccine hesitancy are needed

India's vaccination pace more than doubled in June compared to May. With an improved supply and sorting of logistical issues, India's daily vaccination pace increased significantly from ~20 lakh doses in May to ~40 lakh doses in June. Unfortunately, the pace has started to slow in early July. While vaccine supply might be an issue in some locations, there are also signs of vaccine hesitancy/complacency setting in after the initial urgency of getting vaccinated during the second wave diminished with a declining intensity of the COVID situation. The daily vaccination pace has slowed from 48 lakhs (7-dma) at the end of June to a daily average of 38 lakhs in the second week of July (till July 14). Overall, India has administered close to 39.5 crore vaccine doses as of July 15, 2021, and as a result, inoculated ~23% of the population with at least one dose and ~5.8% of the population with both doses.

In June, the government scaled down its earlier ambitious vaccine supply projection of 217 crore doses for August-December to 135 crores now for the same period. The new supply projection is relatively realistic, enough to vaccinate the target population (93-94 crore adults) by Dec '21 (additionally assuming ~13.7 crore doses in July). Based on the recent pace of vaccination and assumptions of vaccine supply, we estimate that around 70% of the adult population can be fully vaccinated by the end of 2021. In an optimistic scenario, the supply should be sufficient to fully vaccinate ~84% of the population. This will require measures to continue to boost supply, including new vaccine approvals, imports, and steps to address vaccine hesitancy.

Vaccination pace shows early signs of slowing after a sharp jump in June



Source: CMIE

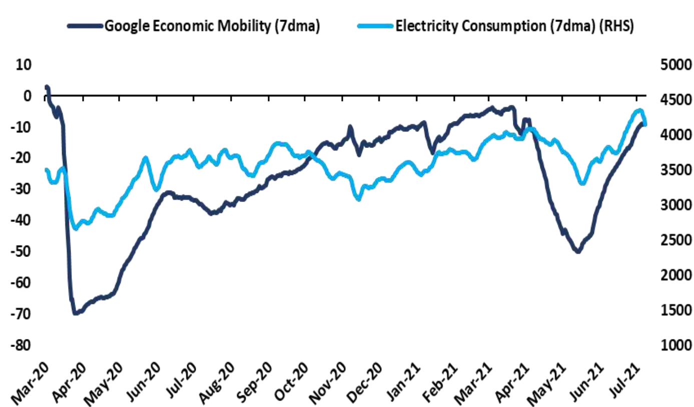
Economic activity starts to gather momentum based on ultra-high frequency indicators

In line with our expectations, the economic impact of the second COVID wave was mainly felt in Q1 FY22. The impact on the economy was also less than what was witnessed in Q1 FY21, given that the intensity of lockdowns was lower compared to last year, adaptability by businesses, and robust export demands, etc. High-frequency indicators showed the impact on sequential recovery in Q1, with the resumption of recovery mid-June onwards. We expect the recovery process to gather pace in the coming months, assuming there is no third COVID wave.

Industrial activity was relatively less impacted by the second COVID wave compared to the first wave last year. The Index of Industrial Production (IIP) rose by 68.8% YoY in April-May'21 compared to an average contraction of 45% during April-May'20. IIP showed a sequential 8% MoM decline in May'21 due to state lockdowns but rose by 29.3% YoY, thanks to the favourable base effect. Compared to pre-COVID levels (taken as FY20 average level), industrial production was at 90% in May'21, which compares favorably with 70% in the same period last year. This reflects the lower intensity of lockdowns during the second COVID wave (with the exemption given to the industry) compared to strict

nationwide lockdown in April-May'20 and business adaptability. Compared to pre-COVID levels, mining and electricity output remained around 100% in May'21 compared to the 80-95% range in May'20, while manufacturing managed to register 88% production levels compared to 65% last year. This resiliency was noted in the PMI manufacturing print for May'21 when the index stayed in the expansion zone with a print of 50.8. However, it has slipped in the contraction zone at 48.1 in June, which is odd considering the relaxation of lockdowns and pick-up in other high-frequency indicators. Even then, the index averaged 51.5 in Q1 FY22, much better in comparison to 35.1 in Q1 FY21. Auto sales, both retail and wholesale, have shown sequential pick-up in June. E-way bills and electricity consumption have also picked up in June and early July. Meanwhile, the central government also maintained its focus on capital expenditure (up by 14% YoY) in April-May'21 in line with budget priorities, while revenue expenditures were kept in check (-9.1% YoY). In the agriculture sector, slower progress in monsoon has however raised some concerns about the impact on its growth in the current crop cycle. Based on rains deficit (7% below long-term average till July 12) and slow summer crop sowing (10.4% below last year levels, till July 9) so far, we expect some impact on Q1 agriculture growth; however, if rains catch up during rest of July, the impact could be limited.

High-frequency data shows a pick-up in economic activity in July



Source: Google, CMIE; Google Economic Mobility index is average of retail and recreation, transit stations, grocery and pharmacy and workplaces mobility indicators

Expectedly, the second COVID wave had a relatively higher impact on the services sector, though it remains less than last year. Compared to a record low of 17.2 in Q1 FY21, the PMI services index fared much better in the first quarter of the current financial year, posting an average of 47.2. The index fell to 46.4 in May from 54 in April and noted a further decline in June to 41.2. While the drop in May was expected, it was surprising to see a further drop in June. Other services-related indicators, such as air traffic, travel, railways freight, etc., showed sequential recovery in June as states relaxed lockdowns. We expect this recovery to gain momentum going forward, assuming there is no third COVID wave. Ultra-high frequency indicators for early July support this view. Google economic mobility improved by 33 points from the trough in mid-May (7-dma) to 17 percentage points below the baseline by the end of June and further to 9 percentage points below the baseline in July (till July 12). Electricity consumption also rose in July (data till July 14) by 17% YoY, compared to 8.5% and 8.0% in June and May, respectively. Meanwhile, external trade continues to grow at a robust pace. In our March'21 report, we had argued that tailwinds from external demand are expected to remain, notwithstanding the domestic COVID situation. External trade data for Q1 supports that view, with exports registering the highest quarterly level of $95 billion, rising by 85% YoY (and an 18% increase from Q1 FY20). We expect this strong export performance to continue during the rest of the year, supported by a faster recovery in external demand (world trade volume is projected to rise by 8.3% YoY in 2021 as per the World Bank), better vaccination levels of key trading partners and government's supportive measures.

Government announces stimulus package while RBI continues to lean towards supporting growth even as the balancing act becoming challenging

To aid economic recovery, the finance minister announced a slew of measures in late June to provide relief to pandemic-impacted segments, enhance health infrastructure, revive tourism, boost exports, and provide an overall fillip to economic growth (please refer to the detailed report here). The timing of the economic package was aligned with the reopening of the economy - after the second COVID wave abated. We had expected the government to time the stimulus with the unlock process for a better multiplier effect, though it came slightly ahead of our expected timeline. The financial implications of the measures announced are estimated to be ~Rs 6.28 lakh crores (almost 2.8% of FY22 Gross Domestic Product [GDP], taking GDP estimates as per the budget), though part of this will be spread over five years. The fiscal cost of the package in FY22 is likely to be much lower (~0.6% of GDP) given a higher reliance on credit guarantees. In mid-July, the government followed up with additional steps, announcing an increase in dearness allowance and dearness relief for central government employees and pensioners from 17% to 28%, with effect from July 2021, ending a freeze since January'20 due to the COVID pandemic. The move is estimated to entail fiscal spending of Rs 34 thousand crores. If state governments also follow a similar move, additional

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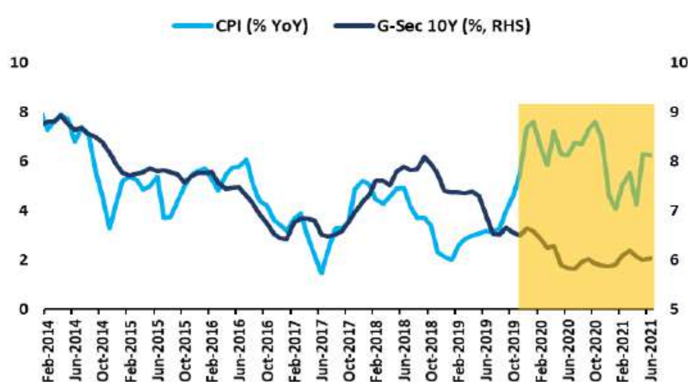
fiscal spending of Rs 50-60 thousand crores is possible, providing a boost to the spending power of consumers.

Meanwhile, the RBI has maintained its dovish leaning to support economic recovery despite an uptick in inflationary pressures. Since the beginning of the pandemic last year, the RBI has delivered extraordinary policy support to the economy and several sectors to help withstand the COVID shock and aid the recovery process. The RBI took several measures, including ensuring successful government borrowing at low costs through its Government-Securities Acquisition Program (G-SAP) and Open Market Operations (OMOs), liquidity injection, and credit support to affected segments-- along with its regulatory and supervisory measures. The RBI has also been proactively intervening in keeping interest rates low through frequent devolvement of bond auctions and the introduction of uniform price auctions. It also recently proposed a framework to define bids at auctions that have a spread of more than 2 basis points (bps) from second market yields as outliers. However, the balancing act is likely to become more challenging with rising inflation pressures. India's Consumer Price Index (CPI) has remained above the upper target band of the RBI (6%) for two consecutive months now -- May (6.30% YoY) and June (6.26% YoY). This will also compel the RBI to revisit its inflation forecasts given Q1 FY22 CPI now averages 5.6% YoY v/s the RBI's forecasted value of 5.2% YoY. Despite rising inflation pressures, the RBI's interventions have kept the yields relatively lower.

Strong intervention by the RBI has kept yields under check despite an increase in inflation



Source: CMIE, Bloomberg

Nevertheless, with the slack in the economy, we expect the RBI to maintain its accommodative stance and continue prioritizing growth over inflation. The advent of the second COVID wave has pushed back the economic recovery process that was on its way to bridge the slack compared to pre-COVID levels. In a recent interview, ahead of the August monetary policy, the RBI governor reinstated the central bank's dovish stance and cautioned against any hasty withdrawal of policy support that could weigh on the nascent recovery that is taking place. On building inflation concerns, the RBI continues to view the recent flare-up as transient and is likely to overlook these and continue focusing on reviving growth. The governor also stated that the RBI policy would be independent of the monetary policy action of advanced central banks such as the US Fed and would be based on the domestic macro-economic situation. Record foreign exchange (FX) reserves at ~$609 billion (as on June 25, 2021) provide a strong cover against any external volatility.

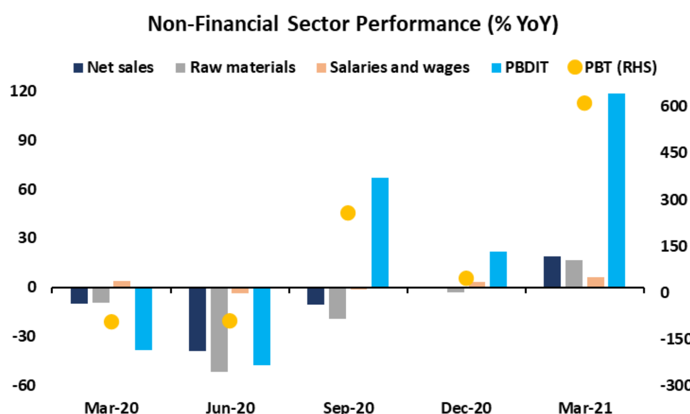
Going ahead, we expect CPI inflation pressures to ease slightly as supply-side issues fade with the reopening of the economy along with a more favourable base effect (from July-November). However, more durable pressures exist, such as the increase in commodity/oil and input prices (as seen in the increase in Wholesale Price Index [WPI]) that are driven by a recovery in global demand. These might become more well-rounded once domestic recovery also catches pace with a pick-up in the share of people being vaccinated that bolsters sentiments and activity towards normalcy. Due to this and coupled with the risk of downward stickiness in inflation pressures, we do not rule out the possibility that a change in the RBI's accommodative stance could come before the presently anticipated Q4 FY22. It could take the form of sterilization of liquidity through variable reverse repo operations and/or a hike in reverse repo rates. However, the first repo rate hike is likely to be announced only in the next financial year. We expect more clarity to emerge on this front from the discussion in the August policy and the minutes thereafter. For now, we expect the RBI to maintain the status quo on its policy stance and key rates in the August policy, even as it acknowledges the recent flare-up in inflation.

Corporate profits soar in Q4 FY21; however, recovery continues to remain unequal

In line with economic recovery gaining traction before the second wave hit, corporate performance remained stellar in the final quarter of the previous fiscal year. Profits reported by corporates soared to record highs on the back of robust sales (also aided by demand shift from the informal to the formal sector) and a modest pick-up in expenses. According to a sample of over 3,000 companies in the non-financial sector (source: CMIE), net sales rebounded in the March 2021 quarter, increasing by ~19% YoY after six consecutive quarters of contraction – buoyed by demand recovery, rise in prices, and a favourable base. Within the broad sectors, manufacturing companies led the rebound as sales increased by 23% YoY, its highest pace in the past nine quarters, followed by construction & real estate (17% YoY) and non-financial services (9.4% YoY). Sales in contact-intensive sectors continued to ail with hotels & tourism (-34%

YoY), air transport (-27% YoY), and education (-27% YoY), recording prolonged contraction even in Q4 FY21.

Corporate profits soar in Q4 FY21 on the back of strong sales and modest spending



Source: CMIE; PBDIT – Operating profit (profit before depreciation interest expense and taxes; PBT – profit before taxes

On the expenses side, raw material expenses for the non-financial sector rose by ~16% YoY in the March 2021 quarter with recovery in the economy and reflation trade pushing commodity and input prices higher. This was a stark departure from the theme in three previous quarters, where raw material costs fell by as much as 51% YoY in the June 2020 quarter during the peak economic impact of the first wave. Salary and wage expenses also recovered in Q4 FY21; however, the increase in pace was more modest at 6% YoY compared to the previous quarters that noted a relatively marginal swing. In contrast, corporates have managed to keep some of their other expenses in check, such as rent & lease (-15% YoY), marketing expenses (-2% YoY), and travel expenses (-71% YoY). This has partially offset the increase in expenses from raw materials and salary & wages and kept a lid on total expenses. Consequently, operating profits for the above set of companies increased by ~118.5% YoY in March 2021, which was a record high (since data available from June 2006). While a base effect is also at play here, nevertheless, the operating profit and profit before tax for corporates stand at ~55% and ~102% above their pre-COVID levels (March 2019), respectively, and are their highest ever in absolute terms.

While the corporate sector has staged an exceptional performance - the inequality appears to have become more acute between large v/s smaller firms. In our February economic monitor report, we had identified emerging themes in the post-COVID era (please refer to the report here), where we highlighted a 'K-shaped' recovery. We revisit some of these themes and notice that the disparity in recovery has widened further.

Firstly, the sharp rebound in sales continues to be led by larger firms, while smaller firms reported negative sales in double digits. The first six deciles of firms (top 60% of firms according to size) noted an increase in sales ranging between 17.5% YoY to 24% YoY compared to last year, while the 7th and 8th decile of firms saw lower growth in sales of 4.6% YoY (despite a favourable base). Meanwhile, sales for the bottom two deciles continued to contract by ~11% YoY and 69% YoY respectively in Q4 FY21, suggesting that smaller firms remain under stress from the pandemic.

Net sales recovery driven by larger firms

Non-financial Sector - Net sales % YoY					
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Total	**-9.9**	**-38.9**	**-10.4**	**-0.6**	**18.7**
Decile 1	-8.4	-37.7	-10.4	-1.2	18.7
Decile 2	-16.8	-44.4	-7.4	6.5	18.5
Decile 3	-16.7	-43.9	-14.2	-2.6	24.0
Decile 4	-17.6	-48.4	-11.1	3.6	17.7
Decile 5	-21.1	-47.1	-14.8	-2.4	17.7
Decile 6	-22.1	-47.9	-16.3	-8.5	17.6
Decile 7	-25.3	-51.9	-18.3	-5.6	4.6
Decile 8	-32.5	-64.6	-24.1	-15.2	4.7
Decile 9	-37.1	-61.1	-68.1	-34.0	-10.9
Decile 10	-62.6	-78.2	-66.6	-60.5	-68.8

Source: CMIE

The weaker recovery of smaller firms also translated to a continued contraction in their salary and wage costs. In fact, the cut back in employee costs for the bottom decile accelerated to -35.8% YoY in March 2021, compared to -31-34% YoY in the previous two quarters. In contrast, larger firms reported a steady increase in employee costs (after a modest dip in Q1 FY21), indicating steadier generation/recovery of employment. Smaller firms also happen to be more labor-intensive (reflected in higher salary and wage expenses to net sales ratios) and, as such, could entail more voluminous job shedding. These could also be representative of a more vulnerable salaried class employed with these firms vis-a-vis employees in top decile firms.

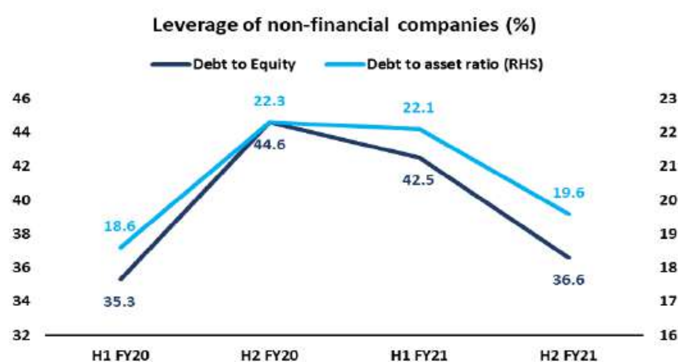
Small corporates continue to trim salary and wage costs in contrast to the recovery seen for larger firms

Non-financial Sector - Salaries and Wages % YoY						Labour intensity (%)*
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	
Total	**3.9**	**-3.6**	**-1.4**	**3.5**	**6.0**	**8.8**
Decile 1	4.5	-1.0	0.4	4.7	6.0	8.3
Decile 2	3.7	-10.3	-5.7	2.3	7.5	11.2
Decile 3	-1.3	-17.6	-12.0	-5.5	5.8	10.9
Decile 4	0.3	-19.0	-10.5	-4.0	2.0	11.7
Decile 5	-3.5	-22.6	-11.3	-5.7	1.6	13.7
Decile 6	1.5	-24.9	-12.6	-6.3	2.4	13.0
Decile 7	-9.5	-23.9	-17.3	-7.3	19.2	14.1
Decile 8	-7.1	-29.5	-18.5	-11.0	10.1	17.0
Decile 9	-10.2	-31.8	-28.2	-18.5	-1.5	20.4
Decile 10	-7.7	-17.9	-34.3	-31.4	-35.8	38.7

*Source: CMIE; * Labor intensity refers to wages as % of net sales in the pre-COVID period (as of December 2019)*

The disproportionate impact on smaller and more marginalized entities is also noted in the wider economy. According to CMIE employment data, small traders and wage labourers have been more acutely hit by the second wave of the virus. Nearly 20 million jobs have been lost in the April-June quarter, with employment for this segment falling to 83.1% of their pre-COVID levels. While government support has been extended towards various sectors in response to the pandemic, more targeted relief is warranted for the vulnerable segments.

Corporates have reduced leverage compared to the previous year



Source: RBI FSR July 2021

In the past year, corporates have gone through a sharp de-leveraging process and have significantly improved their balance sheets. This has been facilitated through policy support that ensured ample and cheap liquidity and credit support to firms to help tide over the COVID impact. In addition, the record high valuations in equity markets due to the flow of abundant liquidity has also propelled companies to raise equity through record (of over $2.5 billion in Q1 CY21) initial public offerings[1]. Given the sub-optimal capacity utilization rates across corporates, the abundant liquidity has been used to retire/replace costly debt instead of taking on new investment projects (as seen by the decline in fixed asset to total asset ratio), thereby strengthening their financials. According to the RBI's report – the leverage of 1,360 private listed companies declined sharply in H2- FY21 compared to the same period last year, as seen from their debt-to-equity and debt-to-asset ratios (refer to the chart above). Cash holdings of corporates have also increased as they built up on their buffers (cash holding ratio increased 3.9% in H1-FY20 to 5.3% in H2-FY21).

Confirming the de-leveraging trend – data of over 3,000 non-financial companies from CMIE indicate a fall in the debt-equity ratio by 11 percentage points between H2-FY20 and H2FY21. However, we note that the disparity among large v/s small firms is also reflected in terms of the progress in improving their respective balance sheets. The top 50% of firms (decile 1-5) have managed to reduce their leverage in the range of 9-33 percentage points between H2-FY20 and H2-FY21. In contrast, firms in the bottom two deciles have seen their leverage reduce by 2-4% points, while firms in the 8th decile saw their leverage rise by over 5 percentage points.

Larger firms have been relatively more successful in reducing leverage compared to smaller firms

Debt to equity ratio - Non Financial Sector				Change in FY 2021
Decile	H2 FY2020	H1 FY2021	H2 FY 2021	
Total	**0.62**	**0.56**	**0.51**	**-0.11**
Decile 1	0.58	0.53	0.49	-0.09
Decile 2	0.91	0.74	0.58	-0.33
Decile 3	0.73	0.69	0.55	-0.18
Decile 4	0.81	0.83	0.62	-0.19
Decile 5	0.86	0.86	0.66	-0.20
Decile 6	1.02	0.77	0.66	-0.36
Decile 7	1.06	0.77	0.61	-0.45
Decile 8	0.61	0.61	0.66	0.05
Decile 9	0.36	0.47	0.32	-0.04
Decile 10	0.64	0.69	0.62	-0.02

Source: CMIE; Change in FY 2021 is calculated as the difference between H2 FY20 and H2 FY21

The financial services sector also reported record-high profits at 165% YoY in the quarter ending March 2021. Total income increased by 3.5% YoY at a slower pace, possibly due to the lower interest income garnered on assets. However, this was commensurate on the liabilities side as interest expense also noted a fall (-2.6% YoY). Provisioning and contingency expenses fell more sharply (-20.5% YoY) due to regulatory relaxations along with slower growth in assets/credit in FY21. This, along with the fall in other operating expenses (rent, transport, etc.), led to a cut back in overall expenses (-2.3% YoY) that aided an increase in profits. After the ban on Non-Performing Asset (NPA) classification was lifted in March 2021, banks' reported Gross NPA (GNPA) ratios have surprised on the positive side. The GNPA ratios of banks have improved to 7.5% in the quarter ending March 2021, compared to 8.4% in the quarter ending March 2020. The improvement in reported GNPAs in FY21 could very well be attributed to the combination of restructuring and write-offs. Banks' write-offs stood at 20.5% of GNPA in FY21, contributing to lower NPAs.

On a sector-wise basis, the fall in GNPAs was driven by an improvement in the industrial and agriculture sectors, while that for personal loans marginally deteriorated. GNPAs decreased for all sub-sectors within the industry and aligned well with the performance of corporate firms led by the industry/manufacturing sector in terms of both profits/sales

[1] https://www.business-standard.com/article/markets/india-records-22-ipos-worth-over-2-5-bn-in-january-march-period-121042100622_1.html

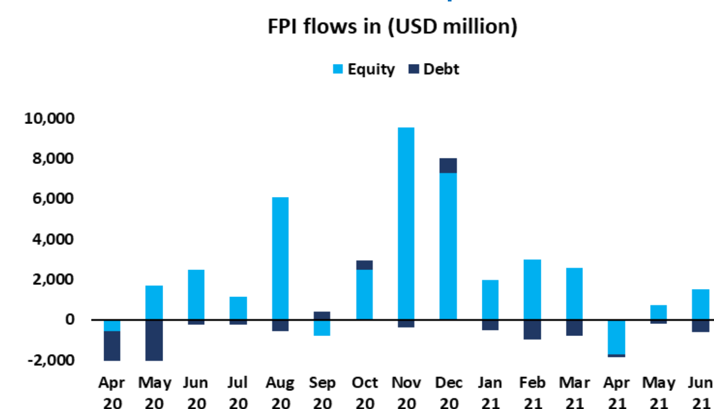
and the recovery in the past year. However, downside risks persist with the rolling back of regulatory relaxations as the economy recovers in the future. As per the RBI's latest data, banks are better prepared for uncertainties given improved balance sheets with banks' capital to risk-weighted assets ratio (CRAR) increasing to 16% in March 2021 from 14.7% a year ago. Accordingly, in the RBI's stress scenario for the year ahead - all 46 banks are likely to maintain CRAR well above the regulatory requirement of 9% even in a severe stress scenario.

Markets Section

The Indian bond markets traded in a steady range in June. Yields on the 10-year benchmark G-sec remained broadly anchored around the 6% threshold as it averaged 6.02% in June, marginally higher compared to 5.99% in the previous month. The continued injection of liquidity, along with bond purchases through the open market and G-SAP operations conducted by the RBI, kept yields under check. However, rising inflationary pressures along with the uptick in oil prices weighed on the steadiness of the G-sec market moving into July. Adding to the pressure was a negative surprise at the G-SAP auction (of Rs 20,000 crores) during the first week of July, wherein the RBI's choice of papers was relatively illiquid and did not include papers from the 5-year and 10-year segments. Consequently, yields on the 5-year and 10-year segments jumped by 8 bps and 9 bps, respectively, following the auction. However, in a recent interview, the RBI governor placated concerns on inflation and the government's borrowing programmes that cooled yields somewhat. A new 10-year benchmark paper was also issued recently that is likely to address concerns of illiquidity, as the RBI had come to hold almost 80% of the 10-year bonds in circulation given its aggressive buying of government securities. Nevertheless, while the pressure on bond yields is likely to remain on the upside, we expect the RBI to continue using all tools in its arsenal to keep yields from overshooting.

Indian equity markets continued on their uptrend as both the indices - NIFTY and SENSEX - reported gains of 0.9% and 1%, respectively in June (this was built on substantial gains of 6.5% in May for both benchmarks). Continued improvement in the COVID situation, along with the resumption in economic activity as localized restrictions eased, buoyed sentiments. This also drove foreign capital flows back into Indian equity markets for the second consecutive month ($0.75 billion in May and $1.5 billion in June). Record profits reported by corporates in Q4 FY21 also supported the rally while improving valuation at the same time. The Price-to-Earnings (P/E) ratio of the NIFTY 50 index reduced further to 28.3 in June 2021 from 29.2 in May and from close to 40 in February earlier this year. The Indian benchmark indices continued to scale fresh record highs moving into July. The recovery phase, bolstered by the ongoing vaccination drive, coincidentally backed by congenial financial conditions, may provide a favourable macroeconomic backdrop for the equity markets.

Foreign investors plough back funds in Indian equity markets as the COVID situation improves



Source: CMIE

The Indian Rupee came under pressure against the Dollar as the USD/INR pair depreciated by half a percentage to average 73.56 in June compared to 73.21 in the previous month. This partially eroded gains from the previous month wherein the Rupee had appreciated by nearly 2% against the Dollar. The greenback strengthened in June against the basket of most currencies as faster recovery in the US economy led to talks of tapering the stimulus from the Federal Reserve and boosted demand for the Dollar. As such, the Dollar index appreciated by 0.8% in June and has strengthened further by another 1.5% in July (until July 12), putting more pressure on emerging market currencies. Accordingly, the USD/INR pair has depreciated by another 1.4% in July and moved above the 74.5 handle. The sharp volatility in oil prices has also weighed on the Rupee, with Brent prices increasing by ~7.5% in June on average compared to May. The return of Foreign Portfolio Investment (FPI) flows aided the Rupee; however, continued intervention by the RBI curtailed any appreciation pressures for the domestic currency as the central bank continued building on its buffers. Going ahead, we expect the Rupee to remain under pressure with volatile oil and commodity prices along with continued market talks of a relatively faster withdrawal of stimulus by major central banks.

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