

## INDIAN ECONOMY

# CRISIL Insights

November 2018

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we highlight the differences in macroeconomic development across major states, as well as contrast them with the national trends as a whole, for fiscal 2018.

## States of growth 2.0

Growth in Indian states does not always tango with the nation's. Fiscal 2018 illustrates this. India's gross domestic product (GDP) growth slipped 40 basis points (bps) to 6.7% that year. But growth in all, save three major states, picked up to surpass the national average.

An annual check on the macroeconomic pulse of 18 key states<sup>1</sup> in fiscal 2018 throws up interesting insights on how their rankings have shuffled since our last report, titled "States of growth", in January 2018. We analysed the states based on three parameters – gross state domestic product (GSDP) growth, fiscal deficit and Consumer Price Index (CPI)-based inflation. Based on their overall macroeconomic performance Gujarat, Karnataka and West Bengal ranked at the top.

Significantly, no state now ranks poorly on all three parameters. All these states have improved on at least one out of the three parameters in fiscal 2018. Also, despite the weaker national GDP growth in fiscal 2018 on-year, some states, including Bihar, Andhra Pradesh, Telangana, Karnataka, West Bengal, and Tamil Nadu, improved and grew faster than the national average.

**Growth:** India's growth slowed in fiscal 2018 partly owing to demonetisation and glitches in Goods and Services Tax (GST) implementation. In contrast, GDP growth for a majority of the states picked up. Among 18 states, only three (Uttar Pradesh, Chhattisgarh, and Jharkhand) recorded GDP growth below the national average and a slowdown from the previous year. Bihar and Andhra Pradesh leapt ahead at double digits, emerging as the fastest growing states.

**Fiscal deficit:** The Centre's fiscal deficit breached the budgetary target of 3.2% of GDP in fiscal 2018 and many states fared no better. 10 of them had fiscal deficit over the Fiscal Responsibility and Budgetary Management (FRBM) Act limit of 3% of GDP. Bihar, Punjab, and Goa were the most fiscally stressed, while Gujarat, Maharashtra, and West Bengal were the least.

**Inflation:** CPI inflation softened across most states in fiscal 2018. While inflation was the lowest in Odisha, it was the highest in Kerala. Interestingly, in most states, inflation fell despite GSDP growth rising – signalling an improving growth-inflation mix.

In a crux, while growth has become more evenly distributed across states, and inflation appears reined in, the fiscal situation remains bothersome.

<sup>1</sup> 18 states classified as 'non-special category' by the RBI have been considered for this analysis

## Money and Banking

Pause amid rise

## Industrial Production

IIP slips lower

## Inflation

Inflation softens

### MONEY AND BANKING

- Interest rates continued to firm up even as the Monetary Policy Committee (MPC) stayed pat in its latest policy meet, indicating progress in the transmission of past rate hikes and tighter liquidity conditions
- For now, the MPC decided to hold the rate to: observe the evolving situation on inflation front and support liquidity in the system, which has come under pressure recently
- Systemic liquidity in the banking space remained slightly constrained despite the Reserve Bank of India (RBI) infusion through open market purchases of securities
- Banking credit continued on its double-digit growth, increasing to 14.6% on-year as on October 26, 2018, up from 13.5% as on September 14, 2018
- As the monetary policy stance has moved from neutral to calibrated tightening, CRISIL believes the RBI can hike the policy rates by another 25 bps this fiscal

### INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) slowed down in September, with growth coming in at 4.5% compared with 4.7% in August
- Slower growth in manufacturing drove down growth in overall IIP, despite faster growth in the electricity sector and a minor uptick in mining
- Specifically, it is the sluggishness in the core sector – or the key infrastructure industry index - that has been dragging down IIP for the past few months
- From an end-use classification, growth in output of capital and intermediate goods tanked, whereas that in construction goods picked up and in consumer and primary goods was fairly stable
- On average, though IIP has posted much stronger growth so far this fiscal (April to September), at 5.2%, compared with 2.6% in the year-ago period

### INFLATION

- Consumer Price Index (CPI)-based inflation softened to 3.3% on-year in October, compared with 3.7% in September, largely due to negative food inflation
- Easing of food inflation indicates ineffective implementation of the increase in minimum support prices (MSP) announced by the government, considering most kharif crops were selling below their MSPs during the month
- In contrast, the Wholesale Price Index (WPI)-based inflation rose 20 bps - to 5.3% on-year from 5.1% in September. Higher fuel and core inflation pushed overall WPI inflation up
- The moderation in CPI inflation may not last for long as a part of it is driven by high statistical base of last year when GST and pay commission hikes by the central government were implemented
- Despite the moderation, core inflation at 5.4% can continue to worry the MPC as with improving domestic demand conditions, manufacturers will pass on higher input costs (from oil and commodity prices) to consumers, which can limit the downside to core inflation
- For fiscal 2019, CRISIL expects CPI inflation to rise to 4.6% from the 3.6% average seen in fiscal 2018

## Interest Rate

Yielding ground

## Rupee

Still bleeding

## Trade

Oil impacts exports

- The bond market exhaled in October as benchmark yields eased following a sharp drop in oil prices and a string of corrective measures by the government and RBI. Yield on the 10-year government security (G-sec)<sup>2</sup> ended October at 7.85%, 17 bps lower on-month
  - The RBI's liquidity support through open market purchases of G-secs for the second consecutive month in October further helped lower the oversupply of government bonds. Investor outlook received a further boost as the RBI announced more open market operations in November
  - This has coincided with a sharp drop in oil prices – ~\$10/barrel during the month – which has helped assuage concerns regarding the health of the economy
  - However, foreign portfolio investors have continued to exit India's debt market, tempted by the rising United States Treasury yields
  - CRISIL expects the 10-year G-sec yield to settle at 7.9% by March 2019 compared with 7.62% in March 2018
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- Mainly propelled by global factors, the domestic currency nosedived during the first half of October, hitting an all-time low of 74.4/\$. However, it recovered a tad during the latter half. Overall, the rupee has depreciated 2% on-month, averaging 73.7/\$ on a stronger greenback and overseas outflow
  - The RBI maintaining a steady policy rate in its October meeting, contrary to market expectations, and absence of policy action to arrest the rupee's fall dented investment sentiment. The rift between the RBI and the government on the issue of the central bank's autonomy also left investors jittery
  - Concerns of fiscal slippage after the central government cut the excise duty on petroleum products to ease the impact of higher crude prices on retail prices also kept investors on edge
  - While the rupee has been falling consistently, CRISIL believes the currency can strengthen to 71/\$ by March 2019 compared with the October average of 73.7/\$
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- Merchandise export growth<sup>3</sup> rebounded 17.9% on-year in October compared with -2.3% previous month. Import growth, too, rose 17.6% versus 10.5%
  - Despite exports growing faster than imports, trade deficit widened. Merchandise trade deficit stood at \$17.1 billion in October, \$3.1 billion higher on-month and \$2.5 billion higher on-year
  - Oil was the key reason behind higher trade deficit. While oil trade deficit was \$3.4 billion higher on-year in October at \$9.7 billion, non-oil trade deficit was \$0.9 billion lower at \$7.5 billion. Not only are oil imports greater than exports in value, but also in terms of growth rate
  - Given the higher merchandise trade deficit, we expect the current account deficit (CAD) to average 2.6% of the GDP this fiscal compared with 1.9% of GDP in fiscal 2018
  - If the recent decline in oil prices sustains, import growth will soften, but export growth still faces headwinds from weaker global trade owing to escalating trade wars

INTEREST  
RATE

RUPEE

TRADE

<sup>2</sup>7.17% GS 2028 paper

<sup>3</sup>All trade figures are in US dollar terms

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**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](http://www.crisil.com)

[in/company/crisil](https://www.linkedin.com/company/crisil) [t@CRISILLimited](https://twitter.com/CRISILLimited) [f/CRISILLimited](https://www.facebook.com/CRISILLimited) [yt/user/CRISILLimited](https://www.youtube.com/user/CRISILLimited) [ig](https://www.instagram.com/lifeatcrisil) Follow us on [@lifeatcrisil](https://www.instagram.com/lifeatcrisil)

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