

# India's Road to Recovery

## Stage set for growth rebound

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### Stage set for growth rebound

**India's economic slowdown is likely to bottom out in FY20 – we expect growth to tick up to 5.5% in FY21 and 6.2% in FY22 spurred by infrastructure spends, funded by strategic sale and divestment of CPSEs. This in turn will induce private sector asset and employment creation. India's young population, competitive service sector, low urbanisation and swift digitisation remain structural growth drivers. Lower corporate taxes and better ease of business should usher in higher corporate savings and thus a self-sustaining growth cycle.**

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**Slowdown to bottom out in FY20:** We believe India's GDP growth will bottom out at 4.8% in FY20 before recovering gradually to 5.5% in FY21. Stronger growth in FY21 would be led by (1) higher government spending backed by strategic divestments, (2) better credit availability in the economy, in particular with NBFCs and, (3) stronger consumption – rural (terms of trade) and tax cuts.

**What's behind the current slump?:** Consumption growth peaked in 2012 and has since decelerated – the current slump is similar to the 1997-2003 downcycle in many ways and has been accentuated by NBFC stress, low corporate profitability (savings), drop in capex by states, muted rural demand and lower global demand.

**How growth will revive...:** We believe higher government infrastructure spending (Rs 103tn pipeline over five years) funded via strategic sale of public sector units and disinvestment will form the bedrock of the capex cycle. This will not only improve productivity but also increase private sector participation and capex in the economy. An accommodative monetary and credit (long-term repo operations) policy should further aid a positive feedback loop.

**...and why:** India's corporate and consumer leverage is lower than other emerging markets. However, general government debt-to-GDP at 67% in FY19 (76% in FY08) is higher than other EMs (average 55%). Private sector efficiency ratios are higher which will induce a productivity-led growth cycle.

**Structural trends favourable:** India has key advantages in the form of (1) scope for urbanisation (34% in 2018 vs. 66.4% for the world) and hence urban housing (urban house ownership at 69%), (2) a relatively young population (avg. 29 years) and addition to the labour force (workforce participation rate 46.8% vs. 60% for G20), (3) movement of workers from agriculture to manufacturing and services, (4) digitisation, and (5) low corporate leverage (53% in 2018 vs. 161% in China).

### KEY HIGHLIGHTS

- India's GDP growth expected to recover from 4.8% in FY20 to 5.5%/6.2% in FY21/FY22
- Structural drivers such as urbanisation, good demographics and digitisation to aid recovery
- Accommodative fiscal and monetary policy will further stimulate growth



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## GROWTH OUTLOOK

We expect gradual recovery in India's GDP growth to 5.5% in FY21 and 6.2% in FY22. While this cyclical upturn is likely to be spurred by stabilisation of general government revenues (following the corporate tax cut) and better credit availability with NBFCs, we believe structural drivers in the Indian economy will take growth higher on a sustained basis. Government infrastructure spending funded by disinvestment will lend added impetus.



## Growth outlook: Expect rebound in FY22

### Cyclical slowdown to bottom out in FY20

India's GDP growth is exhibiting a cyclical slowdown and is en route to a decadal low of 5% in FY20, as per Advance Estimates of CSO and RBI estimates. We peg growth even lower at 4.8% before a gradual recovery in FY21, albeit with a continued sub-6% print.

The current slowdown is due to a mix of domestic and global factors. While exports have fallen due to lower global demand (-2% in FYTD20 vs. 9.3% in FY19), domestic demand has been sapped by lower liquidity with NBFCs and a cutback on capital spending by state governments (5.7% in FYTD20 vs. 16.9% in FY19). MSMEs have been hit hard by the current slowdown in the auto sector, while depressed real estate sales and reduced state-level capex have exerted pressure on the construction sector.

### Reforms to aid gradual pullback next year

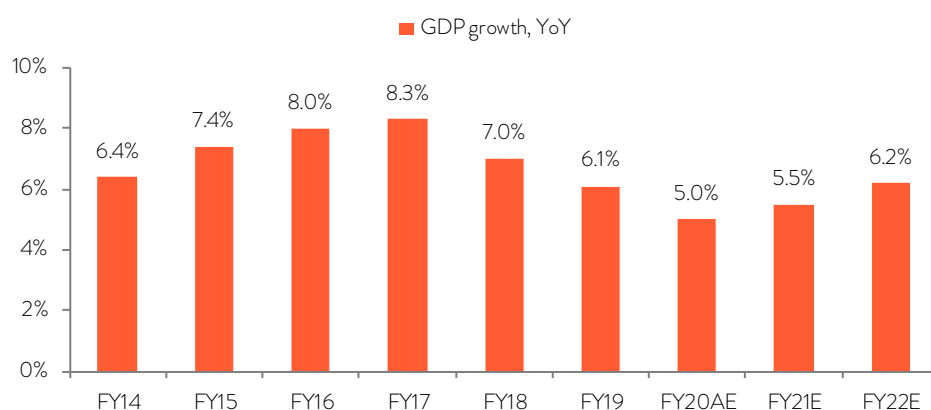
Recovery is likely to be visible from next year, in our view. Global demand should pick up supported by monetary easing in major economies, easing US-China trade tensions with the Phase 1 accord in place, and Britain's exit from the EU on 31 Jan 2020 – suggesting that global growth may have bottomed out. This will aid an exports revival. Our research shows a strong correlation between exports and global demand. While global growth is likely to be soft in the near term due to the coronavirus impact, global trade and output should pick up in H2FY21.

We expect domestic demand to also recover as more liquidity is being made available to non-banking (NBFC) and housing finance companies (HFC). Government revenues too are likely to pick up next year after the corporate tax cut in Sep'19. The maximum impulse to growth will come from (1) the government's reform initiatives to improve the ease of doing business and to increase private sector participation (via strategic divestments and higher public-private infrastructure investments), as well as (2) underlying structural drivers.

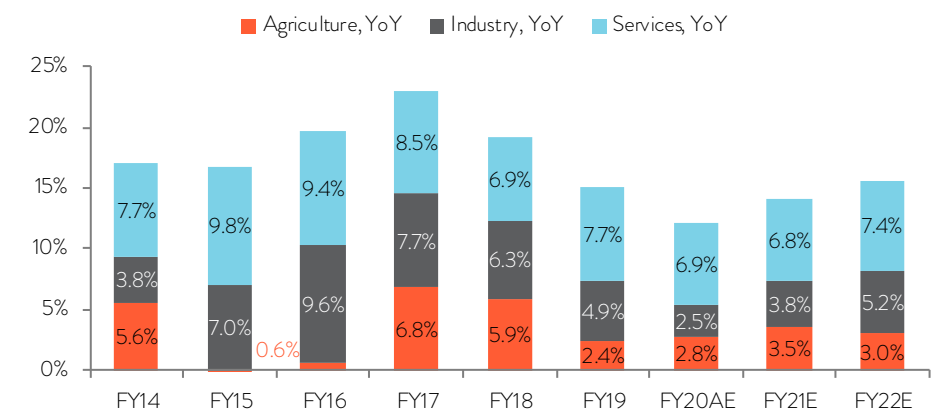
### Structural story intact; reforms to push growth higher

India remains favourably placed in comparison to G20 economies on a number of structural parameters, discussed in detail later in this report, such as (1) demographic dividend with respect to addition to work force, (2) increase in urbanisation and thus urban house ownership, (3) relatively lower level of consumer credit to GDP, (4) digitisation, (5) household savings, and (6) deleveraging of the corporate sector.

Private sector participation in the economy will increase after the record disinvestment and strategic sale program (Air India, Container Corporation and BPCL) being undertaken by the government at Rs 2.1tn (0.9% of GDP), including the IPO of LIC in FY21. Private sector return ratios (PAT/ Net Worth) are also expected to improve on the back of (1) reduction in corporate tax rate and (2) elimination of DDT paid by companies. This gives us confidence that growth will retrace above 6% in FY22 before climbing higher in FY23.

**FIG 1 – GDP GROWTH TO RECOVER TO 5.5% IN FY21E AND 6.2% IN FY22E**


Source: CSO, MOSPI, Bank of Baroda Research | Note: AE - Advanced estimate, E - Bank of Baroda estimate

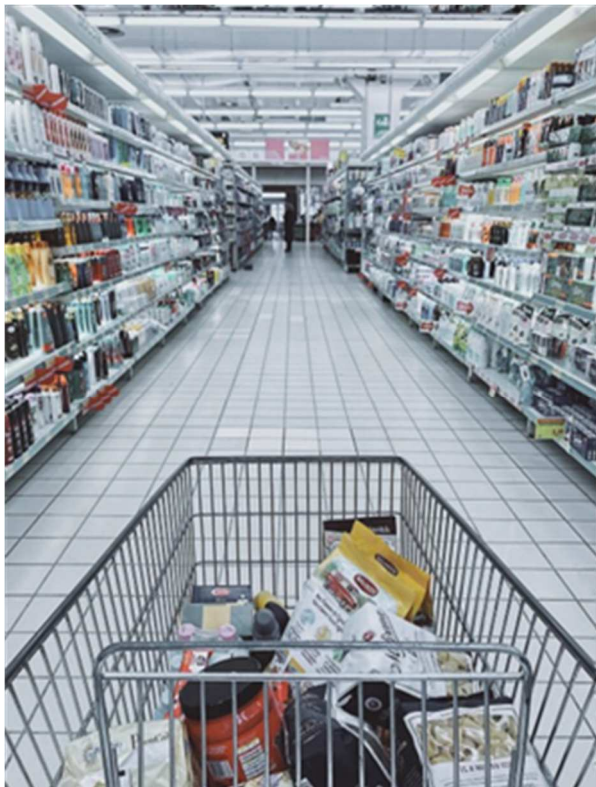
**FIG 2 – ...LED BY REVIVAL IN INDUSTRIAL SECTOR**


Source: CSO, MOSPI, Bank of Baroda Research | Note: AE - Advanced estimate, E - Bank of Baroda estimate

**FIG 3 – COMPONENTS OF GDP GROWTH**

(% change)	FY17	FY18	FY19	FY20AE	FY21E	FY22E
Private final consumption expenditure (PFCE)	8.1	7.0	7.2	5.8	6.3	6.4
Govt. final consumption expenditure (GFCE)	6.1	11.8	10.1	10.5	9.0	7.0
Gross Fixed Capital Formation (GFCF)	8.5	7.2	9.8	1.0	5.0	6.0
Change in stocks (CIS)	(48.8)	76.0	22.5	2.3	4.4	4.4
Valuables	(18.6)	27.2	(11.9)	13.5	2.4	3.5
Exports	5.0	4.6	12.3	(2.0)	5.0	5.0
Less Imports	4.4	17.4	8.6	(5.9)	4.3	5.0
<b>GDP</b>	<b>8.3</b>	<b>7.0</b>	<b>6.1</b>	<b>5.0</b>	<b>5.5</b>	<b>6.2</b>

Source: CSO, MOSPI, Bank of Baroda Research | Note: AE - Advanced estimate, E - Bank of Baroda estimate



## CONSUMPTION

India's consumption growth has slumped to 7% in H1FY20 from 12% in FY19, as evident from faltering auto sales and lower non-oil, non-gold and electronic imports. Our analysis of key economic indicators over the last four consumption cycles suggests a far deeper slowdown this time around – accentuated by the NBFC/HFC liquidity crunch and muted rural demand.

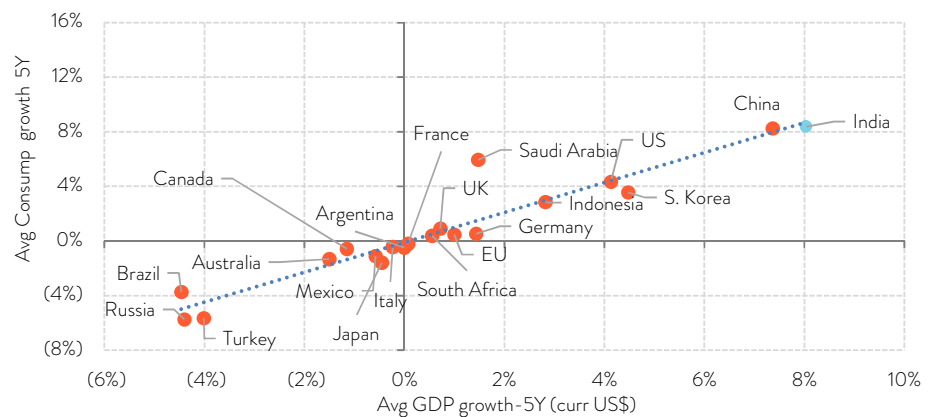
## Consumption: The weak link

### Demand in the doldrums

During 2014-18, India was the fastest growing economy amongst G20 countries, backed by a consumption engine that was accelerating at an average rate of 8.4% in nominal USD terms. Only China came close to India's consumption growth. The share of private consumption in India's nominal GDP thus increased to 59% in FY18 from 57.6% in FY14.

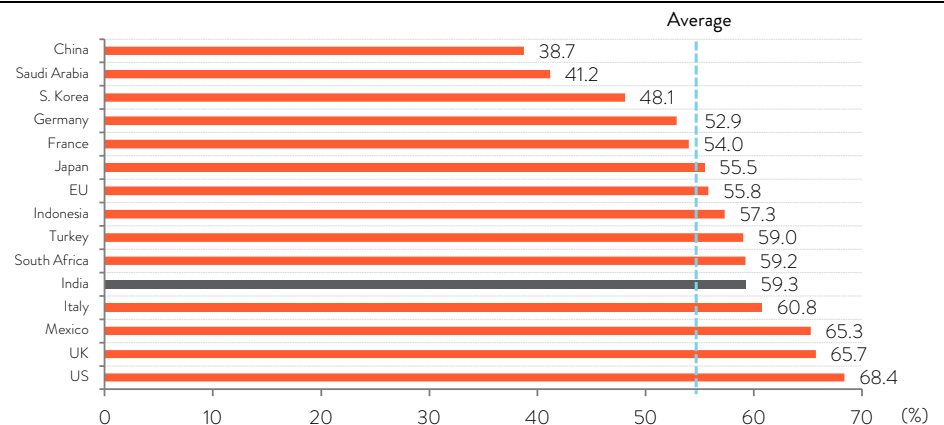
However, the stellar growth run slowed last year as both investment and consumption weakened. Consumption growth has fallen to 7% in H1FY20 from 12% in FY19 in nominal rupee terms. The government's advance estimates for FY20 peg nominal and real consumption growth at 9% and 5.8% respectively.

**FIG 4 – CONSUMPTION HAS BEEN A KEY DRIVER OF INDIA'S GROWTH**



Source: World Bank, MOSPI, Bank of Baroda Research

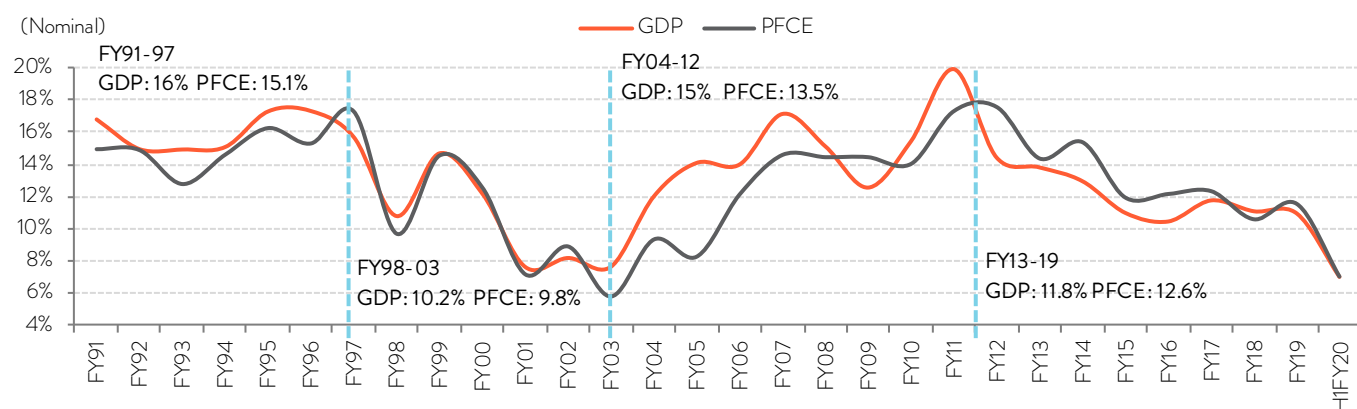
**FIG 5 – PRIVATE CONSUMPTION EXPENDITURE AS % OF GDP, 2018**



Source: World Bank, Bank of Baroda Research | Note: Average expenditure share: 56.1% of GDP | Data for India pertains to FY18



Statistically speaking, India has seen four consumption cycles since 1991, divided between two upcycles and two downcycles, lasting eight years on average. The trend in high frequency indicators (capital goods, consumer goods, steel, cement, credit) over these periods suggests a far deeper slowdown in the current cycle. The slump in consumption demand has accelerated since H2FY19 as visible in falling auto sales and lower non-oil, non-gold and electronic imports and has continued in H2FY20.

**FIG 6 – CONSUMPTION AND GDP HAVE VERY HIGH CORRELATION IN INDIA**


Source: CEIC, Bank of Baroda Research

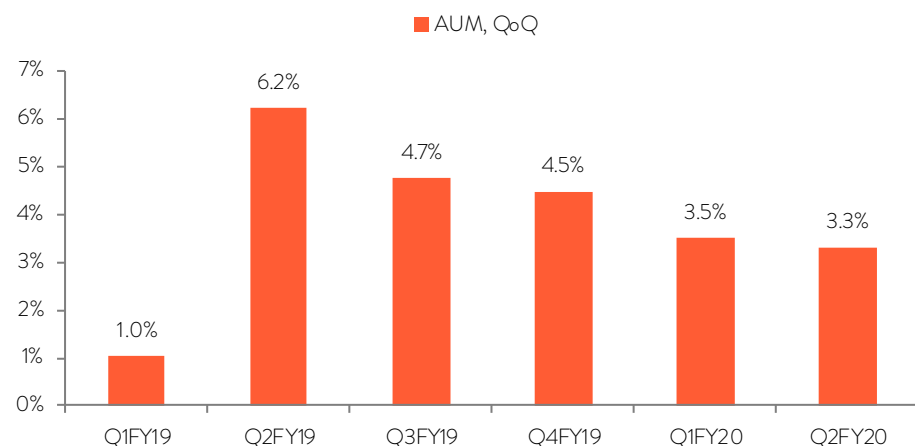
**FIG 7 – HIGH FREQUENCY INDICATORS SHOW SHARP DOWNTURN IN CURRENT CYCLE**

(Sectors %)	FY91-97	FY98-03	FY04-12	FY13-19	FYTD20
Capital Goods	3.7	5.7	17.0	0.3	(12.3)
Consumer Durable	8.8	7.9	17.0	3.5	(6.6)
Consumer Non-Durable Goods	5.8	5.2	6.2	5.0	2.8
Steel Output	3.2	(6.6)	4.5	5.8	5.2
Cement Output	2.2	(6.3)	4.6	5.7	0.7
Credit Growth	15.3	16.7	23.7	11.6	9.5
Cargo Handled	6.3	5.6	6.8	3.3	1.1

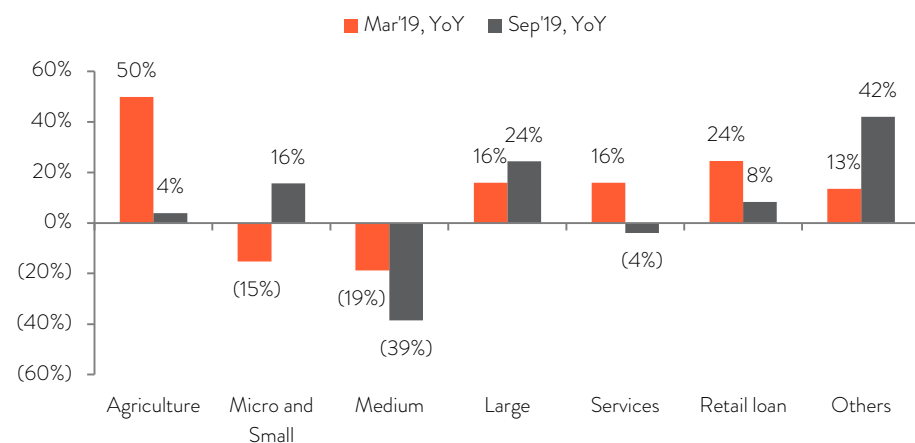
Source: Economic Survey, RBI, CEIC, Bank of Baroda Research

### Lack of credit partly explains soft demand

We note an interplay between the decline in consumption and credit availability in India. Assets under management (AUM) at NBFCs have been steadily decelerating in the last few quarters. Though banks have continued to disburse loans to the retail sector, NBFCs have curtailed lending sharply – not just to retail, but to agriculture and mid-industry segments as well. The resultant dearth of credit in H1FY20 has stifled demand.

**FIG 8 – AUM OF NBFCs SLIPPING**

Source: Annual Report, Bank of Baroda Research

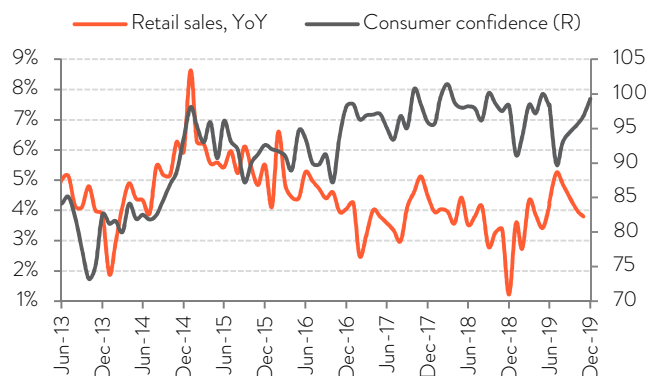
**FIG 9 – NBFC LENDING HAS DECLINED IN SOME POCKETS**

Source: RBI, Bank of Baroda Research

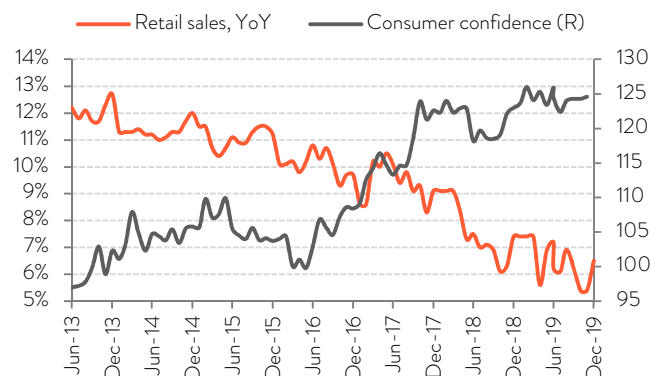
## Global markets also battling weak consumption

The consumption slowdown is not unique to India. Retail sales have been trending down in China for a while now accentuated by the US-led trade tensions. US retail sales are holding up but consumer confidence, an early indicator of consumer demand, had plunged since Dec'18 – it has, however, picked up in the last few months. In the EU, we note worrying signs of slowdown with both consumption and retail sales faltering in recent months. In the case of India, consumer confidence has fallen further to 83.7 in Jan'20.

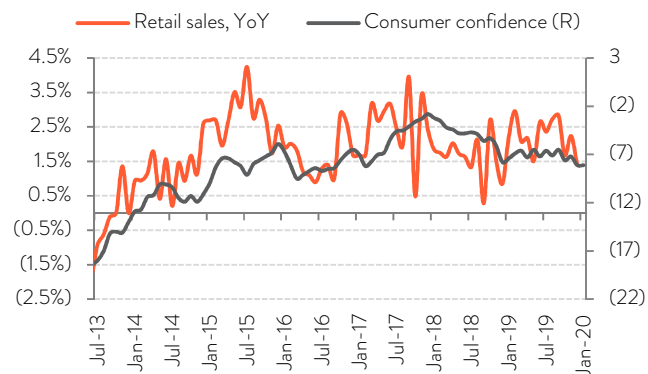
The downturn in retail sales is most visible in auto demand. Even in countries where retail sales show an uptick, auto volumes continue to trend down, implying negative shifts in underlying structural drivers such as demographics, consumer behaviour and usage patterns of public/shared transport. In the US, auto sales have slipped by (-) 1.2% in 2019 from growth of 0.9% in 2018. Notably, in China, the decline in auto sales has worsened from (-) 4.3% in 2018 to (-) 9.5% during 2019.

**FIG 10 – EARLY SIGNS OF RECOVERY IN US CONSUMPTION**

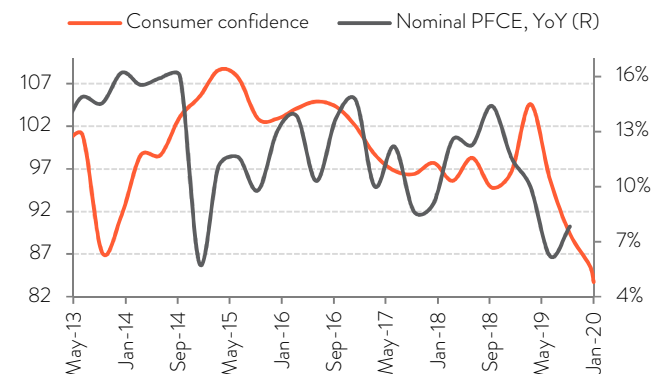
Source: Bloomberg, Bank of Baroda Research

**FIG 11 – SIMILAR TREND IN CHINA**

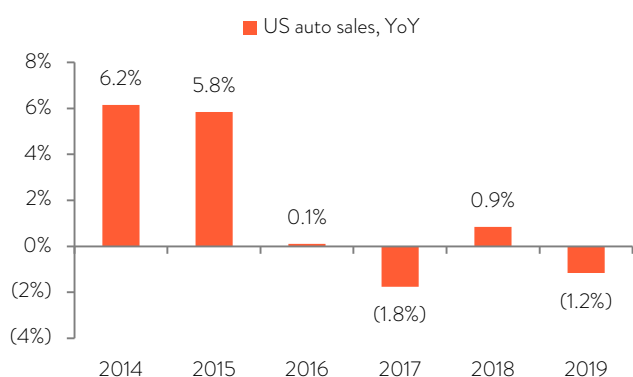
Source: Bloomberg, Bank of Baroda Research

**FIG 12 – CONSUMER CONFIDENCE FALTERING IN EU...**

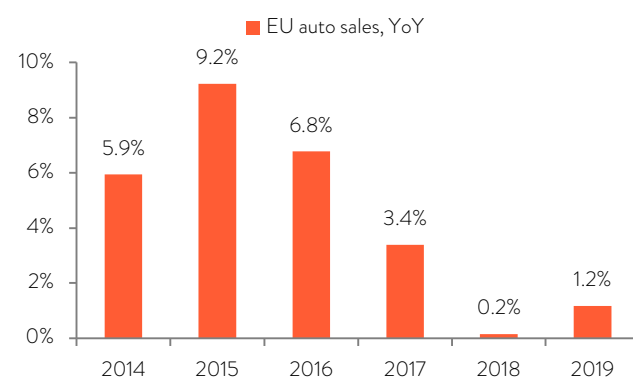
Source: Bloomberg, Bank of Baroda Research

**FIG 13 – ...SLUMPS IN INDIA**

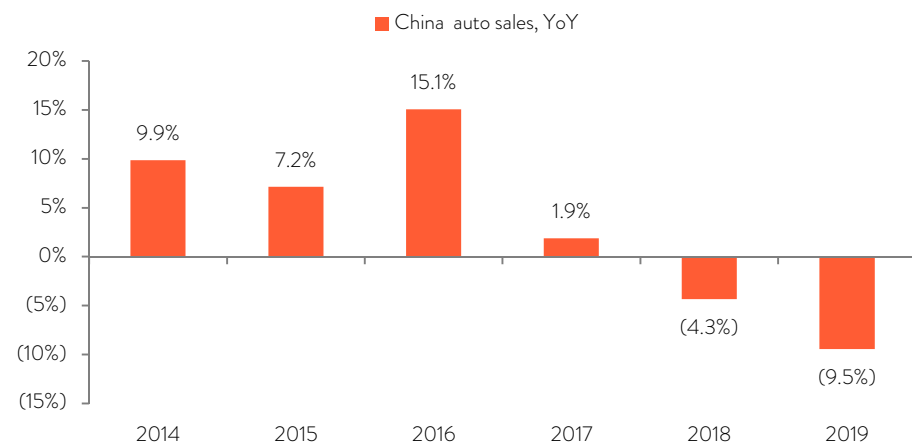
Source: CEIC, Bank of Baroda Research

**FIG 14 – DECLINE IN US AUTO SALES...**

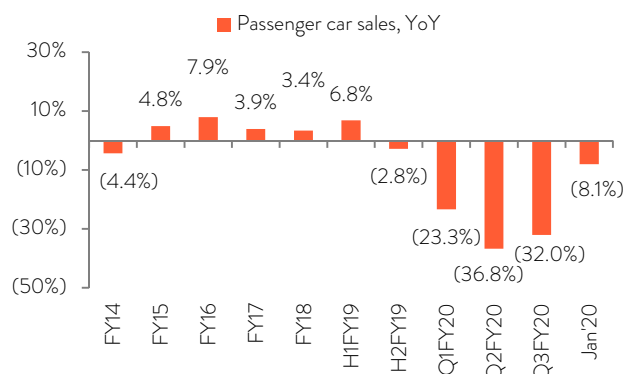
Source: Bloomberg, Bank of Baroda Research

**FIG 15 – ...SURPRISE IMPROVEMENT IN EU SALES**

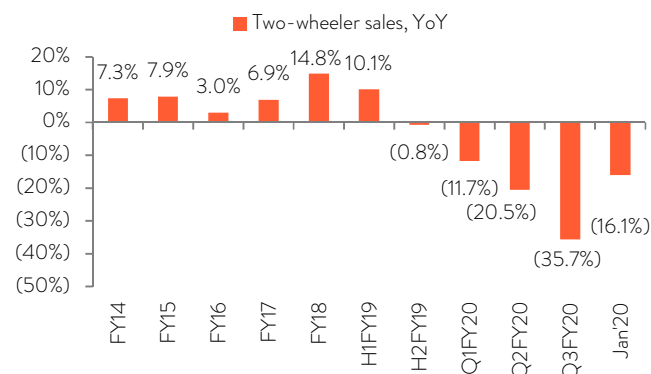
Source: Bloomberg, Bank of Baroda Research

**FIG 16 – AUTO SALES IN CHINA CONTINUE TO CONTRACT FURTHER**

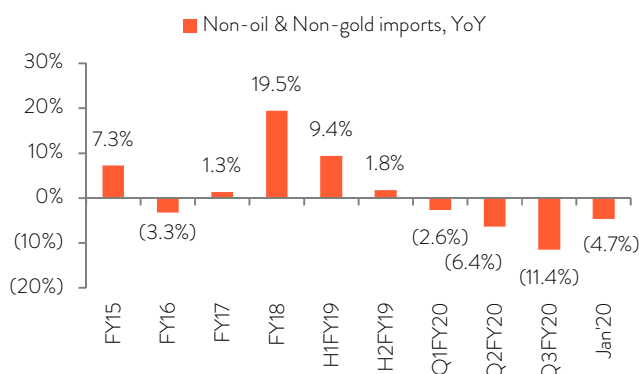
Source: Bloomberg, Bank of Baroda Research

**FIG 17 – INDIA'S PASSENGER CAR SALES HAVE PLUNGED...**

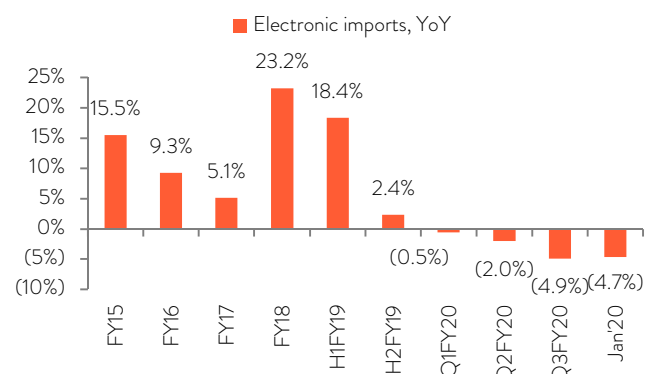
Source: CEIC, Bank of Baroda Research

**FIG 18 – ...AS HAVE TWO-WHEELER SALES**

Source: CEIC, Bank of Baroda Research

**FIG 19 – WEAKNESS IN INDIA'S NON-OIL, NON-GOLD IMPORTS...**

Source: CEIC, Bank of Baroda Research

**FIG 20 – ...AS ALSO ELECTRONIC IMPORTS**

Source: CEIC, Bank of Baroda Research



## INVESTMENT

India's corporate investment is far below most high-growth Asian economies, partly due to weak corporate savings. Reduction in DDT and corporate tax will increase savings. General government investment in India is far higher. With disinvestments and strategic stake sales on the cards, private capex should increase and the government will garner revenue for infrastructure spends. Cyclically, states will be in a better position to spend in FY21 once tax collections improve.



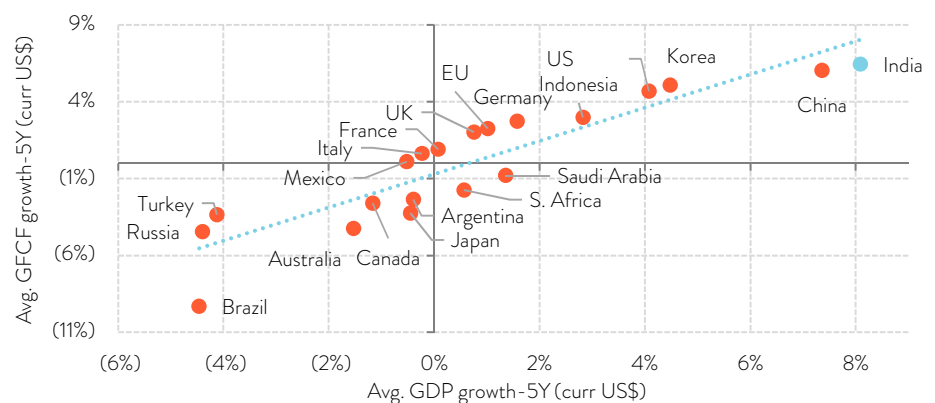
## Investment: On a downcycle

### High nominal rates, limited fiscal space

India's investment growth is facing a slowdown in-line with G20 countries despite a comfortably higher growth rate in the past five years (averaging 8% in current USD terms). Higher nominal rates, muted demand and limited fiscal space have impinged on the country's corporate sector, household (especially residential) and general government investment. The twin balance sheet problem (corporate and banks) has also hobbled corporate investment, though IBC may partly remedy this.

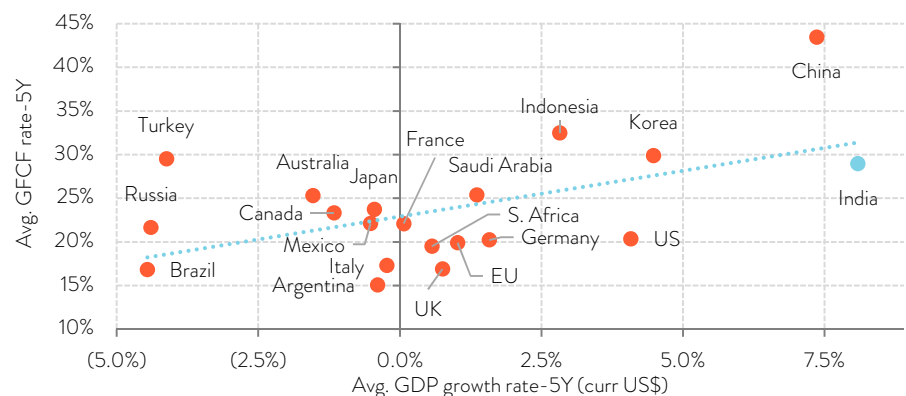
Apart from consumption, investment has an equally strong role in driving India's growth. Over 2014-18, India has clocked one of the highest growth rates in investment among G20 countries. Once again, China is the only country that comes close on this metric. However, China has a very high investment rate as a percentage of GDP at 42.6% compared with 29.4% for India. Other Asian countries that are ahead of India are Indonesia (32.3%), Korea (30.1%) and Turkey (29.7%). Notably, investment rates in China and India have both declined by 270bps and 110bps respectively in the past five years.

**FIG 21 – INVESTMENT RATE AND GDP GROWTH POSITIVELY CORRELATED**



Source: World Bank, Bank of Baroda Research

**FIG 22 – CHINA HAS THE HIGHEST INVESTMENT RATE**

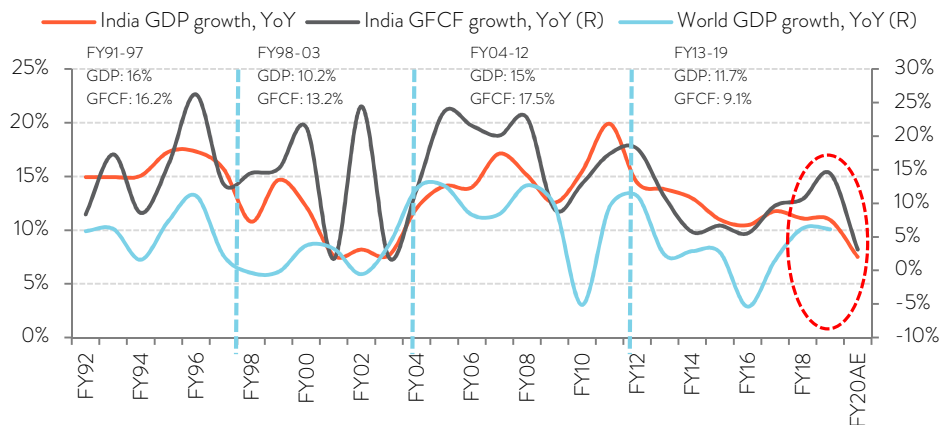


Source: World Bank, Bank of Baroda Research

## India's growth and investment cycle move in tandem

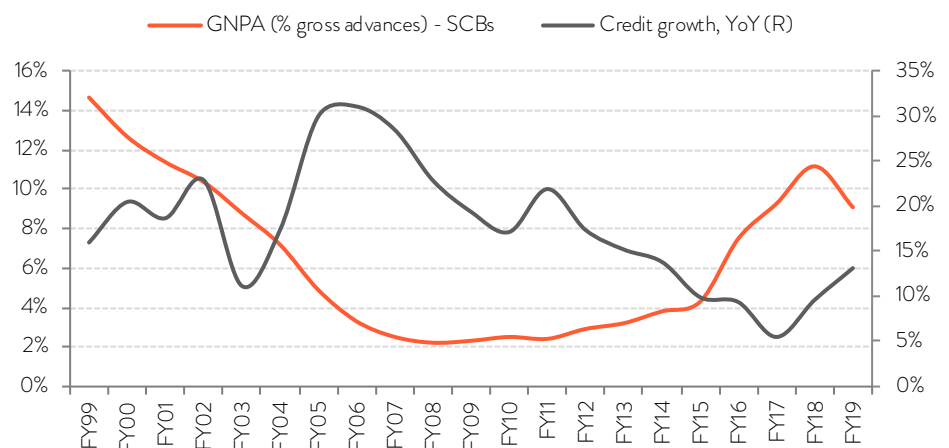
In the current cycle (FY13-19), average investment in India has increased by 9.1% alongside an 11.7% increase in nominal GDP (in current rupee terms). We note that both metrics have increased at a slower pace than in the previous three cycles, in part due to lower global growth and banks' elevated NPAs.

**FIG 23 – INDIA'S GROWTH AND INVESTMENT CYCLE IN CONSONANCE WITH GLOBAL GROWTH**



Source: World Bank, CEIC, Bank of Baroda Research | Note: India's GDP & GFCF growth in nominal rupee terms & World GDP growth in current US\$ terms | AE: Advance Estimate

**FIG 24 – ELEVATED GNPA RATIO A KEY REASON FOR MUTED INVESTMENT DEMAND IN INDIA SINCE FY14**



Source: RBI, Bank of Baroda Research | Note: SCB – Scheduled Commercial Banks

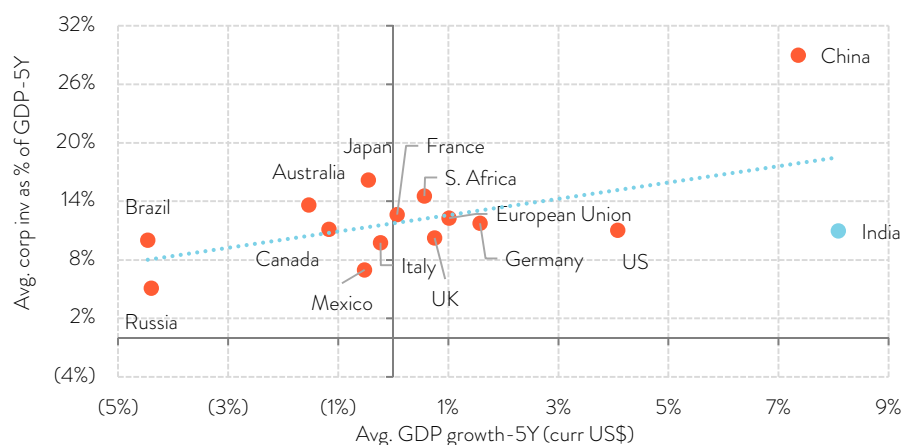
## Drivers of investment demand: India vs. global peers

### Corporate investment – relatively low share

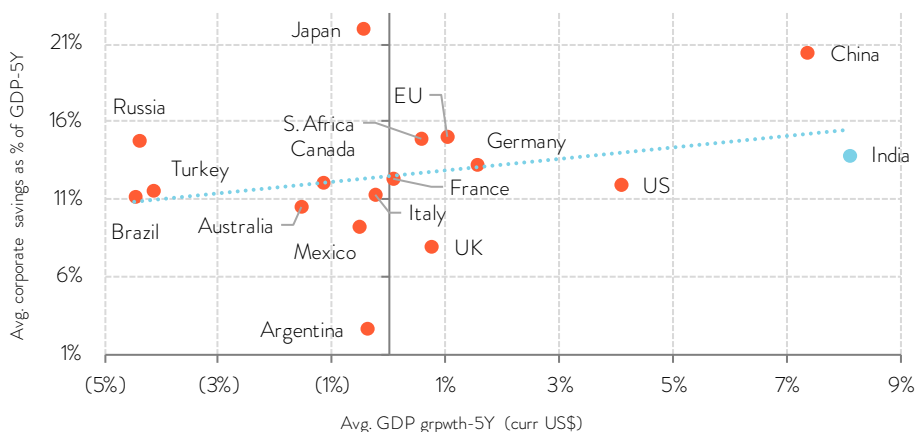
We observe divergent global trends with regard to drivers of investment spending. Countries such as China, Japan and South Africa have a higher share of corporate investment (29%, 16% and 14% respectively) as a percentage of GDP. For China and Japan, this rate has improved by 40bps and 90bps respectively over the last five years. In India's case, corporate investment (average FY15-19) is far lower at 10.9% of GDP and has fallen by 120bps since FY14. The slowdown in private capex has been far more intense in last three years with CAGR of 7% compared with CAGR of 13.8% between FY13-16.

The country's relatively weaker corporate investment can be explained by 1) lower corporate savings, 2) poor capacity utilisation levels (69% in Q2FY20) and 3) high corporate sector NPLs. While soft aggregate demand implies firms prefer to wait for demand to pick up before investing more, India's relatively high nominal rates also hurt corporate capex. Recent decision by government to reduce corporate tax and abolish dividend distribution tax (DDT) will be helpful in improving corporate profitability and nudge firms to reinvest.

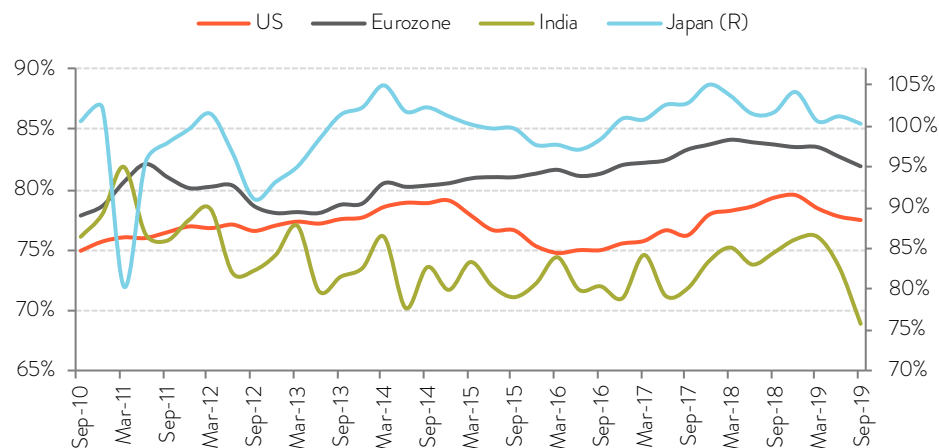
**FIG 25 – CORPORATE INVESTMENT AND GDP GROWTH – CHINA OUTPERFORMS; INDIA BELOW AVERAGE...**



Source: World Bank, OECD, Bank of Baroda Research

**FIG 26 – ...AS CORPORATE SAVINGS IN INDIA ARE LOWER...**

Source: World Bank, UNSTATS, Bank of Baroda Research

**FIG 27 – ...AND INDIA'S CAPACITY UTILISATION IS ALSO FAR LOWER AT 69%**

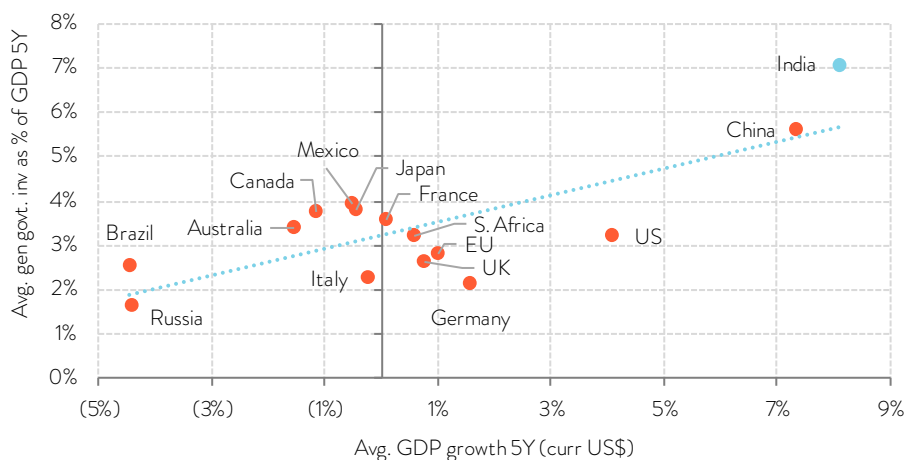
Source: Bloomberg, RBI, Bank of Baroda Research

### General government investment – driving investments in the past

In India's case, general government investment is an important driver with a share of 7% in GDP in the last five years. This figure is relatively lower for other major countries such as the US (3.2%), China (5.6%) and Japan (3.8%). The Centre recently announced Rs 103tn infrastructure pipeline for the next five years which is further aimed at bolstering investment spending in the country.

Recent revival in planned central government capex to Rs 4.1tn in FY21, up by 18.1% as against 13.4% growth in FY20, is also a step in this direction. Central government enterprises will lend support with investments pegged at Rs 7.1tn in FY20 and Rs 6.7tn in FY21, significantly higher than the Rs 3.1tn seen five years ago.

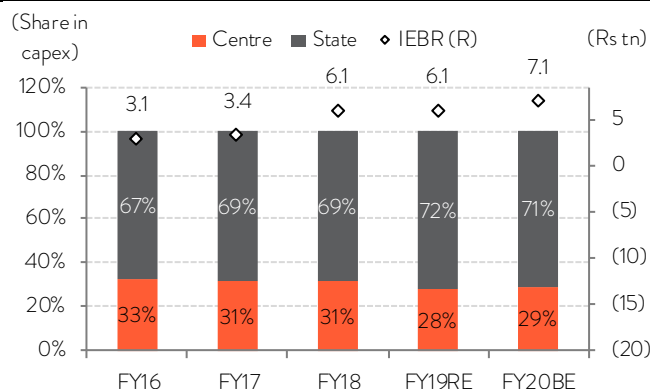
**FIG 28 – GENERAL GOVERNMENT INVESTMENT AND GDP GROWTH – GOVT. A PRIME DRIVER OF INVESTMENT DEMAND IN INDIA**



Source: World Bank, OECD, Bank of Baroda Research

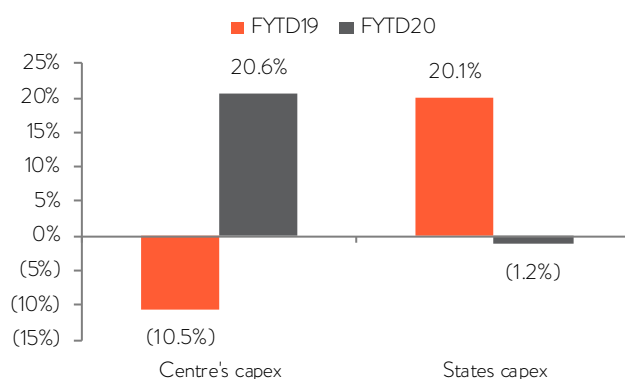
Despite higher spending by Central government, capital expenditure is likely to take a hit because of muted spending by state governments. This is because, states have a bigger share in capex at 71% compared with the Centre at 29%.

**FIG 29 – HIGHER STATE GOVERNMENT SHARE IN CAPEX...**



Source: RBI, Union Budget, Bank of Baroda Research| Note: IEBR – Internal and Extra Budgetary Resources

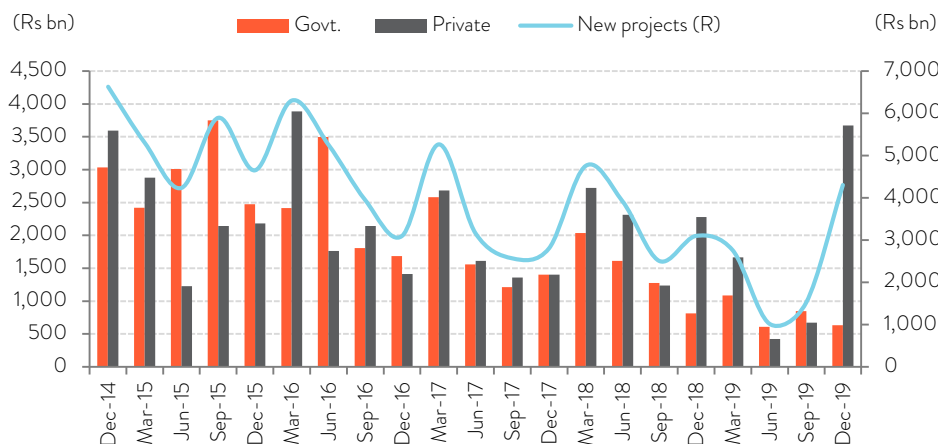
**FIG 30 – ...BUT STATE CAPEX HAS SLUMPED IN FYTD20**



Source: CEIC, Bank of Baroda Research| Note: FYTD: Apr-Dec

After weakness seen in the past few quarters, private capex increased in Dec'19. However, most of it was driven by two mega projects – Indigo's aircraft acquisition worth Rs 2.3tn and Reliance Industries' Jamnagar refinery expansion worth Rs 0.7tn. Government sector project announcements decelerated in Dec'19 as muted tax collections constrained revenues. Given the current low capacity utilisation, private sector capex is unlikely to revive in the near future. But government has taken requisite steps to revive corporate profitability through tax reduction which will improve corporate capex in the medium term.

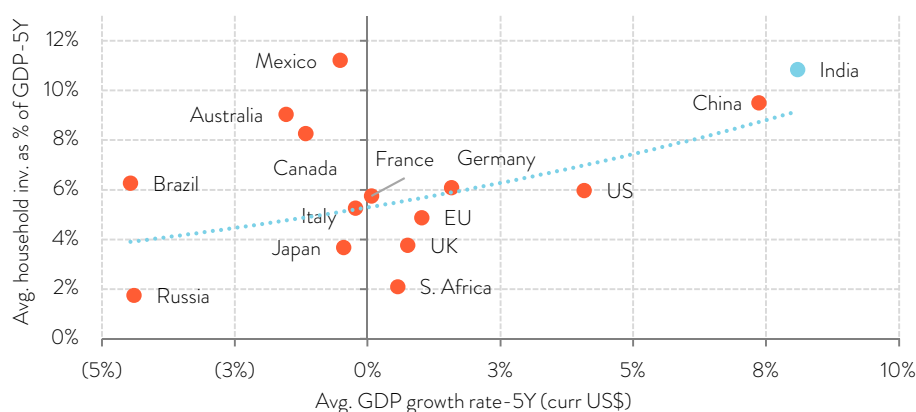


**FIG 31 – BOTH GOVERNMENT AND PRIVATE CAPEX WEAK FOR THE PAST FEW QUARTERS, BARRING TEMPORARY SPIKE IN PVT. SPENDING IN DEC'19**


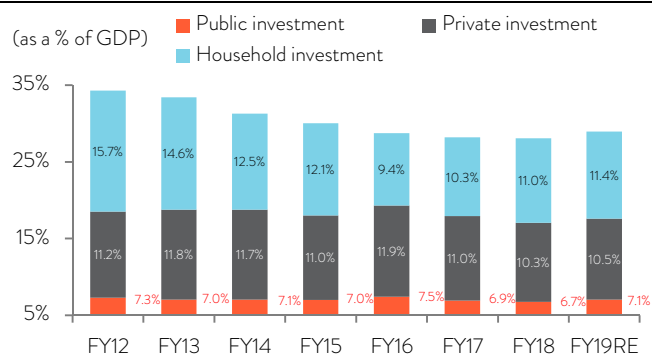
Source: CMIE Capex, Bank of Baroda Research

### Household investment – a large contributor

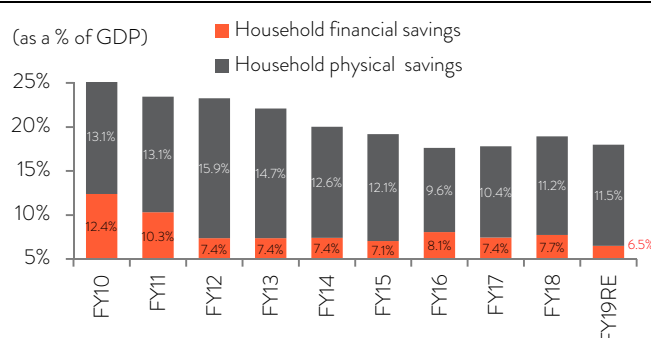
For India, household investment is a key component of investment (39% of overall investment). It is also a key driver of growth, logging a higher CAGR of 9.4% (FY14-19) compared with other large economies such as the US (6%) and Japan (3.7%). Household investment in China also comes close to India at 9.5%. However recently, the share of households in India's total investments has fallen from 15.7% in FY12 to 11.4% in FY19. However, over the last three years household investments have increased at a CAGR of 16.8% compared with a (-) 4% CAGR over FY14-16.

**FIG 32 – HOUSEHOLD INVESTMENT AS % OF GDP FAIRLY HIGH FOR INDIA**


Source: World Bank, OECD, Bank of Baroda Research

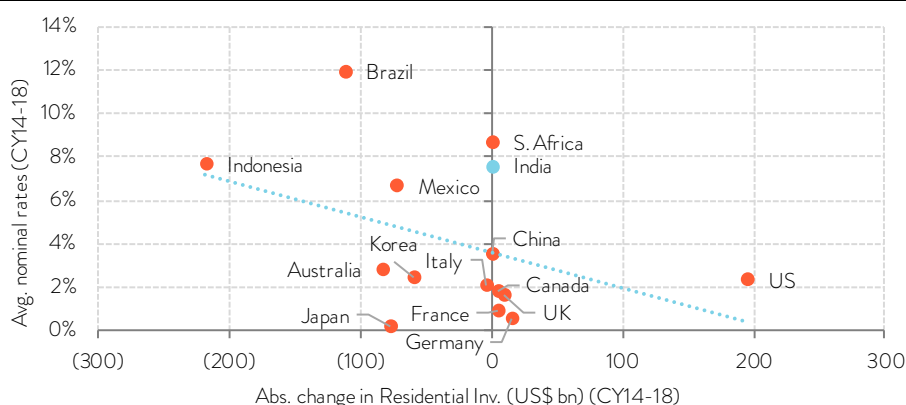
**FIG 33 – INDIA'S HOUSEHOLD INVESTMENT EDGING DOWN OFF LATE...**

Source: CEIC, Bank of Baroda Research | Note: RE: Revised Estimate

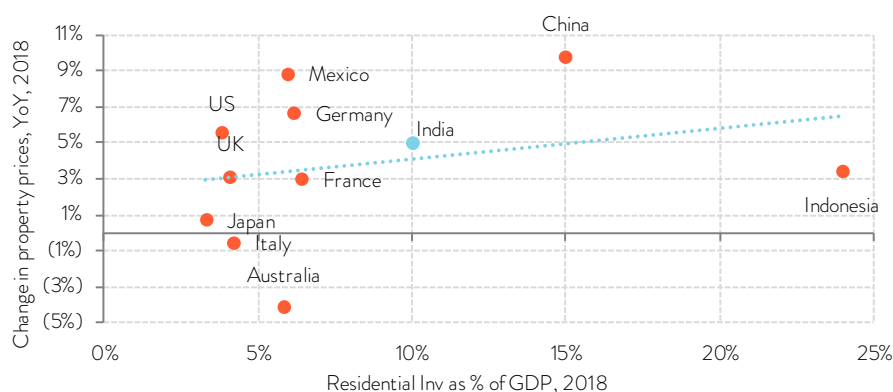
**FIG 34 – ... PHYSICAL SAVINGS HAVE PICKED PACE BUT FINANCIAL SAVINGS HAVE FALLEN SHARPLY**

Source: CEIC, Bank of Baroda Research | Note: RE: Revised Estimate

Residential investment by households has picked up since FY17 onwards. This was largely driven by government measures to boost affordable housing such as slashing of GST rates 5% to 1% and PMAY (Pradhan Mantri Awas Yojana). However, there remains scope for further revival in demand as monetary transmission improves and home loan rates soften (further details on Page 39: India's structural drivers intact).

**FIG 35 – INDIA'S RESIDENTIAL INVESTMENT STAGNANT DUE TO HIGHER NOMINAL RATES**

Source: OECD, Bloomberg, Bank of Baroda Research | Note: 10Y Yield is taken as nominal rates, China's residential investment data is taken from IMF working paper-The long run trend of residential investment in China

**FIG 36 – PROPERTY PRICES AND RESIDENTIAL INVESTMENT AS A PERCENTAGE OF GDP**

Source: OECD, BIS, Bloomberg, CEIC, Bank of Baroda Research | Note: We use the Property Price Index for China and HPI from RBI for India; physical savings is used as a proxy for residential investment for India



## FISCAL SPACE

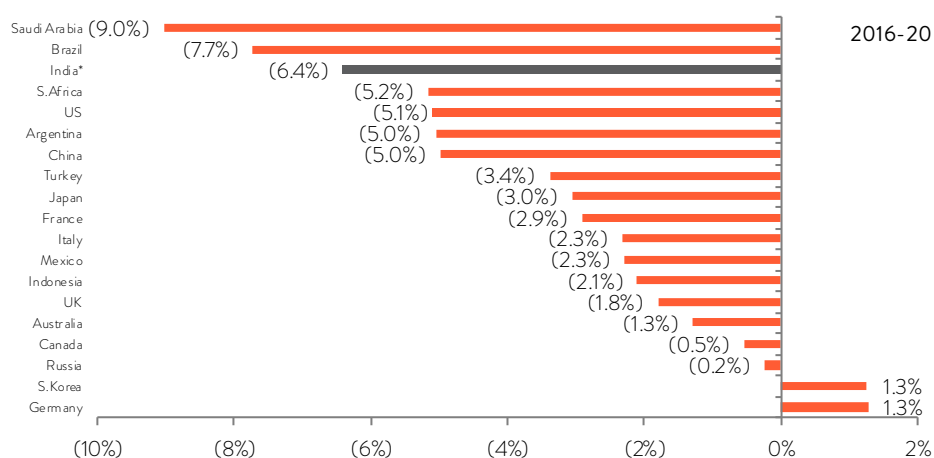
India has the third highest fiscal deficit amongst G20 countries – at 6.8% of GDP in FY20 and 6.3% budgeted for FY21. A quarter of revenue is spent on interest payments – higher than G20 and other EMs. General government debt-to-GDP ratio at 67% is also higher than EMs (55%). Large repayments in the next five years further limit room for the government to expand fresh borrowing.

## Constrained fiscal policy space

### India's fiscal deficit the third largest globally

Amid the current economic slowdown, one of the most common arguments made in favour of revitalising growth is to allow expansionary fiscal policy. But the bigger question is whether there is enough room for fiscal expansion. After Saudi Arabia and Brazil, India has the highest fiscal deficit amongst G20 countries – at 6.8% of GDP in FY20 and 6.3% budgeted for FY21.

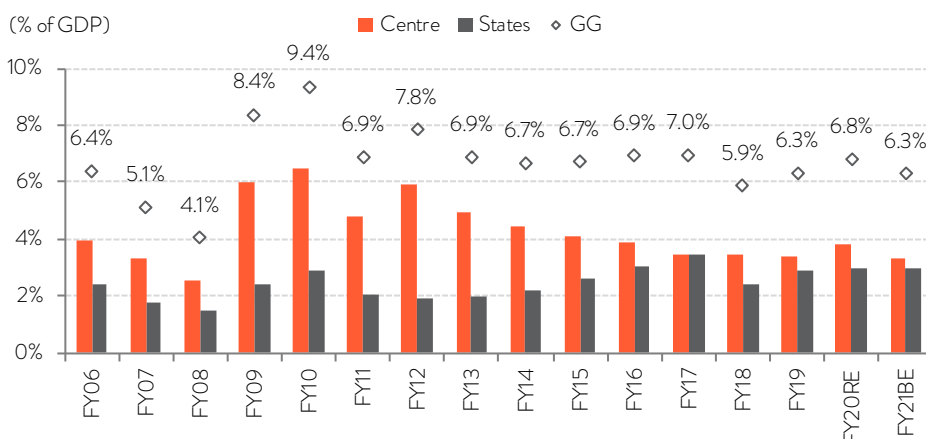
**FIG 37 – GENERAL GOVERNMENT (CENTRE+STATE) FISCAL DEFICIT AS % OF GDP – INDIA AMONGST THE HIGHEST**



Source: IMF fiscal monitor estimates, RBI, Union Budget of India, Bank of Baroda Research | \*CY20=FY21

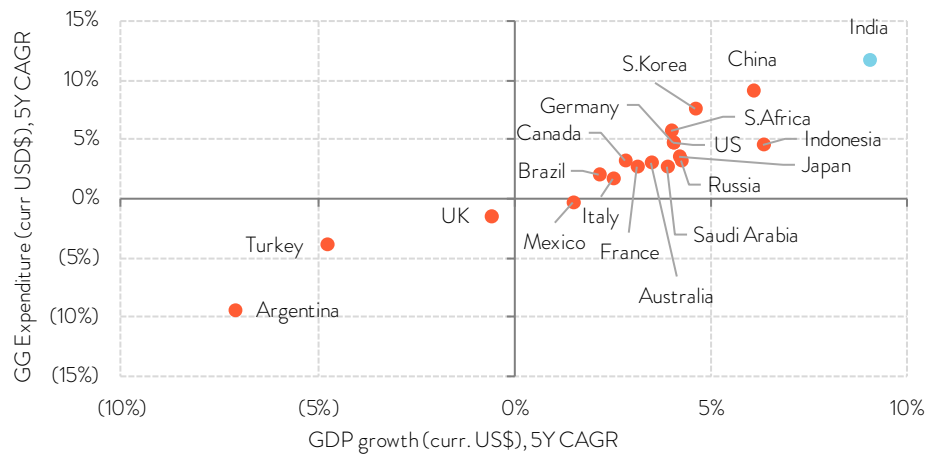
While the Centre has striven for fiscal consolidation in recent years, this has been offset by rising deficits of states. Despite the Centre's discipline, general government (GG) spending has increased robustly at 10.7% CAGR over 2016-20 in USD terms, thus providing support to growth.

**FIG 38 – CENTRAL GOVERNMENT CONSOLIDATING FISCAL DEFICIT BUT STATES EXPANDING – KEEPING OVERALL DEFICIT UNCHANGED**



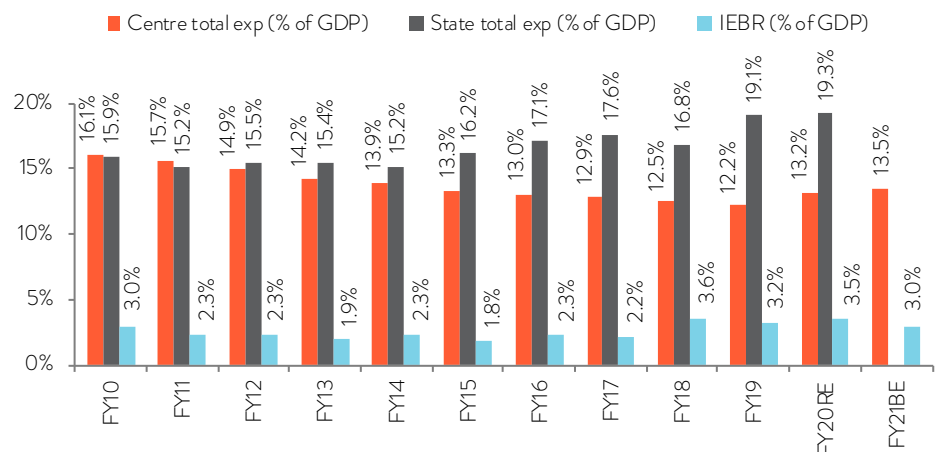
Source: RBI, Union Budget of India, Bank of Baroda Research | Note: RE-Revised Estimates, BE-Budget Estimates; BoB estimates for state fiscal deficits in FY20RE and FY21BE

**FIG 39 – GENERAL GOVERNMENT SPENDING A KEY CONTRIBUTOR TO HIGHER GDP GROWTH IN INDIA**



Source: IMF fiscal monitor, Bank of Baroda Research

**FIG 40 – STATES SUPPORTING GENERAL GOVERNMENT SPENDING IN INDIA**

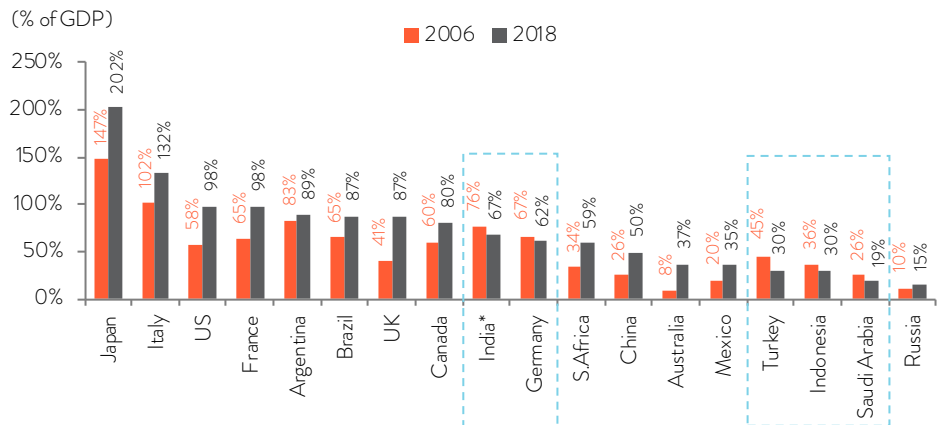


Source: RBI, Union Budget of India, Bank of Baroda Research | Note: RE-Revised Estimates, BE-Budget Estimates; FY20RE=FY20BE for states

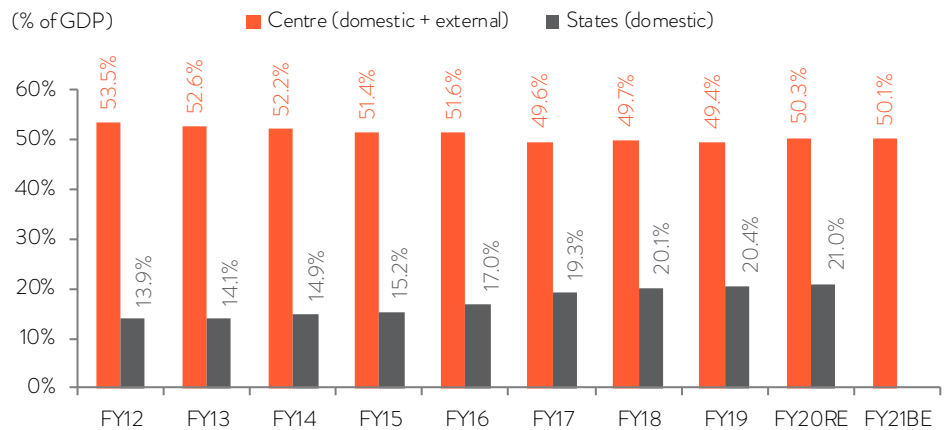
### Debt remains elevated...

India's general government debt stands at a high 67% of GDP vs. 76% in FY07, despite fiscal prudence measures, largely driven by fiscal consolidation at Centre. States on the other hand have expanded their debt levels to support spending.



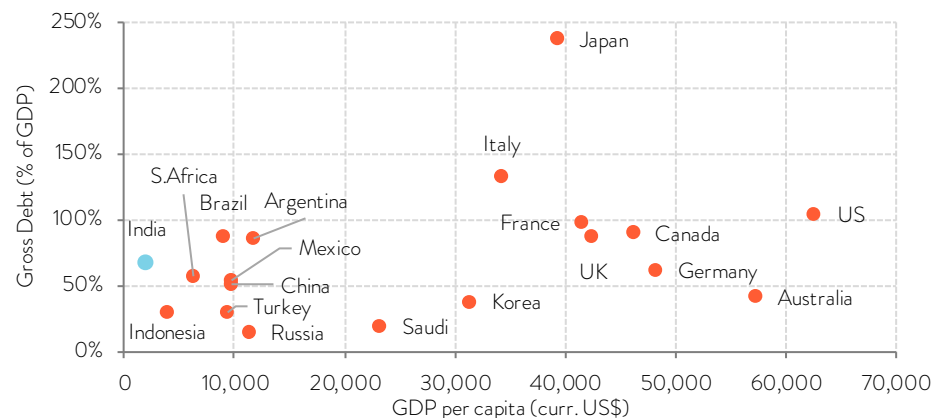
**FIG 41 – GENERAL GOVERNMENT DEBT HIGH DESPITE CONSOLIDATION**

Source: BIS, Bank of Baroda Research | \*2006=FY07 and 2018=FY19

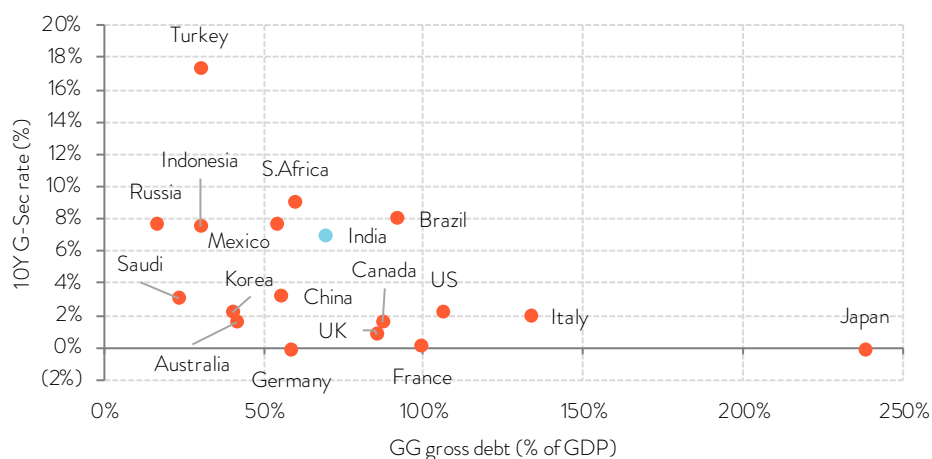
**FIG 42 – CENTRAL GOVT. CONSOLIDATING GROSS DEBT; STATES EXPANDING**

Source: RBI, Bank of Baroda Research | Note: RE - Revised Estimates, BE - Budget Estimates; FY20RE=FY20BE for states

While advanced economies typically have higher debt-to-GDP ratios, they also have lower interest rates. As India's debt level amongst Asian and EM peers (other than Brazil and Argentina) is on the higher side, interest rates are also elevated.

**FIG 43 – INDIA'S GROSS DEBT HIGH VS. GDP PER CAPITA**

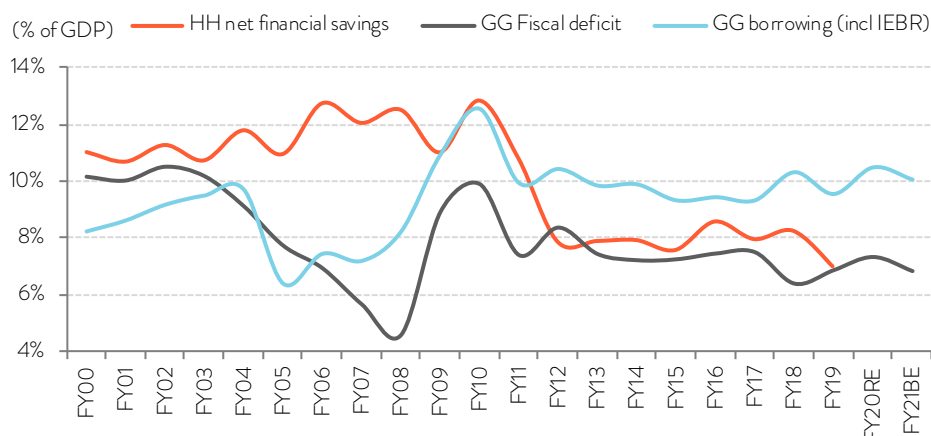
Source: IMF fiscal monitor, Bank of Baroda Research

**FIG 44 – HIGH GROSS DEBT TRANSLATING INTO HIGHER INTEREST RATES**

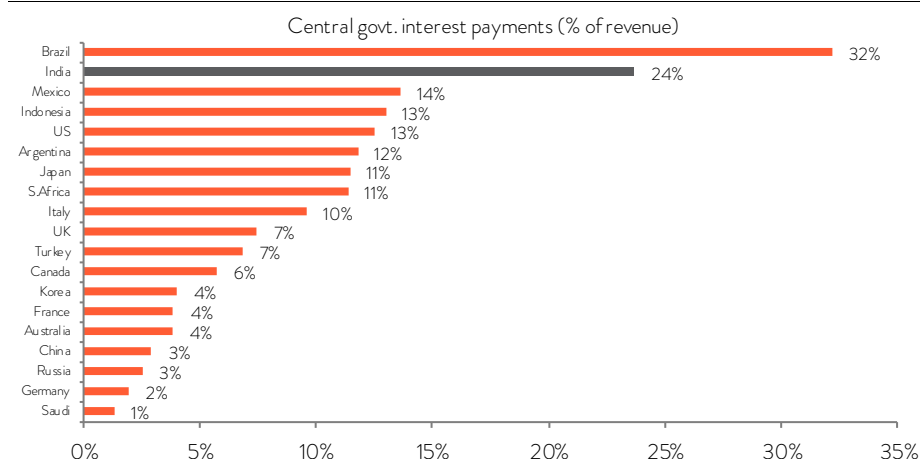
Source: IMF fiscal monitor, Bloomberg, Bank of Baroda Research

**...leaving little room for expansionary policy**

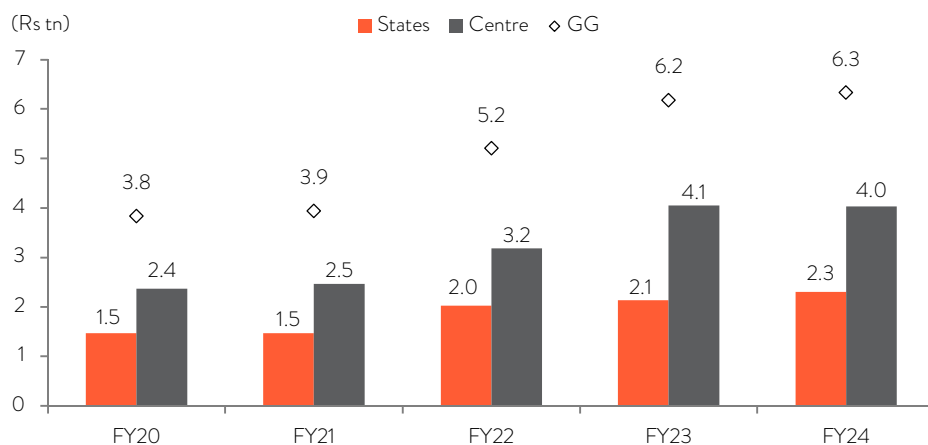
Most household financial savings (6.5% of GDP) are being utilised for financing the general government deficit. In addition, as much as 24% of the Centre's revenue is spent on servicing debt. Repayments of large amounts in the next five years also implies very little room for expanding fresh government borrowing at present.

**FIG 45 – DEFICIT IN INDIA MAINLY FINANCED BY HOUSEHOLD SAVINGS**

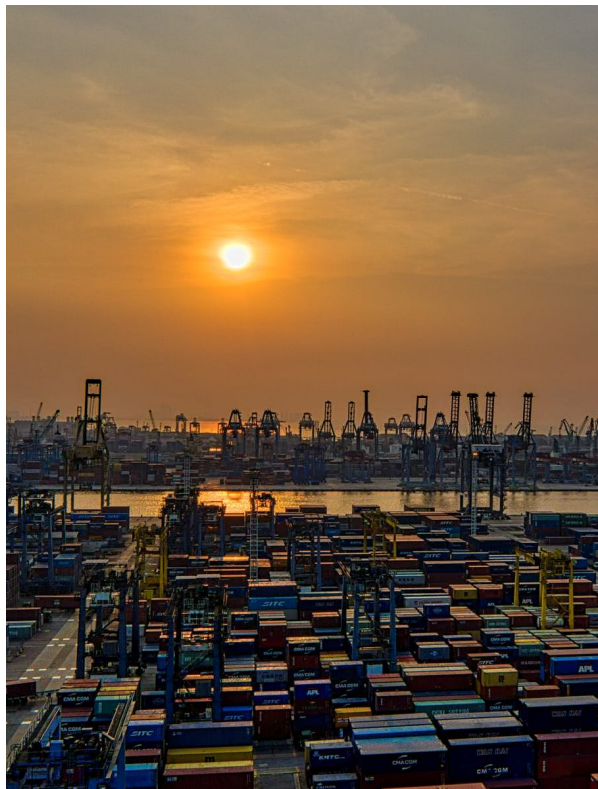
Source: RBI, Union Budget of India, CEIC, Bank of Baroda Research | Note: RE - Revised Estimates, BE - Budget Estimates; FY20RE = FY20BE for states; FY21BE for states are BoB estimates

**FIG 46 – CENTRAL GOVERNMENT INTEREST PAYMENT A FOURTH OF REVENUE**

Source: World Bank, Bank of Baroda Research

**FIG 47 – INDIA'S GENERAL GOVERNMENT INTEREST REPAYMENTS**

Source: RBI, Bank of Baroda Research



## EXTERNAL DEMAND

Exports of goods and services form 19.7% of India's GDP vs. the world average of 29%. Rising wage costs in China are driving realignment of global supply chains, with Vietnam and Bangladesh gaining share in some export segments. India has a few success stories, viz. pharma and software services, but overall exports have stagnated (-2% CAGR) over the past five years. While the coronavirus is a near-term risk to global demand, better infrastructure, attractive tax rates and policy framework should bolster exports in the medium term.

## Global trade: Persisting headwinds

### India's exports stagnant amid dull global demand

Though India's economy has been growing, exports remain relatively stagnant, which marks a sharp contrast to a number of other advanced countries. Exports of goods and services account for over 40% of GDP for Germany and Korea vs. just 19.7% for India. After a muted showing in the last five years, the country's merchandise exports to GDP ratio at 11.9% is also well below the world average of 22.8% and China's 18.3%.

Global demand is an important determinant of India's merchandise exports. Between 1991 and 1995, when world GDP increased at a 6% CAGR, India's exports grew by 12%. Thereafter, world growth dropped to 1% between 1996 and 2001 which saw India's exports slow to 6% CAGR, followed by a 22% rebound amid an 8% global upswing over 2002-11. As world economic growth weakened again over the next five years to 1%, India's exports fell at (-) 2% CAGR. In a similar vein, the current downturn in world markets explains tepid export growth.

**FIG 48 – INDIA'S EXPORTS CLOSELY LINKED TO GLOBAL DEMAND**

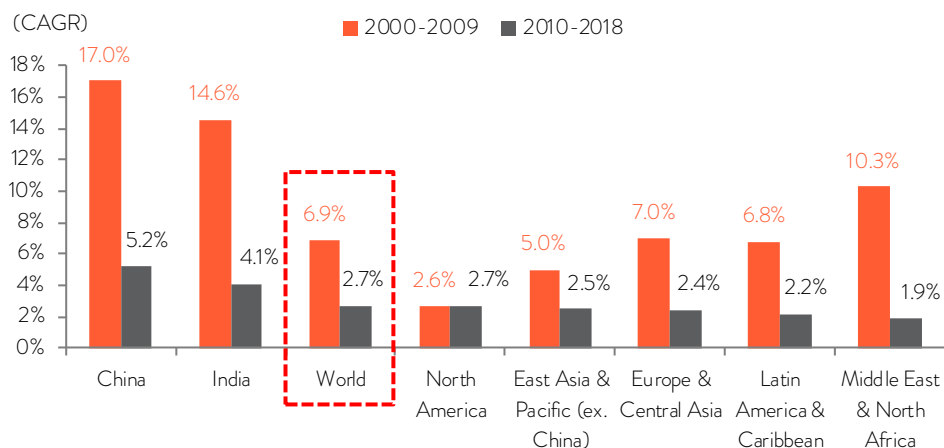


Source: World Bank, Bank of Baroda Research

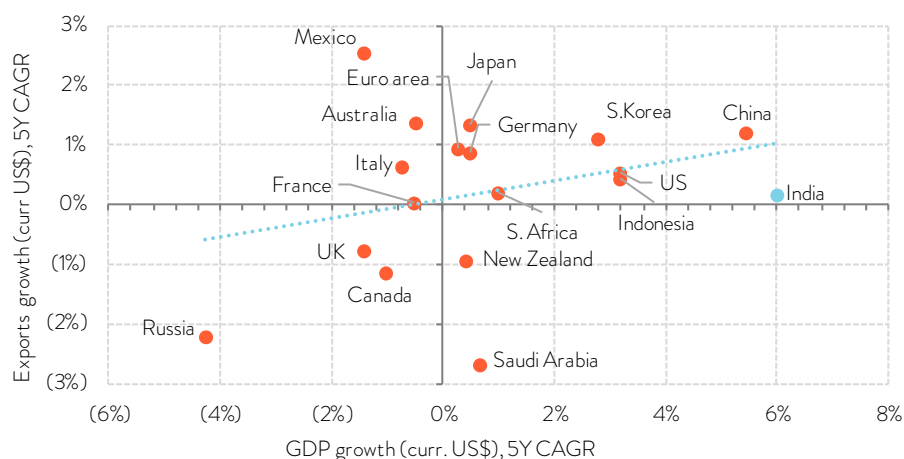
### Exports have slowed globally

The weakness in exports is not limited to India. Global exports increased at just 3% CAGR over 2010-18 compared with a 7% CAGR in the 2000s. The decline in growth has been more pronounced for China (17% to 5%) and India (15% to 4%), with the situation deteriorating even further in 2019. Apart from slowing world economic growth, lower commodity prices and US-China trade tensions have buffeted global trade, pulling down exports in all major economies.



**FIG 49 – GLOBAL GOODS EXPORT GROWTH HAS HALVED OVER 2010-18 VS. PREVIOUS DECADE**


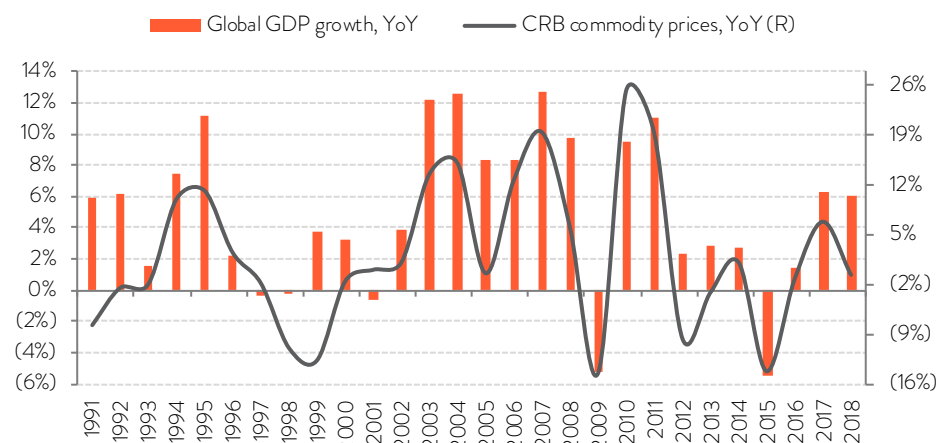
Source: World Bank, Bank of Baroda Research

**FIG 50 – SLOWDOWN IS VISIBLE ACROSS ECONOMIES**


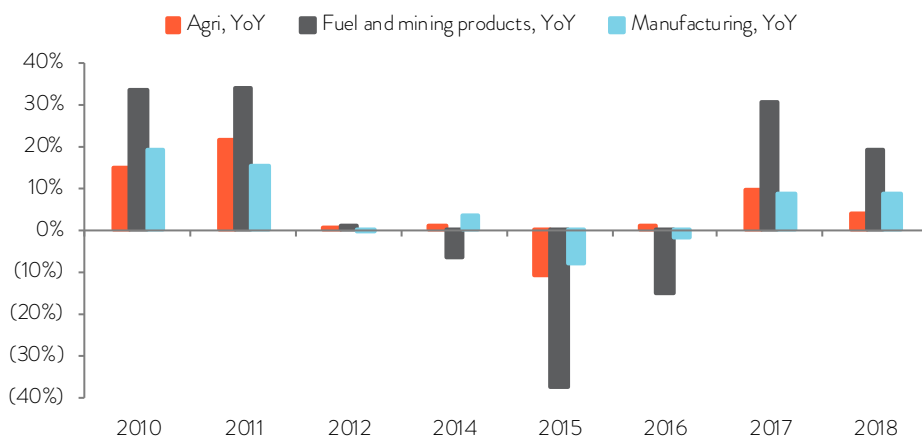
Source: World Bank, Bank of Baroda Research

The decline in global growth has percolated down to commodity prices as well. Average oil prices remained elevated in 2010/11 at US\$ 102/bbl before falling 52% to US\$ 49/bbl in 2015/16. Prices recovered subsequently in 2018 to US\$ 72/bbl but have since fallen to US\$ 64/bbl in 2019 due to weak global demand. Other commodity prices too have seen a similar declining trend.

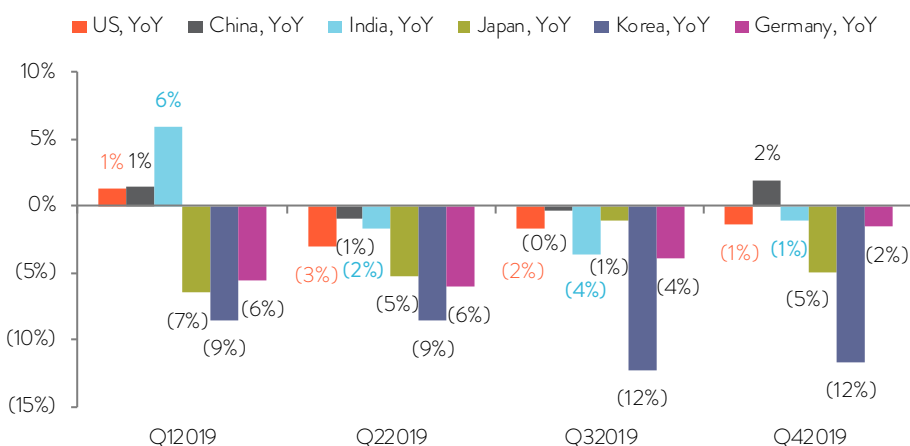
The change in commodity prices is reflected in nominal exports across categories, with fuel and mining product exports registering large declines in 2015/16, followed by a sharp jump in 2017/18. Manufacturing and agriculture exports too have seen cyclical swings alongside that in the fuel group.

**FIG 51 – WEAK COMMODITY PRICES...**

Source: World Bank, Bloomberg, Bank of Baroda Research

**FIG 52 – ...LED TO DECLINE IN GLOBAL AGRI AND FUEL EXPORTS**

Source: WTO, Bank of Baroda Research

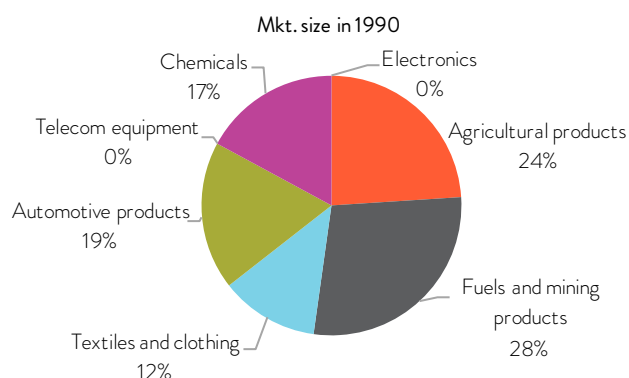
**FIG 53 – EXPORTS FROM MAJOR COUNTRIES SLIPPED FURTHER IN 2019**

Source: Bloomberg, Bank of Baroda Research

## Change in composition and market share of world exports

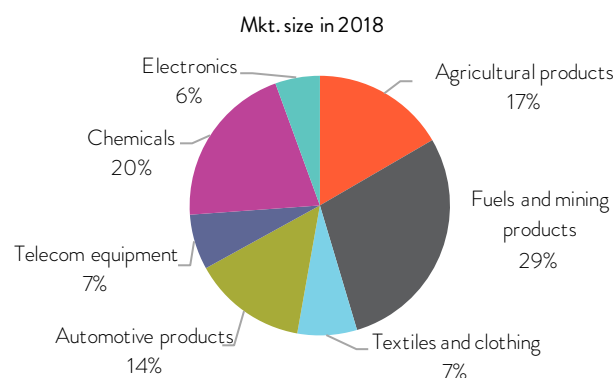
While global exports have slowed in the last decade, we note an underlying shift in trade patterns. First, the share of agriculture exports has been falling – from a high of 24% in 1990 down to 17% in 2018. Second, the share of manufacturing products has been increasing. Third, within manufacturing, the share of textiles and clothing has been falling (from 12% in 1990 to 7%) and that of telecom equipment (from negligible to 7%) and electronic goods (negligible to 6%) is rising. Fourth, fuel and mining is relatively stable (28-29%).

**FIG 54 – PRODUCT-WISE MARKET SHARE, 1990**



Source: World Bank, Bank of Baroda Research

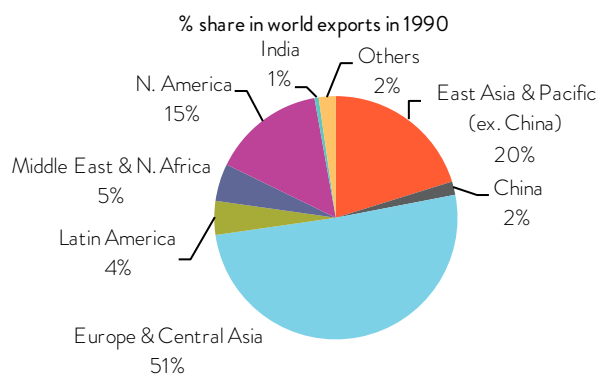
**FIG 55 – PRODUCT-WISE MARKET SHARE, 2018**



Source: World Bank, Bank of Baroda Research

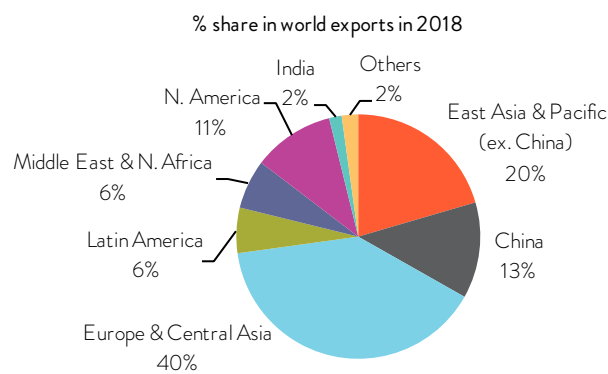
China has been at the forefront, capturing a large market share in sectors whose share in global exports is rising. Overall, China now accounts for 13% of the world's exports compared to 2% in 1990. In the fast-growing telecom sector, its share is as high as 42% and in electronic exports 36%. In textiles, it has registered a fall from a high of 38% to 34% now.

**FIG 56 – REGION-WISE EXPORTS MARKET SHARE, 1990**



Source: World Bank, Bank of Baroda Research

**FIG 57 – REGION-WISE EXPORTS MARKET SHARE, 2018**



Source: World Bank, Bank of Baroda Research

While China remains a market leader for many goods, the changing dynamics of world trade in recent years (trade wars, global supply chains) have opened up avenues for other countries, including India. For example, Vietnam and Bangladesh have gained share from China in textiles (see Page 32). In electronics, South Korea and Mexico have gained market share at the expense of China. US has moved up in fuel exports because of its shale oil discoveries. Australia has also added share in energy exports because of China's appetite for natural resources. Russia and OPEC are losing ground.

While India's overall market share for goods exports has remained relatively stable, it has improved in some categories such as chemicals (particularly pharmaceuticals) and automotive products. Services exports too have remained robust driven by software services.

**FIG 58 – MARKET SHARE FOR AGRICULTURAL EXPORTS HAS REMAINED BROADLY THE SAME**

Country (%)	2013	2014	2015	2016	2017	2018
EU	38.3	38.2	37.4	37.8	37.2	37.7
-Netherlands	6.4	6.4	6.1	6.3	6.1	6.2
-Germany	5.7	5.7	5.5	5.5	5.4	5.3
-France	4.8	4.6	4.4	4.3	4.2	4.3
-Spain	3.1	3.1	3.2	3.3	3.3	3.3
-Italy	2.7	2.7	2.7	2.8	2.8	2.8
US	10.1	10.4	10.4	10.4	9.8	9.5
Brazil	5.2	5.0	5.1	4.9	5.1	5.2
China	4.1	4.2	4.7	4.8	4.5	4.6
<b>India</b>	<b>2.7</b>	<b>2.4</b>	<b>2.2</b>	<b>2.1</b>	<b>2.2</b>	<b>2.2</b>

Source: WTO, Bank of Baroda Research

**FIG 60 – MARKET SHARE OF MANUFACTURING EXPORTS REMAINED STAGNANT**

Country (%)	2013	2014	2015	2016	2017	2018
EU	38.4	38.4	37.4	38.6	38.6	38.7
-Germany	10.4	10.4	10.1	10.4	10.4	10.4
-Netherlands	3.4	3.4	3.3	3.4	3.6	3.7
-France	3.8	3.7	3.5	3.6	3.5	3.5
China	17.5	17.9	18.9	17.6	17.5	17.6
US	9.5	9.5	9.9	9.8	9.3	8.9
Japan	5.3	4.9	4.8	5.1	5.0	4.9
S.Korea	4.1	4.0	4.2	4.0	4.2	4.0
Hong Kong	3.7	3.7	4.0	4.0	3.9	3.9
<b>India</b>	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>	<b>1.7</b>	<b>1.7</b>	<b>1.7</b>

Source: WTO, Bank of Baroda Research

**FIG 59 – US HAS GAINED SIZEABLE SHARE IN FUEL EXPORTS**

Country (%)	2013	2014	2015	2016	2017	2018
EU	16.5	16.4	18.6	18.9	18.4	18.4
-Netherlands	3.9	3.7	4.0	4.1	4.0	4.0
-Norway	2.8	2.7	2.8	2.6	2.5	2.7
Russia	9.8	9.8	10.0	7.6	8.9	8.4
US	4.8	5.4	6.1	6.4	6.8	7.6
Saudi Arabia	8.0	7.6	6.6	6.9	6.6	6.3
Australia	4.0	4.0	4.6	5.6	5.4	5.5
Canada	3.8	4.2	4.4	4.3	4.3	4.2
China	1.5	1.7	2.3	2.5	2.4	2.5
<b>India</b>	<b>2.0</b>	<b>1.9</b>	<b>1.7</b>	<b>1.8</b>	<b>1.8</b>	<b>1.9</b>

Source: WTO, Bank of Baroda Research

**FIG 61 – VIETNAM'S SHARE OF GLOBAL TEXTILE EXPORTS HAS INCREASED AT CHINA'S EXPENSE**

Country (%)	2013	2014	2015	2016	2017	2018
China	37.6	37.4	38.3	36.2	35.2	34.3
EU	25.3	25.4	24.0	25.6	26.3	27.0
-Germany	4.4	4.4	4.1	4.2	4.6	4.8
-Italy	4.9	4.9	4.5	4.6	4.7	4.7
-Spain	2.1	2.1	2.1	2.3	2.5	2.5
Vietnam	2.9	3.2	3.7	4.0	4.2	4.5
<b>India</b>	<b>4.7</b>	<b>4.5</b>	<b>4.8</b>	<b>4.7</b>	<b>4.7</b>	<b>4.3</b>
Bangladesh	3.3	3.4	3.8	4.2	4.1	4.3
Turkey	3.6	3.7	3.5	3.6	3.5	3.4
Hong Kong	4.3	3.8	3.7	3.3	2.9	2.6

Source: WTO, Bank of Baroda Research

**FIG 62 – US AND KOREA'S SHARE OF AUTOMOTIVE EXPORT FALLS, EU AND MEXICO GAIN**

Country (%)	2013	2014	2015	2016	2017	2018
EU	48.6	49.7	49.3	50.2	50.4	50.6
-Germany	18.2	18.8	18.5	18.1	17.8	17.3
-Spain	3.9	4.0	4.0	4.2	3.9	3.9
Japan	11.3	10.3	10.3	10.6	10.2	10.2
US	10.0	9.8	9.7	9.4	9.2	8.8
Mexico	6.2	6.6	7.3	7.0	7.4	8.0
S.Korea	5.5	5.4	5.3	4.8	4.4	4.1
Canada	4.4	4.4	4.7	4.8	4.3	3.9
China	3.4	3.6	3.7	3.5	3.7	3.9
<b>India</b>	<b>0.8</b>	<b>0.8</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>1.0</b>

Source: WTO, Bank of Baroda Research

**FIG 64 – CHINA'S SHARE IN GLOBAL CHEMICAL EXPORTS HAS RISEN**

Country (%)	2013	2014	2015	2016	2017	2018
EU	48.8	48.8	48.6	49.1	48.9	48.7
-Germany	11.5	11.6	11.4	11.7	11.8	11.4
-Belgium	6.9	6.6	6.4	6.5	6.1	6.4
-Netherlands	5.3	5.3	5.2	5.1	5.3	5.5
-France	5.5	5.4	5.1	5.1	5.1	4.8
-Switzerland	4.3	4.5	4.8	5.3	5.0	4.8
-Ireland	3.3	3.3	3.9	4.0	3.9	4.5
US	10.4	10.3	11.2	10.9	10.4	9.9
China	6.0	6.6	7.0	6.7	7.1	7.4
<b>India</b>	<b>2.0</b>	<b>1.8</b>	<b>1.9</b>	<b>2.0</b>	<b>2.1</b>	<b>2.2</b>

Source: WTO, Bank of Baroda Research

**FIG 63 – CHINA AND HONG KONG ACCOUNT FOR OVER HALF OF WORLD TELECOM EXPORTS**

Country (%)	2013	2014	2015	2016	2017	2018
China	36.4	37.8	41.4	40.5	36.5	42.3
EU	23.7	23.6	22.5	22.9	26.7	24.3
-Netherlands	5.6	5.8	6.2	6.3	7.8	6.6
-Germany	3.4	3.4	3.2	3.5	3.7	3.5
Hong Kong	12.9	12.6	13.7	13.9	14.9	13.3
Viet Nam	3.4	3.7	4.9	6.0	8.4	8.4
US	7.2	7.3	7.5	7.5	8.1	6.0
Mexico	5.8	5.3	5.5	5.2	5.9	4.8
UAE	3.6	3.4	0.8	0.7	2.6	3.5
<b>India</b>	<b>0.6</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.1</b>	<b>0.3</b>

Source: WTO, Bank of Baroda Research

**FIG 65 – KOREA'S SHARE OF GLOBAL ELECTRONIC EXPORTS HAS MORE THAN DOUBLED FROM 2% TO 5.5%**

Country (%)	2013	2014	2015	2016	2017	2018
China	40.7	42.2	38.7	37.1	42.4	36.2
EU	23.2	24.8	23.3	24.6	20.0	22.8
-Netherlands	8.9	9.2	8.4	9.3	6.7	7.5
-Germany	4.4	4.8	4.7	4.8	4.4	4.8
Hong Kong	9.8	10.1	10.3	10.1	8.4	9.5
US	9.0	9.4	9.6	9.8	7.6	9.2
S.Korea	2.0	2.3	2.4	2.3	4.8	5.5
Mexico	3.6	4.3	4.2	4.8	4.1	5.2
Thailand	3.3	3.4	3.6	3.6	2.9	3.4
<b>India</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.2</b>	<b>0.2</b>

Source: WTO, Bank of Baroda Research

### Textile export hubs Vietnam and Bangladesh – a case study

The emergence of Vietnam and Bangladesh as major hubs for textile exports is worth noting. While China has been losing market share in exports of clothing and textiles due to rising costs, Vietnam and Bangladesh have gained share by virtue of cheaper labour. Further, their geographical location along with government measures to attract FDI in these sectors has also contributed immensely.

**Bangladesh:** Bangladesh registered record FDI inflows in 2018, topping the list in South Asia at US \$3.6bn (up 67.94% YoY) according to UNCTAD's World Investment Report 2019. China became the leading investor in the country at US\$ 1bn, followed by the Netherlands at US\$ 0.7bn, and the UK at US\$ 0.4bn. FDI inflow burgeoned because of significant investments in power generation and labour-intensive industries such as readymade garments (RMG).

Bangladesh is the world's second largest RMG exporter, just behind China. About 81% of the country's exports come from the RMG sector. The textile and apparel sector contribute ~20% to Bangladesh's GDP, employing ~20mn people. Key factors behind its successful exports story are a cheap and vast workforce, duty-free market access or reduced tariff facilities to many developed and developing nations, and improvement in technology and quality parameters. The government is also supporting FDI to boost the sector.

**Vietnam:** Vietnam has over 6,000 textile manufacturing companies that employ some 2.5mn people. Vietnam Textile and Apparel Association expects textile manufacturing to grow 10% to US\$ 40bn by end-2019 — which would propel the nation into the ranks of the top three exporters of textiles and garments worldwide.

Apart from low labour costs, Vietnam also enjoys close proximity to key markets such as China and North America. The country has signed a number of FTAs including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) which removes duties on 95-98% of tariff lines, including footwear and textile exports. This is expected to boost Vietnam's export turnover by 4%, with CPTPP member countries becoming its second largest export market after the US — and lift the economy by 1.3%.

Other trade agreements such as the EU-Vietnam Free Trade Agreement (EVFTA) are also playing a pivotal role in attracting investment and driving textile sales. The EVFTA, which will remove tariffs on more than 99% of Vietnamese exports to the EU and vice versa, is expected to bring in more orders from established international apparel brands when ratified in 2019 or 2022.

The total amount of FDI capital invested into Vietnam's textile, dyeing and garment industry has crossed US\$ 19bn during the last 30 years, involving 1,383 projects, according to the Vietnam Textile and Apparel Association. South Korea led the countries with registered capital of US\$ 4.8bn invested in 464 projects. This was followed by Taiwan (nearly US\$ 3bn), Hong Kong (US\$ 2.4bn) and China (US\$ 2.1bn). Several other countries, including Singapore, Samoa, Turkey, Japan, the Seychelles and the UK, have also actively invested in the Vietnamese textile and apparel sector with capital ranging from US\$ 350mn to US\$ 850mn.

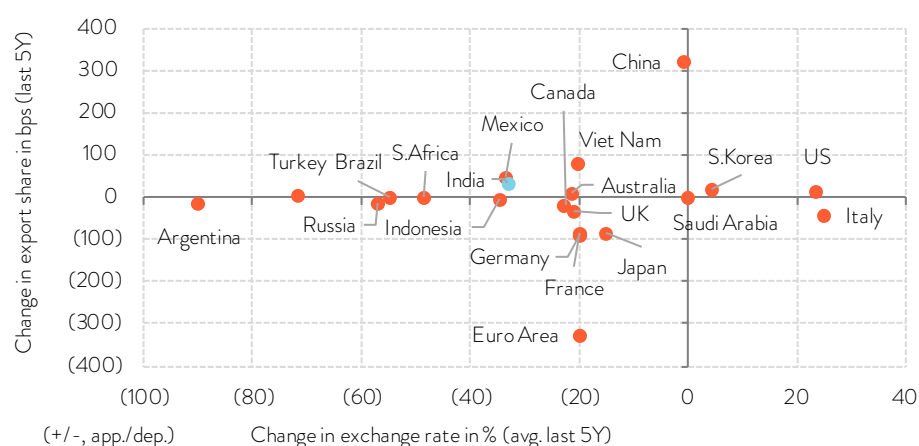
India too can gain from improving linkages in GSCs. With the government's thrust on improving India's rank in Ease of Doing Business and enabling infrastructure such as SEZs, exports should see a pickup.

## Exports – the way ahead

### Exchange rate: Is currency depreciation a way out?

Economic theory postulates that a depreciating currency is positive for exports as it makes a country more competitive. However, with the changing nature of world manufacturing trade, this theory no longer appears to hold true. For services exports, this seems to still hold true.

**FIG 66 – CHANGE IN EXCHANGE RATE AND EXPORT SHARE**

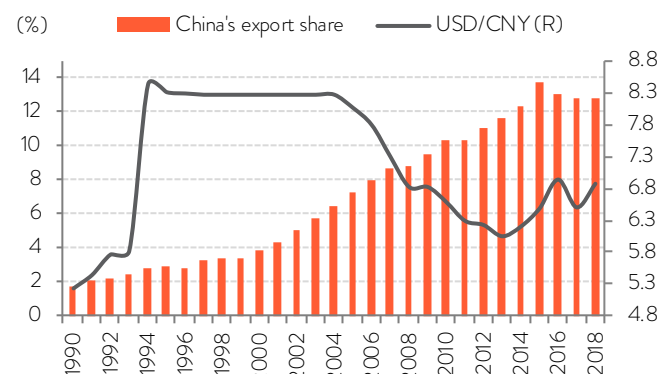


Source: Bloomberg, World Bank, Bank of Baroda Research

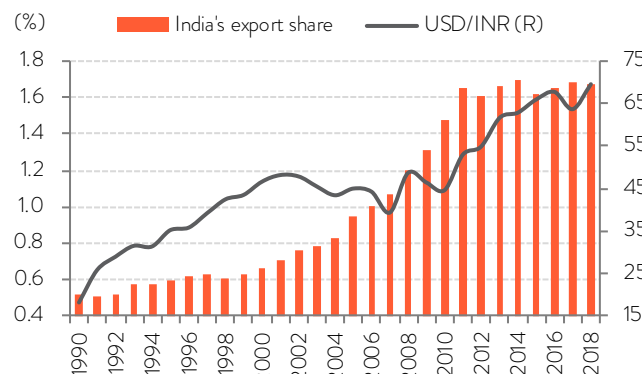
Due to increased interlinkages and liberalisation, the nature of world trade has seen a marked shift. Production of goods is no longer undertaken in a single location but spread across different geographies. This has led to the emergence of GSCs which help reduce costs and improve efficiency. The emergence of these supply chains offers great opportunities for developing countries with abundant cheap labour and low production costs.

China with its large labour supply, well-developed port network and conducive government policy has gradually emerged as the centre for GSCs. As a result, it gained a sizeable share in world exports from just ~1.8% in 1990 to 12.8% in 2018. In the same period, India's share in global exports has increased from 0.5% to just 1.7% despite a steep (-) 74% decline in exchange rate.



**FIG 67 – CHINA'S EXPORT SHARE HAS RISEN SHARPLY...**

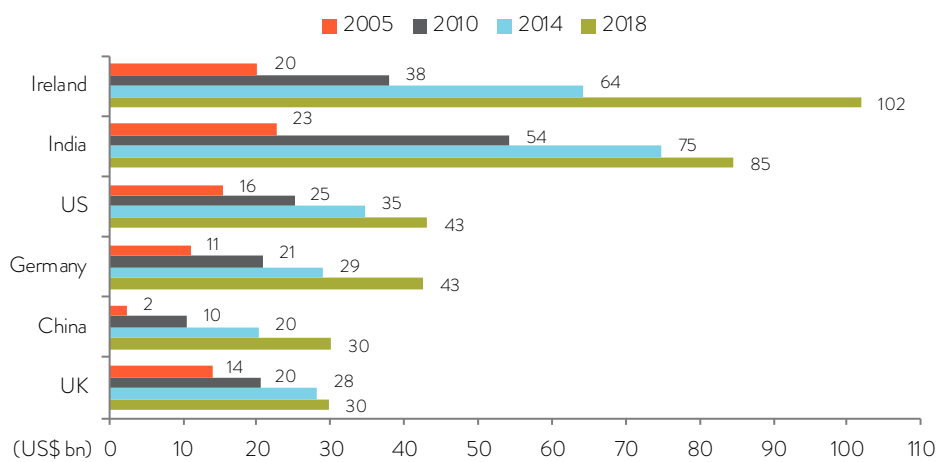
Source: World Bank, Bank of Baroda Research

**FIG 68 – ...WHILE INDIA'S SHARE HAS REMAINED FLATTISH**

Source: World Bank, Bank of Baroda Research

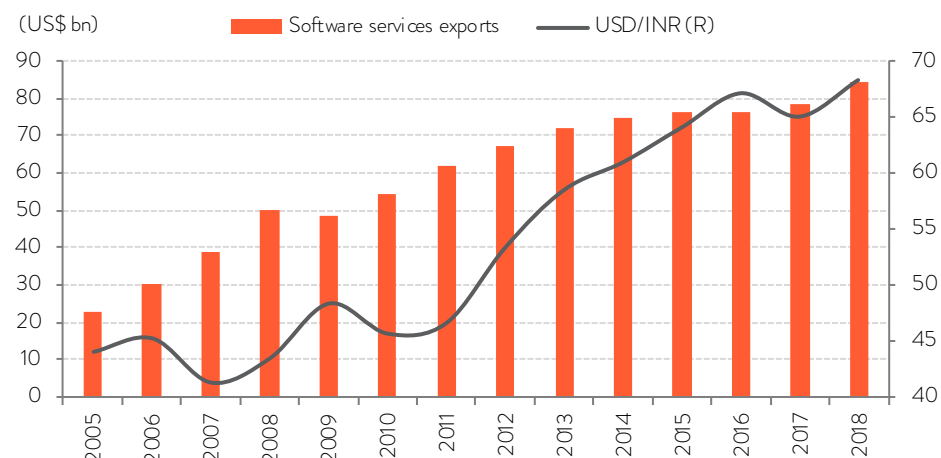
### Software service exports resilient

India is amongst the leading exporters of software services globally, second only to Ireland. In 2018, software service exports (including telecom services) from India stood at US\$ 84.5bn compared with US\$ 54.2bn in 2010. In H1CY19, software service exports have grown by 11% YoY to US\$ 45.6bn, while goods exports rose by just 2.5% in the same period.

**FIG 69 – INDIA IS THE SECOND LARGEST EXPORTER OF SOFTWARE SERVICES AFTER IRELAND**

Source: IMF Balance of Payments Database, Bank of Baroda Research

The US remains the largest destination for India's software service exports, though its share has come down recently to ~57% in 2016-17 from 80%. On the flip side, this will insulate Indian IT players against market concentration. Software service exports are negatively affected by INR appreciation against the USD. Thus, INR depreciation by (-) 2.3% in 2019 worked in the sector's favour.

**FIG 70 – SOFTWARE SERVICES EXPORTS AND EXCHANGE RATE ARE NEGATIVELY RELATED**


Source: IMF Balance of Payments Database, Bloomberg, Bank of Baroda Research

### Pharma exports robust

India's share in global pharma exports has increased from 1.1% in 2000 to 2.5% in 2018. Low cost of production, a skilled workforce and increasing expenditure on R&D have increased India's competitiveness in the global market. The country is the largest provider of generic drugs globally (in volume terms) and these account for over 70% of the total pharma sector in India. The US is the biggest market for Indian exports of drugs and pharmaceuticals at US\$ 5.8bn in FY19, followed by the UK (US\$ 630mn) and South Africa (US\$ 619mn).

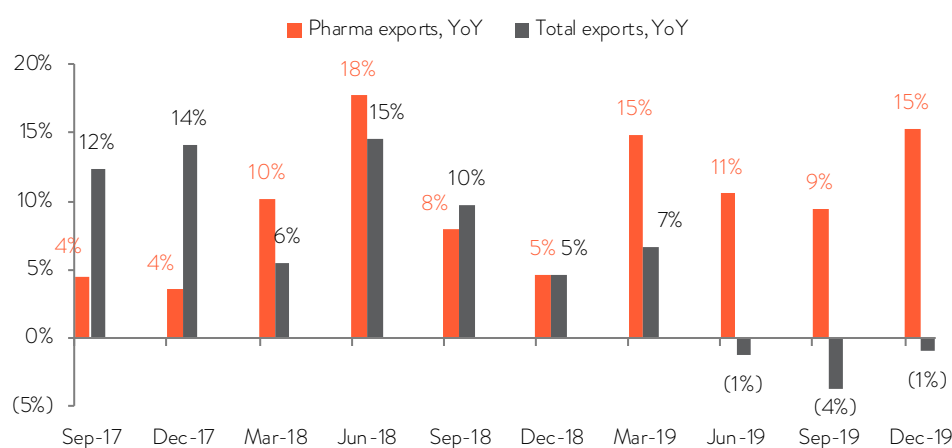
**FIG 71 – INDIA'S SHARE IN PHARMA EXPORTS HAS RISEN**

Market share (%)	2000	2005	2010	2015	2016	2017	2018
EU	65.3	70.5	66.2	63.8	62.9	65.0	66.0
-Germany	12.7	13.9	14.3	14.3	14.3	14.9	15.3
-Switzerland	9.2	9.2	10.6	12.2	13.3	12.6	12.1
-Ireland	4.6	6.6	6.9	6.3	6.2	7.0	8.6
-Belgium	6.3	12.7	11.0	8.6	8.4	8.0	8.0
-Netherlands	4.1	4.3	3.4	5.7	5.7	6.3	7.2
-France	9.6	8.3	7.5	5.9	5.8	5.7	5.5
-UK	9.9	8.2	7.4	7.0	6.2	5.9	4.9
US	12.1	9.4	9.6	9.9	9.5	8.7	7.9
China	1.6	1.4	2.3	2.5	2.5	2.6	2.7
<b>India</b>	<b>1.1</b>	<b>1.0</b>	<b>1.5</b>	<b>2.6</b>	<b>2.7</b>	<b>2.5</b>	<b>2.5</b>

Source: CEIC, Bank of Baroda Research

Despite a dismal performance in overall exports, India's exports of drugs and pharmaceuticals have been resilient. While total exports have remained flat in 2019, pharma exports increased 12.7% to US\$ 21bn in the same period. Given the buoyancy in the sector, there is potential to further increase exports. States such as Andhra Pradesh and Uttar Pradesh are looking to tap this potential with plans to set up pharma parks.

**FIG 72 – INDIA'S PHARMA EXPORTS HAVE SHOWN RESILIENCE DESPITE A SHARP DIP IN OVERALL EXPORTS**



Source: CEIC, Bank of Baroda Research

India's drugs and pharma sector attracted cumulative FDI inflows worth US\$ 16.2bn between Apr'00 and Jun'19. However, inflows have been muted in recent years, falling by 74% to US\$ 266mn in FY19 compared with US\$ 1bn in FY18 due to policy uncertainty, regulatory issues, price ceilings and weak IPRs. These concerns must be addressed in order to attract more investment.

The relative outperformance of India's software services and pharma exports suggests that competitive advantage more than currency depreciation fuels higher exports (though in the case of services, currency depreciation does help at the margin). Improvement in ease of doing business and a facilitating infrastructure alongside FDI inflows will help raise India's participation in GSCs and hence bolster export competitiveness in other segments as well. However, the recent COVID-19 outbreak and its economic fallout may further dent exports and remains a key risk.



## DRIVERS OF GROWTH

Underlying structural trends in India favour a bounce back in growth. Full benefits of key reforms such as RERA, GST, IBC and corporate tax cuts are yet to play out. These along with a cyclical global rebound, CPSE privatisation, transmission of lower rates and pick-up in foreign inflows suggest growth will retrace to higher levels in a gradual manner. We expect a GDP print of 5.5% in FY21 and 6.2% in FY22, further supported by India's underlying drivers – young population, competitive services, low urbanisation, deleveraging corporate sector and digitisation.

## India's structural drivers intact

We expect a GDP print of 5.5% in FY21 and 6.2% in FY22 aided by the following growth drivers –

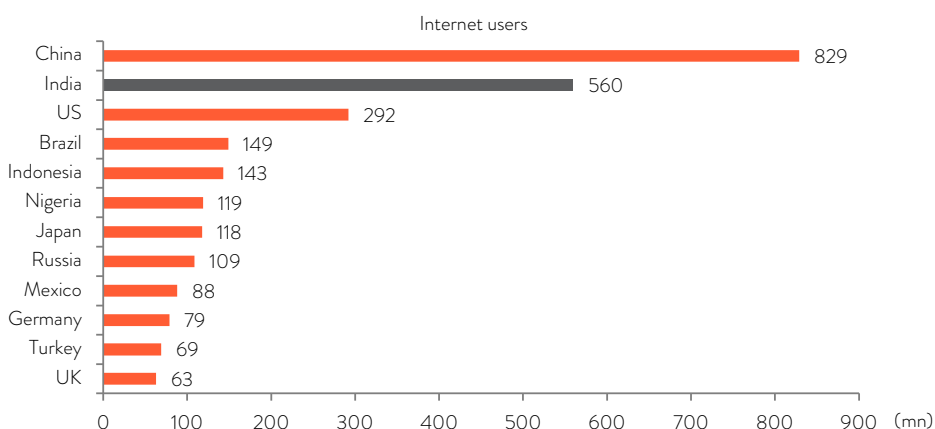
- **Digitisation:** India has been the fastest growing market for digital payments. The size of the ecommerce market and penetration levels suggest further upside potential. Digital investments will drive productivity and growth higher.
- **Demographics:** Over the last decade, India's population has increased by 14% but its workforce has surged 24%, which will yield demographic dividends. Workforce in agriculture has declined to 43.2% from 48.9% at the beginning of the decade.
- **Urbanisation and housing demand:** India's urbanisation levels are the lowest among G20 countries – with only 46 cities housing, populations over a million as against 102 and 10 such cities in China and the US respectively.
- **Ease of doing business:** India's rank in Ease of Doing Business has improved to 63 in 2019 from 142 in 2015 – research shows positive correlation to economic growth.
- **Strategic disinvestments and role of private sector:** India's corporate sector has not levered up in the last five years. Profitability and capacity utilisation are low. But the government's series of planned disinvestments can increase the private sector's role in the economy and aid growth. Lower corporate tax and abolition of DDT is a positive.
- **Infrastructure investments:** Strategic sales will give the government the resources to meet its infrastructure spending target of Rs 103tn over the next five years (vs. Rs 51tn in the last six years).
- **Global demand and exports:** World trade has slowed down in 2019. So have India's exports. With the US-China trade war easing, trade should improve. In addition, India has a chance to improve its exports if it invests in infrastructure.
- **Monetary transmission:** Interest rates have not fallen to the extent by which RBI has reduced policy rates. As deposits get rolled over to lower rates, banks' cost of funds will decline and so will lending rates.
- **Change in NPA cycle:** Banks tend to lend less when NPAs are rising. As the NPA cycle turns in the coming quarters, bank profitability and credit growth will increase.

## Digitisation to boost domestic growth

India's internet user base has burgeoned over the last few years to over 560mn (Jun'19) and is now second only to China with 829mn users. Rising internet penetration is driving the country's ecommerce sales which stood at US\$ 400bn in 2017. However, most of this is B2B; the share of B2C is only at 8% but expanding rapidly.

We expect B2C ecommerce to drive growth given the mix of demographics and internet penetration. Already, India is the fastest growing market for cashless payments. Formalisation of the economy will thus receive an impetus and tax collections should increase further – providing much-needed resources to the government and ensuring that the pace of investments in the digital economy remains high.

**FIG 73 – TOTAL INTERNET USERS (MN)**

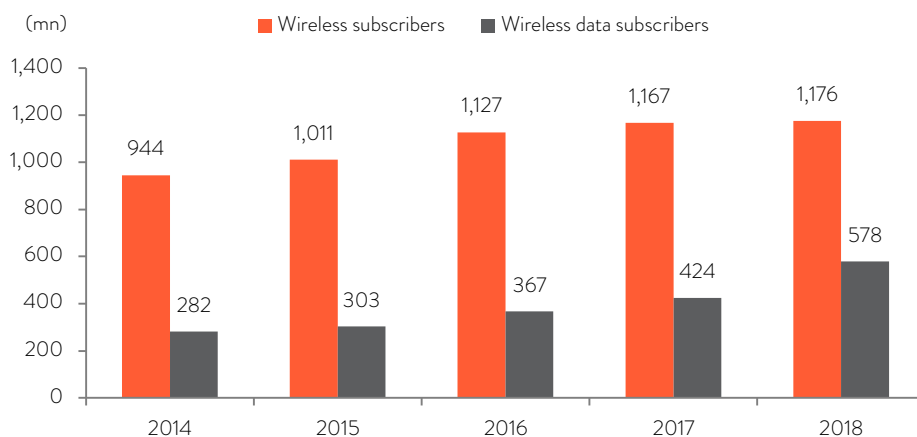


Source: internetworldstat, Bank of Baroda Research. As of Jun'19

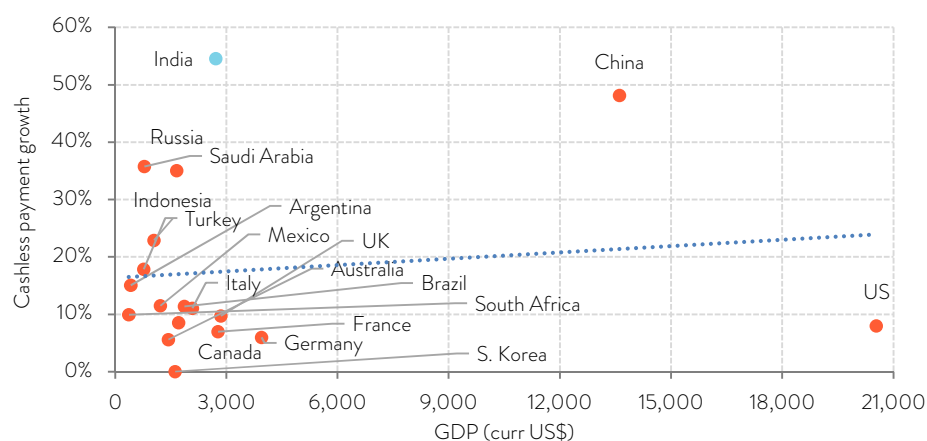
**FIG 74 – ECOMMERCE SALES ACROSS COUNTRIES**

Ecommerce Sales (2017)	Total (US\$ bn)	% share of GDP
Italy	333	17
<b>India</b>	<b>400</b>	<b>15</b>
Canada	512	31
France	734	28
UK	755	29
Republic of Korea	1,290	84
Germany	1,503	41
China	1,931	16
Japan	2,975	61
US	8,883	46

Source: UNCTAD

**FIG 75 – INDIA'S WIRELESS DATA SUBSCRIBER BASE HAS SURGED...**

Source: TRAI, Bank of Baroda Research

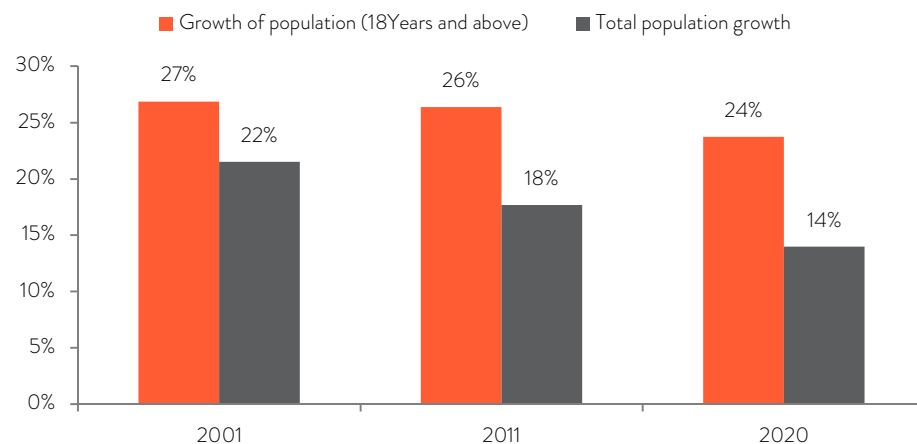
**FIG 76 – ...AND CASHLESS PAYMENTS SHOW STEEP GROWTH, 2018**

Source: BIS, Bank of Baroda Research

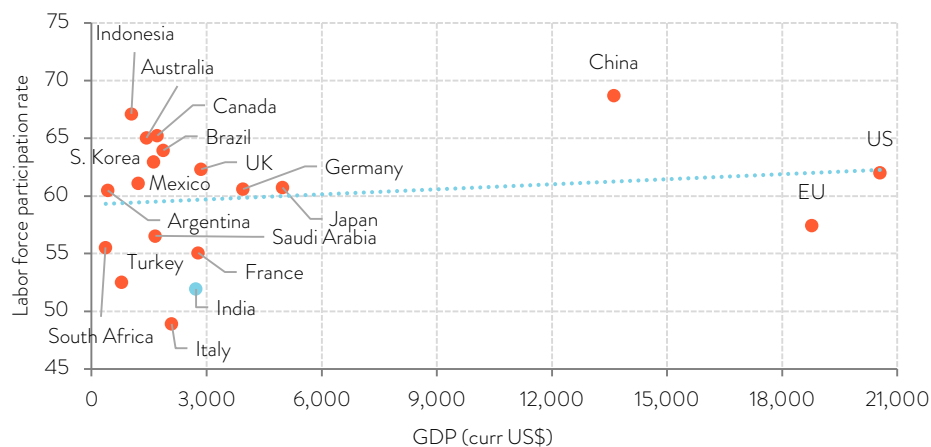
### Demographic dividend and formalisation to aid job growth

India's current workforce participation rate is 46.8% compared with an average of 60% for G20 countries. Notably, the participation rate for Indian women is only 22%. While the challenge is to find productive jobs away from agriculture in manufacturing and services, India's demographic dividend arising from a large share of working-age population gives it a natural advantage to outperform other countries. From 1991 to 2020, India's share of population aged above 18 years has grown from 56% to 68%. According to IMF, India is expected to add 2% per capita growth in GDP because of this demographic dividend.

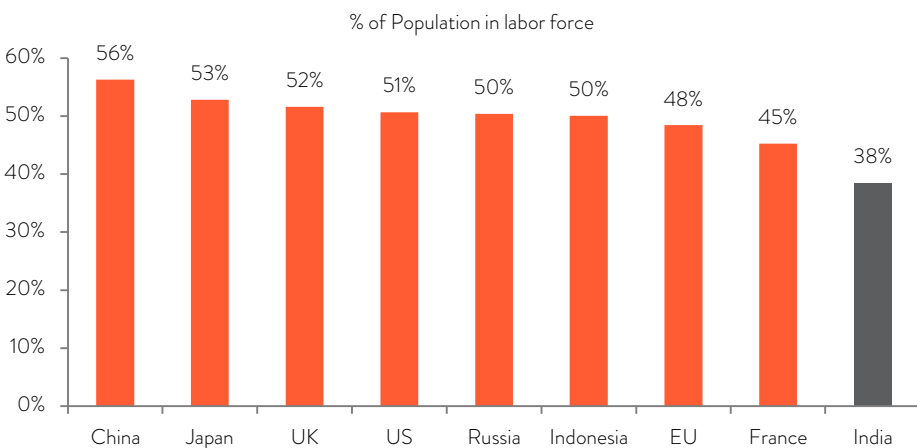


**FIG 77 – POPULATION GROWTH OVER THE YEARS**

Source: CEIC, Census. Data for 2020 based on UN projections

**FIG 78 – LABOUR PARTICIPATION RATE, 2018**

Source: World Bank, Bank of Baroda Research

**FIG 79 – INDIA HAS A LOWER SHARE OF LABOUR FORCE THAN G20 COUNTRIES, 2019**

Source: World Bank, Bank of Baroda Research

We also note a shift towards formalisation with salaried jobs increasing to 23% of overall jobs in 2017-18 (18% in 2011-12) and casual workers declining to 25% from 30% in 2011-12. Private sector investments and job creation will play an important part in the coming years, as seen in the banking sector where the share of government jobs (PSBs) has fallen to 58% in FY18 from as high as 84% in FY02.

**FIG 80 – SHARE OF PRIVATE SECTOR BANK EMPLOYEES HAS INCREASED OVER THE YEARS**

Type of banks (%)	FY92	FY02	FY12	FY18
PSBs	87	84	74	58
Private	5	8	17	30
Foreign	1	1	2	2
Others (RRBs and SFCs)	7	7	7	9
<b>Total SCBs</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: CEIC, Bank of Baroda Research

**FIG 81 – SHARE OF WORKFORCE IN AGRICULTURE CONTINUES TO FALL**

% of total employment	1991	2001	2011	2019
Agriculture	63.0	59.0	49.0	43.2
Industry	15.3	16.7	23.5	24.9
Services	21.7	24.3	27.5	31.9

Source: ILO, Bank of Baroda Research

## Urbanisation trends to bolster construction demand

India's urban population ratio at 34% in 2018 is at the lower end of the spectrum compared to its G20 counterparts. This is expected to increase as infrastructure investments in cities gather pace.

**FIG 82 – URBAN POPULATION (% OF TOTAL POPULATION)**

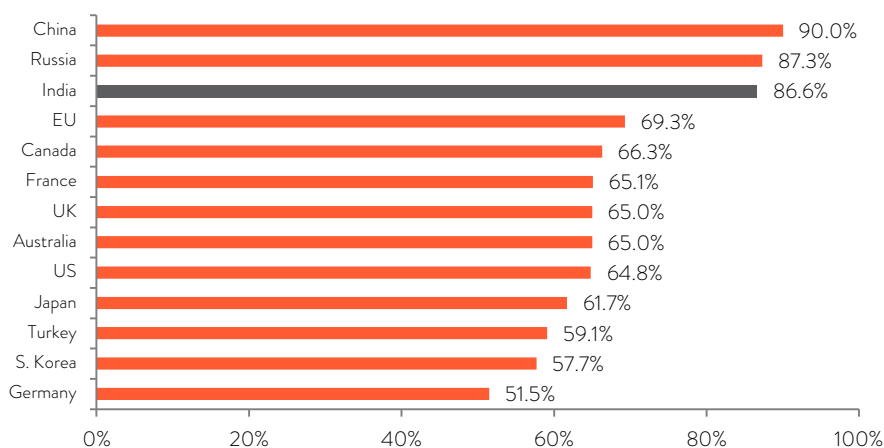
G20 (%)	1991	2001	2011	2018
Argentina	87.3	87.5	90.9	91.9
Australia	85.4	85.3	85.3	86.0
Brazil	74.7	75.4	84.6	86.6
Canada	76.6	76.9	81.1	81.4
China	27.3	28.2	50.5	59.2
Germany	73.2	73.4	77.2	77.3
European Union	70.6	70.7	74.2	75.7
France	74.2	74.4	78.6	80.4
United Kingdom	78.1	78.2	81.6	83.4
Indonesia	31.6	32.7	50.6	55.3
<b>India</b>	<b>25.8</b>	<b>26.0</b>	<b>31.3</b>	<b>34.0</b>
Italy	66.7	66.7	68.4	70.4
Japan	77.5	77.6	91.1	91.6
Korea, Rep.	75.0	75.8	82.0	81.5
Mexico	71.8	72.2	78.1	80.1

G20 (%)	1991	2001	2011	2018
Russian Federation	73.4	73.4	73.7	74.4
Saudi Arabia	77.2	77.8	82.3	83.8
Turkey	60.0	60.5	71.4	75.1
United States	75.7	76.1	80.9	82.3
South Africa	43.4	43.7	52.1	55.3
World	52.5	53.0	62.7	66.4

Source: World Bank, Bank of Baroda Research

Urbanisation will also drive more house ownership in India. At present, house ownership is 86.6% which is far higher than many advanced economies. But this is largely driven by rural India. In urban India, house ownership is 69% (as per the 2011 census), which is in line with other large countries. Given the underlying trends of urbanisation and formal job creation, housing construction will remain a driver of demand in the country. Within the housing sector, affordable housing remains the segment with the most potential given fiscal incentives.

**FIG 83 – INDIA'S HOUSE OWNERSHIP RATE marginally BELOW CHINA**

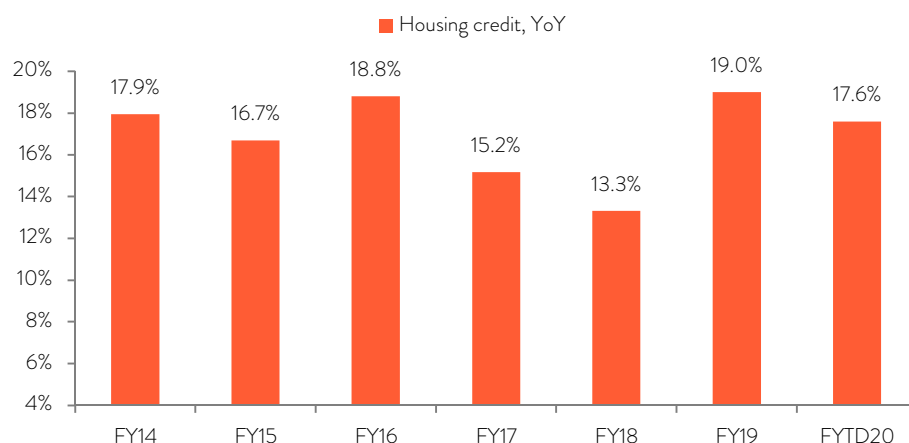


Source: India-Census, US-Census Bureau, Forbes | Based on last available data

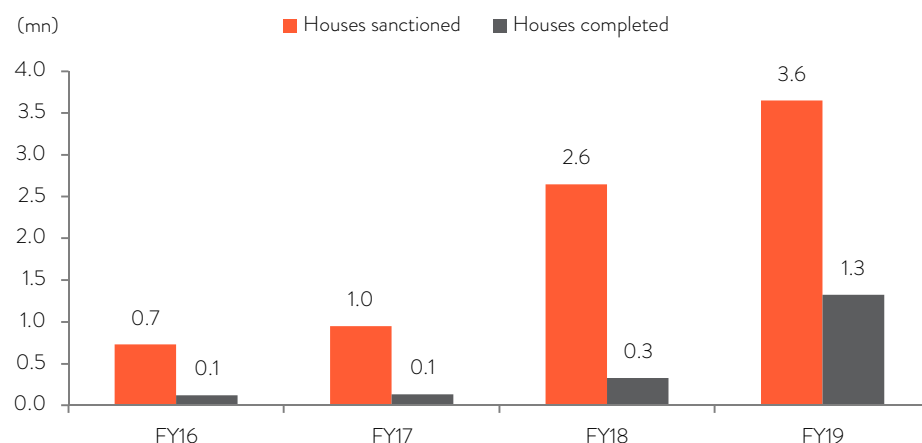
**FIG 84 – HOUSE OWNERSHIP IN RURAL AND URBAN (INDIA)**

House ownership (%)	2001		2011	
	Rural	Urban	Rural	Urban
Owned	94.4	66.8	94.7	69.2
Rented	3.6	28.5	3.4	27.5

Source: Census, Bank of Baroda Research

**FIG 85 – HOUSING CREDIT HAS DECELERATED IN FYTD20**

Source: CEIC, Bank of Baroda Research

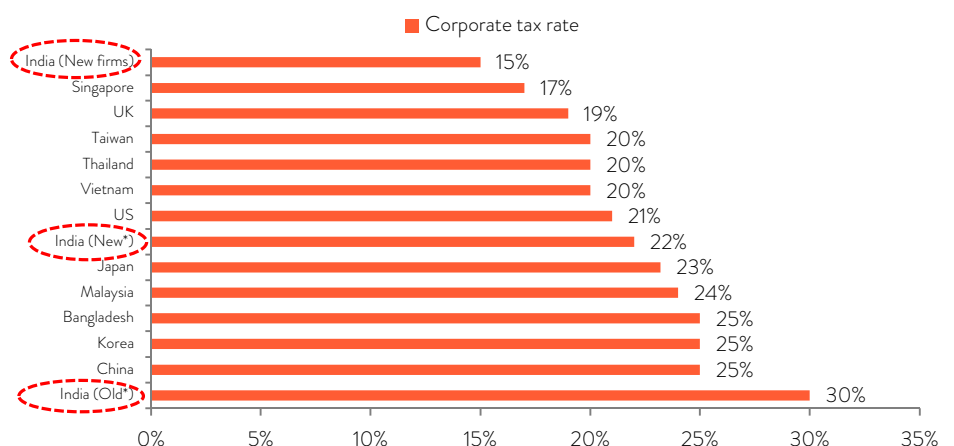
**FIG 86 – HOUSING COMPLETED AND SANCTIONED UNDER PMAY**

Source: Ministry of Housing and Urban Affairs, Bank of Baroda Research

## Private investment to pick up aided by reforms

### Lower corporate tax

India now stands competitively amongst major economies with its recent reduction in corporate tax rate to 22% (25.17% incl. surcharge and cess) for existing companies from 30% (34.94% incl. surcharge and cess). For new manufacturing companies as well, the tax rate has been reduced to 15% (17% incl. surcharge and cess) from 25% earlier.

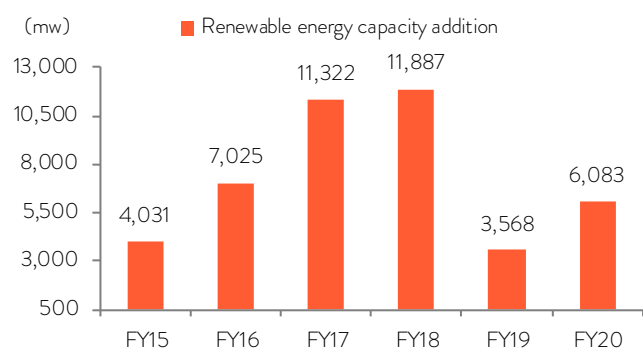
**FIG 87 – INDIA'S NEW CORPORATE TAX RATES IN LINE WITH OTHER MAJOR ECONOMIES**

Source: Newspaper reports, Bank of Baroda Research | \*Existing companies

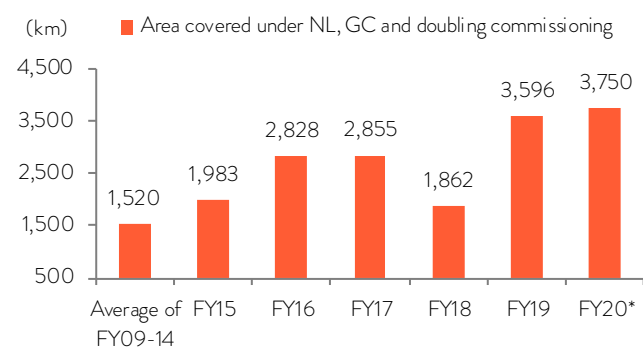
### Infrastructure boost

Identifying India's lack of infrastructure as a major constraint to economic growth, the government recently announced a Rs 103tn infrastructure investment plan called National Infrastructure Pipeline or NIP spread over five years. The major thrust areas are energy (23.9%), roads (19.2%), urban development (15.9%) and railways (13.4%). Within this, two sectors where investments are likely to see a major leap are renewables and railways. Government has reduced corporate tax rate on new power plants in-line with new manufacturing plants to 17%.

With respect to financing of these projects, while the Centre and state governments are expected to finance 39% each, the rest (22%) is to be financed by the private sector. A major source of financing can also be asset monetisation of existing CPSEs. Of the total Rs 103tn, projects worth Rs 42.7tn (42%) are under implementation and projects worth Rs 32.7tn (32%) are in the conceptualisation stage, while the rest are still under development.

**FIG 88 – CAPACITY ADDITION FOR RENEWABLE ENERGY IS INCREASING**

Source: PIB, Bank of Baroda Research

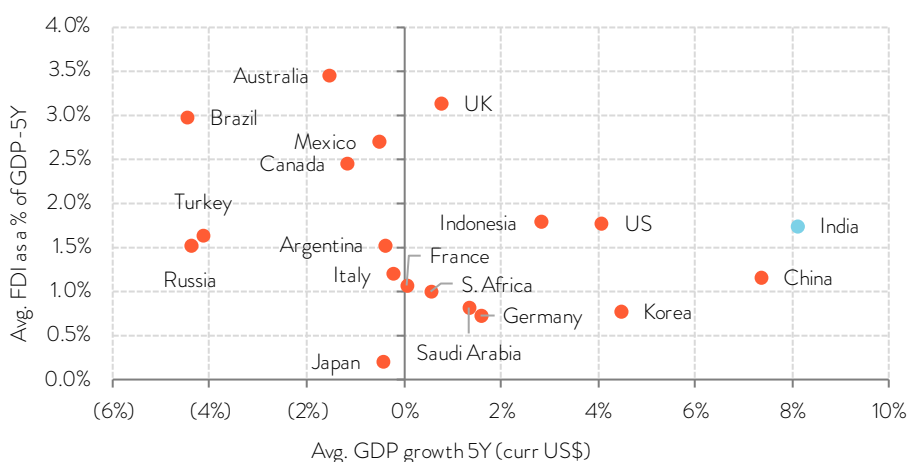
**FIG 89 – RAILWAY CONSTRUCTION PICKING UP PACE**

Source: PIB, Bank of Baroda Research | Note: NL-New Lines, GC-Gauge Conversion | \*Data for FY20 is the targeted level

## Foreign inflows and asset monetisation

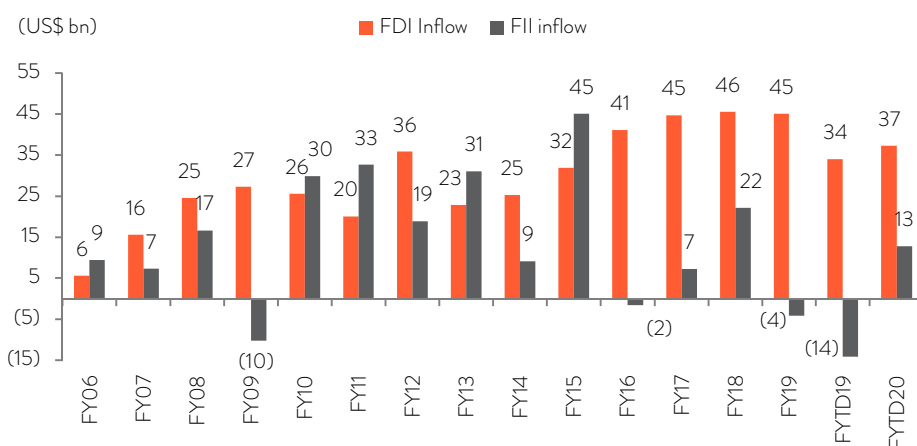
India's FDI as a percentage of GDP has been at ~1.6%, which is lower than countries such as Australia (4.2%), Brazil (3.3%), Mexico (2.6%) and Argentina (2.3%). Liberalisation of FDI norms and privatisation of CPSEs should bolster foreign inflows (FDI and FPI) into India. While FII inflows have picked up pace to US\$ 13bn in FYTD20 compared with outflows of US\$ 14bn in the same period last year, inflows can be much higher if the government's asset monetisation plan plays out as per budgeted.

**FIG 90 – FDI AS A PERCENTAGE OF GDP AND GDP GROWTH**



Source: UNCTAD, World Bank, Bank of Baroda Research

**FIG 91 – FDI AND FII INFLOWS INTO INDIA GATHERING MOMENTUM**



Source: RBI, Bank of Baroda Research | FYTD: Apr-25Feb'20

## Better performance in ease of doing business

India's ranking in Ease of Doing Business has risen to 63 in 2019 from 142 in 2015, led by improved terms of credit, insolvency resolution mechanisms, trading across borders and increased electrification. The improvement is likely to continue as ongoing reforms play out, translating into higher investments and growth in the long run. We note that the top 20 countries in Ease of Doing Business also show much higher capita income and higher FDI as a percentage of GDP.

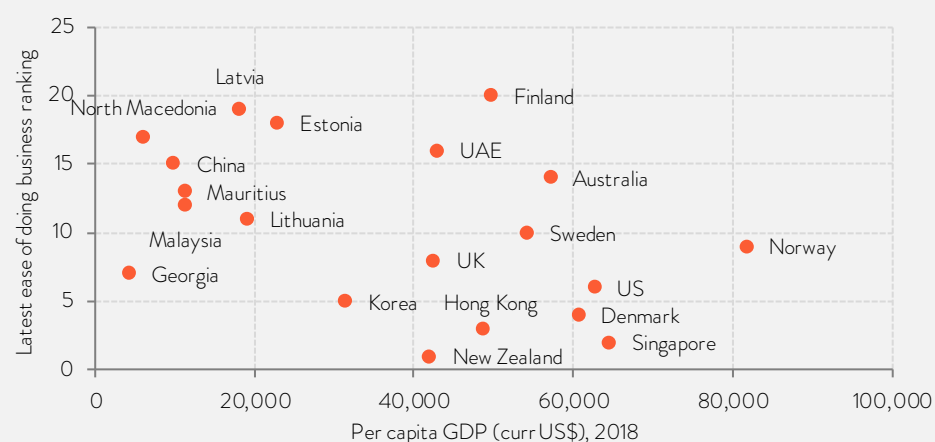
### Higher per capita GDP and FDI correlates to better Doing Business rank

Economist John Cochrane has shown that there is a correlation between GDP per capita, as measured by its natural logarithm, and the World Bank's "distance to frontier" (DTF) index, which is derived from the better-known ranking of countries, when comparing across a large set of advanced and emerging economies at a point in time. In particular, higher GDP per capita correlates well with a higher DTF score, and vice versa.

Similarly, studies by World Bank have shown that that FDI inflows are indeed higher for economies performing better on Doing Business indicators. Results suggest that on average across economies, a difference of 1 percentage point in regulatory quality as measured by Doing Business DTF scores is associated with a difference in annual FDI inflows of US\$ 250mn–500mn.

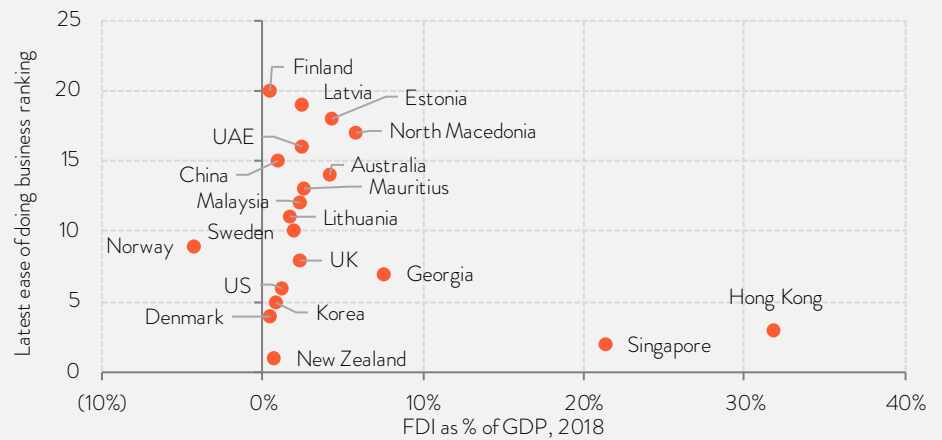
Note: DTF score illustrates the distance of an economy to the 'frontier', which represents the best performance observed on each Doing Business topic across all economies, on a scale of 0-100.

**FIG 92 – COUNTRIES WITH HIGHER PER CAPITA GDP FARE WELL IN TERMS OF EASE OF DOING BUSINESS RANKINGS**

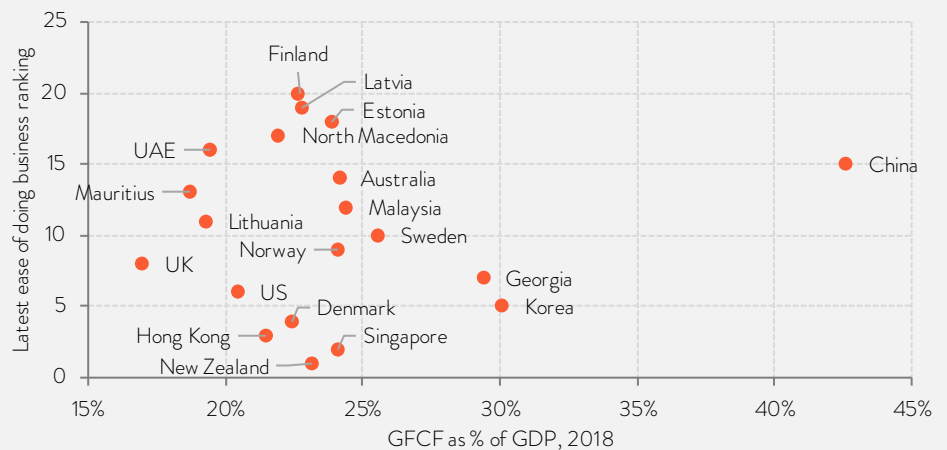


Source: World Bank, Bank of Baroda Research

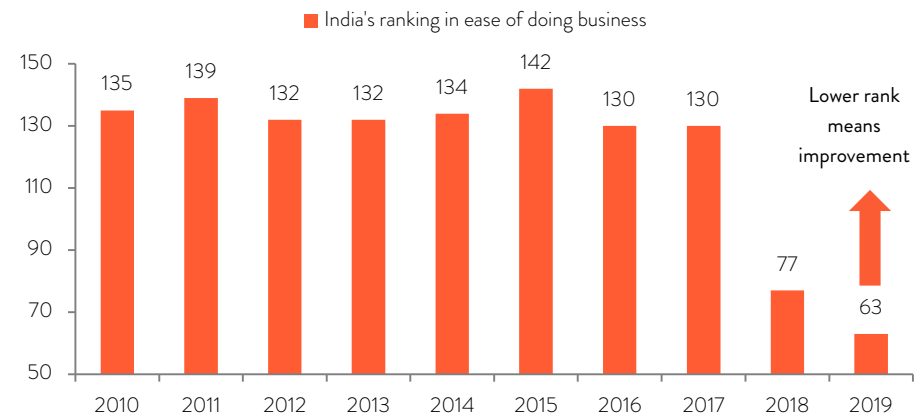


**FIG 93 – HONG KONG & SINGAPORE HAVE FAIRLY BETTER EASE OF DOING BUSINESS RANKINGS AND BUOYANT FDI INFLOWS**


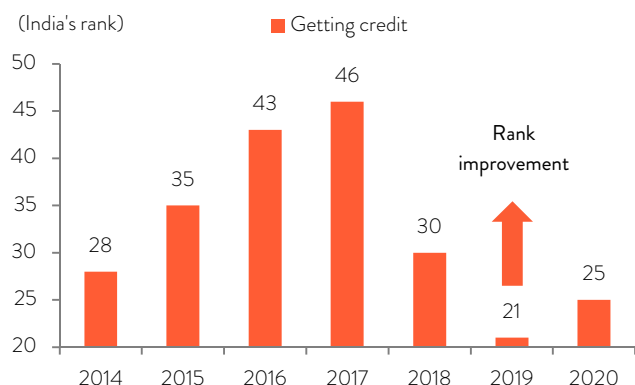
Source: World Bank, UNCTAD, Bank of Baroda Research

**FIG 94 – INVESTMENT RATE AND EASE OF DOING BUSINESS RANKINGS**


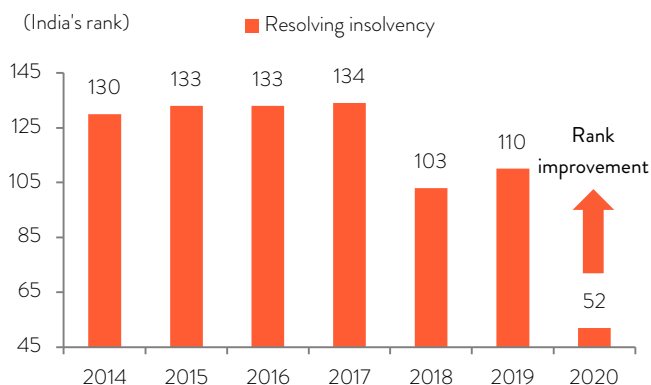
Source: World Bank, Bank of Baroda Research

**FIG 95 – INDIA'S RANKING IS IMPROVING...**


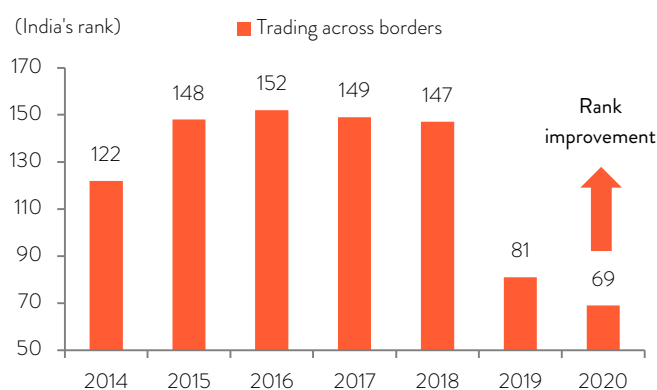
Source: Doing Business 2020, Bank of Baroda Research

**FIG 96 – ...LED BY GETTING CREDIT...**

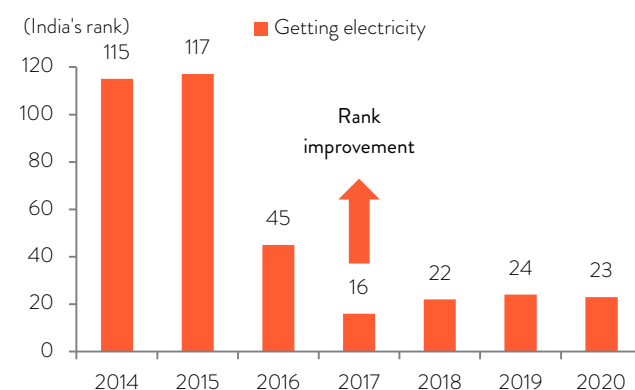
Source: Doing Business 2020, Bank of Baroda Research

**FIG 97 – ...RESOLVING INSOLVENCY...**

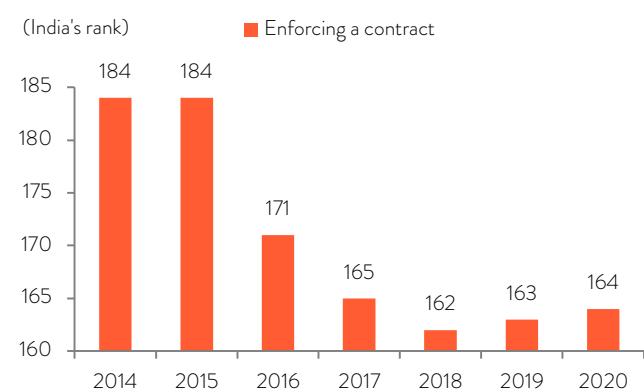
Source: Doing Business 2020, Bank of Baroda Research

**FIG 98 – ...TRADING ACROSS BORDERS...**

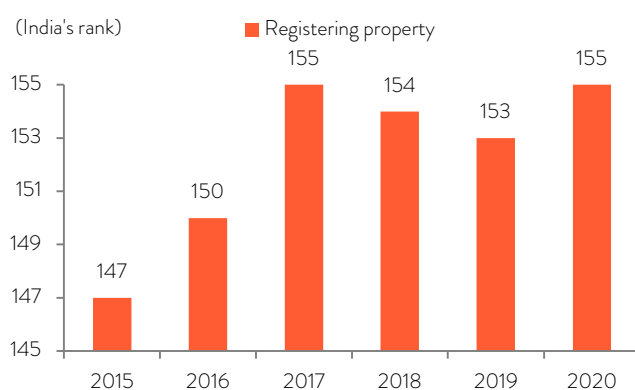
Source: Doing Business 2020, Bank of Baroda Research

**FIG 99 – ...AND GETTING ELECTRICITY**

Source: Doing Business 2020, Bank of Baroda Research

**FIG 100 – SCOPE FOR IMPROVEMENT IN ENFORCING A CONTRACT...**

Source: Doing Business 2020, Bank of Baroda Research

**FIG 101 – ...AND REGISTERING PROPERTY**

Source: Doing Business 2020, Bank of Baroda Research



## POLICY FRAMEWORK

Despite a constrained fiscal policy, space for monetary easing by way of transmission remains. RBI has introduced long-term refinancing and CRR exemption on certain categories of loans to improve transmission. Central banks globally have been cutting rates this year and the trend is likely to sustain – we expect RBI to lower rates once inflation is below its 4% target. Global yields have declined in 2020 as markets expect further easing by central banks to mitigate the coronavirus impact.

## Easing monetary policy

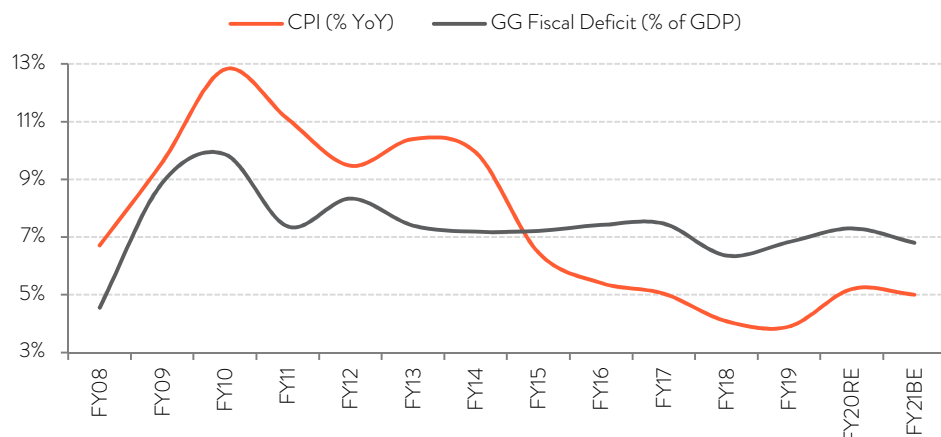
Alongside the government's structural reforms, RBI's easing monetary policy should also help revive growth. The government's conscious efforts toward prudent expenditure management and fiscal discipline have contained inflation at lower levels and allowed RBI to cut rates (by 135bps since Feb'19). The current spike in inflation is a seasonal phenomenon led up an uptick in food prices which should subside in the near term, giving RBI the leeway for further monetary stimulus.

## Inflation stable despite expansionary fiscal policy

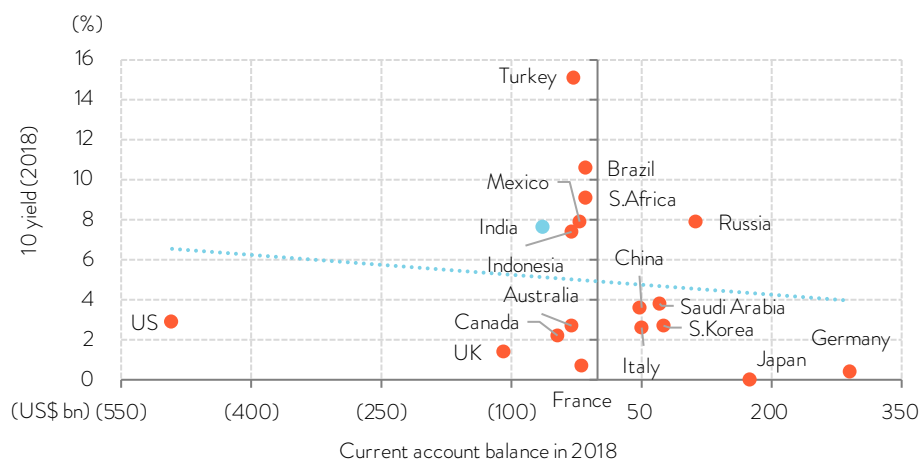
History suggests an expansionary fiscal and monetary policy may lead to higher inflation. We look at the period between 2008 and 2016 as a case in point:

- Between FY09 and FY14, India's retail inflation averaged more than 10%.
- Notably, between FY09 and FY13 the Centre's fiscal deficit averaged 5.5% compared with 3.6% in the prior five-year period.
- In addition, RBI had reduced the repo rate to 4.75% in 2009 before gradually increasing it to 5% in Mar'10, 6.75% in Mar'11 and 8.5% in Oct'11 as inflation increased.
- In 2014-15, the Centre's fiscal deficit fell to 4.1% and has only fallen since then.
- Only once monetary and fiscal policy reversed course did inflation revert to under 6% in 2015-16.

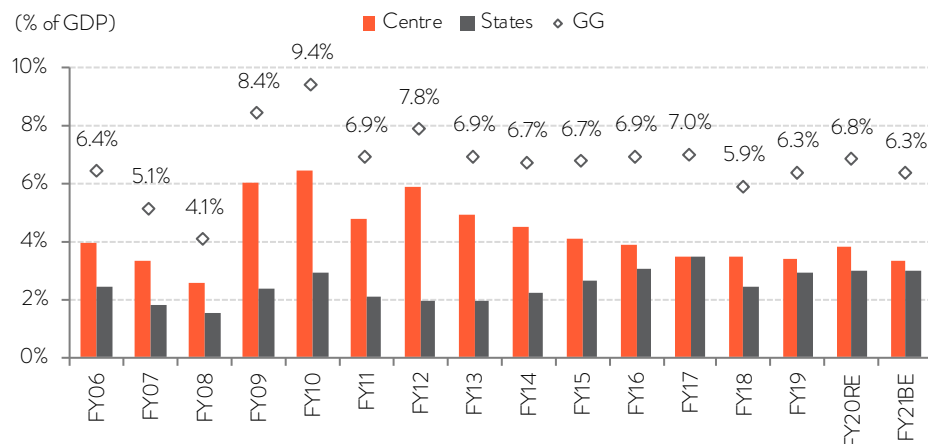
Fiscal policy has played an important role in achieving lower inflation as there is a negative feedback loop between domestic expansionary policies and inflation through currency depreciation. An expansionary fiscal policy had led to higher trade deficit and CAD in India in the FY10 to FY13 period, which resulted in sharp INR depreciation in 2013. Foreign outflows accentuated the pressure on currency which reinforced higher domestic inflation. In the current scenario, though the monetary policy is expansionary, the general government fiscal deficit is steady, thus ensuring stable inflation.

**FIG 102 – GENERAL GOVERNMENT FISCAL DEFICIT & CPI MOVE IN TANDEM**

Source: RBI, Bank of Baroda Research| Note: RE - Revised Estimates, BE - Budget Estimates; FY20RE = FY20BE for states; FY21BE for states are BoB estimates; CPI projections for FY20 & FY21 are BoB estimates

**FIG 103 – CAD VS. NOMINAL INTEREST RATES, 2018**

Source: IMF fiscal monitor, Bank of Baroda Research

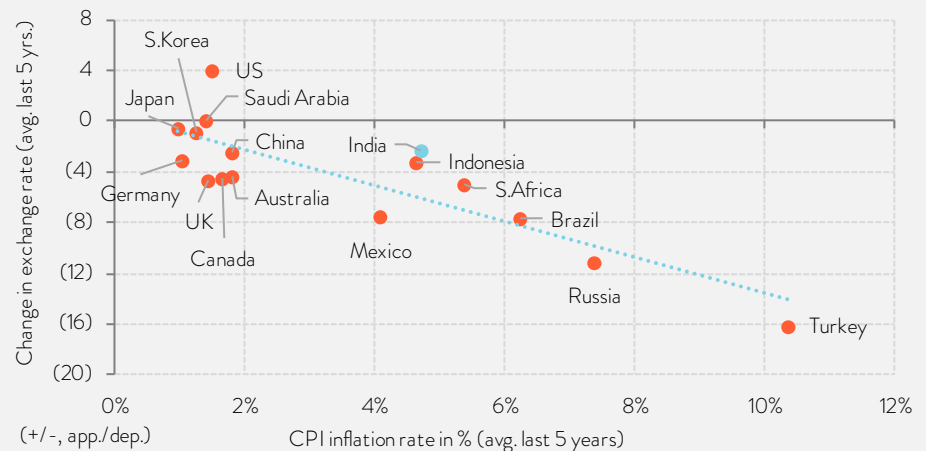
**FIG 104 – CENTRAL GOVERNMENT CONSOLIDATING FISCAL DEFICIT; STATES EXPANDING – KEEPING GENERAL GOVT. DEFICIT LARGELY STEADY**

Source: RBI, Bank of Baroda Research| Note: RE - Revised Estimates, BE - Budget Estimates; FY20RE = FY20BE for states; FY21BE for states are BoB estimates

### Inflation and the exchange rate

Inflation and the exchange rate are inversely related. Typically, in countries with consistently higher inflation, the exchange rate depreciates as purchasing power decreases relative to other currencies. In the last five years, US inflation averaged ~1.5% while the DXY appreciated by 4%. In countries such as Japan and South Korea which have less than 2% inflation, the extent of currency depreciation was limited. However, Turkey with an average inflation rate of 10.4% over the past five years saw a sharp depreciation in its currency by (-) 16.1%.

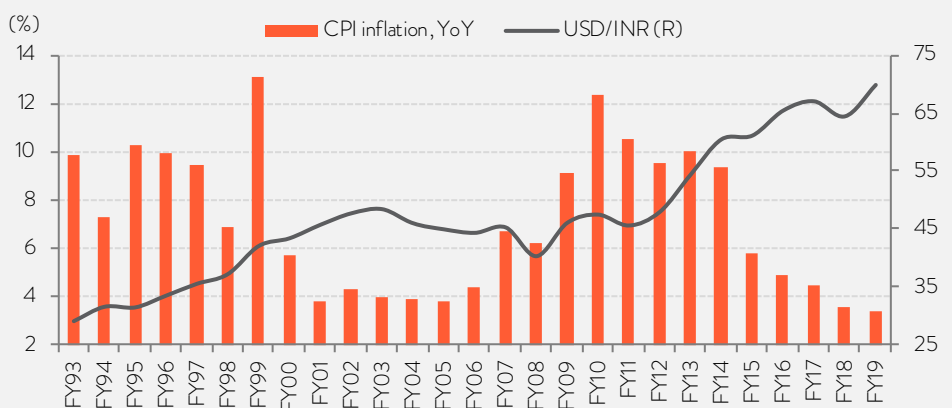
**FIG 105 – HIGHER INFLATION LEADS TO CURRENCY DEPRECIATION**



Source: Bloomberg, IMF World Economic Outlook Database, Bank of Baroda Research

For India as well, periods of high inflation are linked to a falling currency. From FY93 to FY99, when inflation remained elevated at 9.5%, the INR depreciated by (-) 7.5% p.a. Between FY00 and FY09, inflation moderated to 5.2%, resulting in a lower (-) 0.7% dip in the INR. Inflation rose again between FY10 and FY14 to 10.3%, putting pressure on the currency which fell by (-) 5.2% p.a. Since then, inflation has averaged at ~4.4% and the INR has depreciated by (-) 2.8% p.a.

**FIG 106 – IN INDIA, HIGHER CPI INFLATION PUTS PRESSURE ON INR**



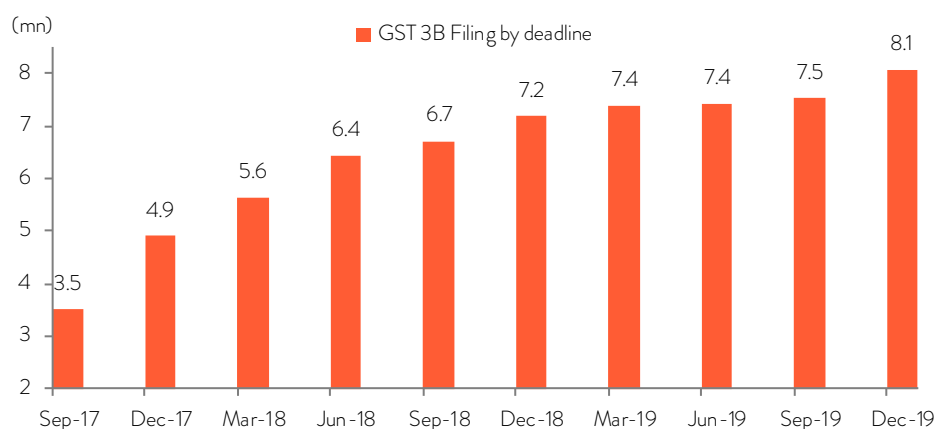
Source: Bloomberg, IMF World Economic Outlook Database, Bank of Baroda Research

## Fiscal management – asset monetisation a way out

Government CPSEs have a total market cap of Rs 12.5tn, of which the top 10 account for ~73% share (Fig 108). The government plans to bring in strategic investors at some of these enterprises, which will lead to efficiency gains in the form of management and technical knowhow. In addition, divestment will spur private sector participation and generate resources for planned infrastructure investments. The latest Union Budget sets a Rs 2.1tn disinvestment target for FY21 (BE). This includes Rs 1.2tn from equity stake sale in PSUs and Rs 900bn from the LIC IPO and privatisation of IDBI Bank.

With stabilisation of GST, indirect tax revenues are also expected to improve – the Union Budget projects an 11.1% jump in FY21 from 5.3% in FY20. Direct tax collections are projected to rise by 12.7% in FY21 from 2.9% in FY20. Overall revenues were lower this year at Rs 18.5tn vs. budget estimates of Rs 19.6tn because of the corporate tax rate cut. This trend of lower receipts is likely to reverse and the Centre's net revenue is estimated to normalise to Rs 20.2tn in FY21.

**FIG 107 – IMPROVEMENT IN GST FILINGS**



Source: PIB, Bank of Baroda Research

**FIG 108 – TOP 10 CPSEs BY M-CAP**

Company	BSE M-Cap* (Rs bn)	BSE M-Cap* (% of GDP)	Government stake (Rs bn)	Government stake (%)
Oil & Natural Gas Corp (ONGC)	1,657	0.80	1,065	64.25
Coal India	1,264	0.61	914	72.33
Indian Oil Corp	1,236	0.60	636	51.50
NTPC	1,149	0.55	626	54.50
Bharat Petroleum Corp	1,109	0.54	591	53.29
Power Grid Corp of India	1,012	0.49	560	55.37
GAIL (India)	568	0.27	299	52.64
Hindustan Petroleum Corp**	430	0.21	220	51.11
Contained Corp of India	353	0.17	193	54.80
NMDC	314	0.15	227	72.28

Source: DIPAM, Bank of Baroda Research | \*As on 29 Nov 2019; \*\*Stake held by ONGC



### The UK example: Thatcher privatisation plan

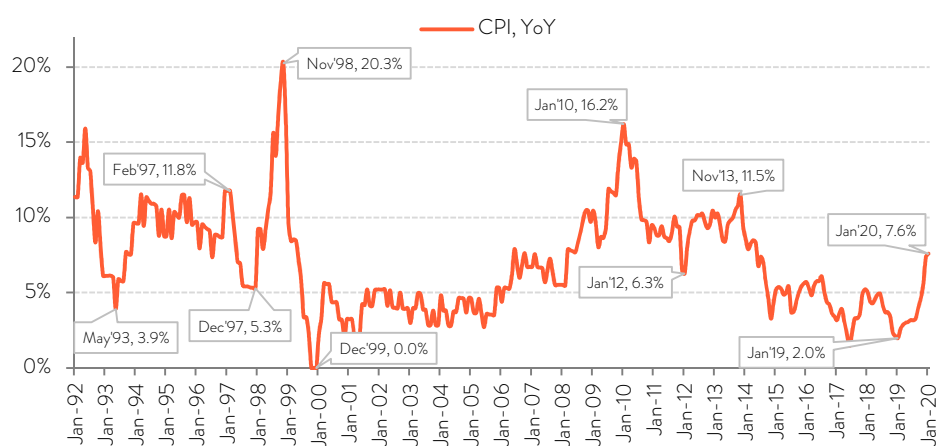
Before the Thatcher government came into power in 1979, nationalised industries represented 10% of the UK economy and 14% of total capital investment. These included industrial sectors such as coal, steel, electricity generation, gas supplies, railways, docks, canals and telecom. Borrowings and losses of state enterprises were running at ~£3bn a year (1.4% of GDP). This led to the need for privatisation.

Many of the key public sector companies were privatised between the late 1970s to 1990s, viz. Rolls Royce Motors (1973), BP (stake sales between 1977 and 1987), British Airways (1987), British Steel (1988), British Coal (1994), British Gas (1986), British Electricity (1990-1995), British Telecom (1984-1993) and Water (1989). British Telecom alone fetched more than £4bn. From 1989 to 1990, government revenue rose by ~£2bn (0.3% of GDP). The government was able to shift away from borrowing for public sector requirements to repaying the debt of public sector companies. Within the two-year period alone, ~12.5% of public debt was repaid.

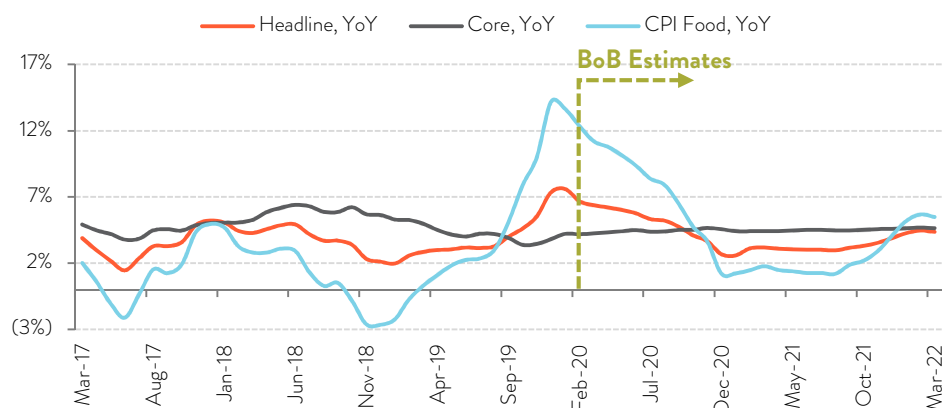
### Monetary policy transmission to play a role

India's inflation rate in the last few years has been far lower than historical levels. While this may lead to lower nominal GDP growth, it also implies lower inflation tax on the populace. Price stability further reinforces financial stability as higher inflation affects currency which in-turn impacts unhedged foreign currency borrowings from abroad by Indian firms.

**FIG 109 – DESPITE BEING HIGHER AT 7.6% IN JAN'20, CPI IS FAR BELOW ITS HISTORICAL PEAKS**



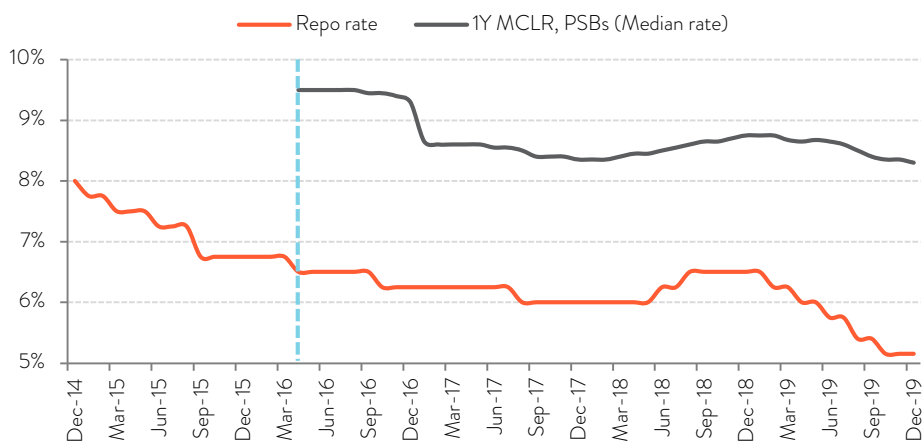
Source: CEIC, Bloomberg, Bank of Baroda Research | Note: Data before Jan'12 pertains to CPI-IW

**FIG 110 – HEADLINE CPI TO REMAIN MODERATELY ABOVE MPC'S TARGET OF 4% BEFORE BOTTOMING OUT IN FY22**


Source: CEIC, Bloomberg, Bank of Baroda Research

### Lower interest rates are not being translated...

Despite a 135bps reduction in repo rate over Feb-Dec'19, transmission has been ineffective, especially for loans. India's inherent nature of deposit concentration in the one-year plus tenor has made loan repricing difficult. In addition, banks have not reduced saving deposits rates. Transmission will improve with external benchmarking of loans. In addition, as term deposits rates are further repriced lower in the coming months and quarters, monetary policy will become more effective.

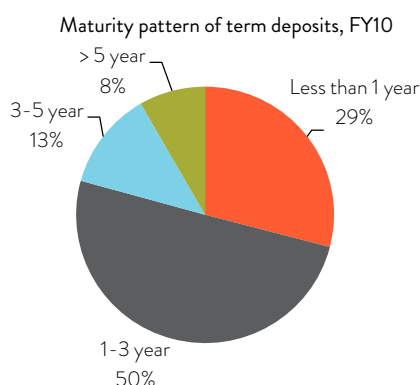
**FIG 111 – INCOMPLETE PASS-THROUGH OF REPO INTO MCLR**


Source: CEIC, Bloomberg, Bank of Baroda Research Note: MCLR was introduced w.e.f. 1 Apr 2016

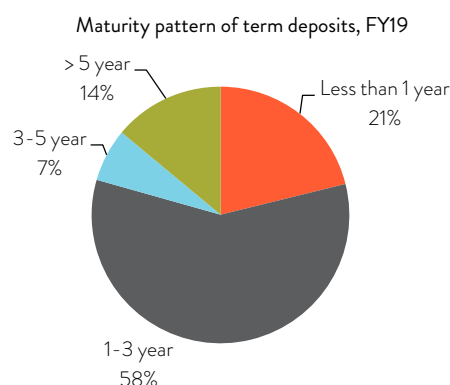
### ...as term deposit rates remain sticky

Most deposits in the banking system are in the form of term deposits, interest rates for which are contractually fixed and can change only on the day of rollover. The concentration of deposits is the highest in the one-year plus tenor. Weighted

average term deposit rates have remained sticky, falling only 30bps in the current cycle. Alternative rates in government savings (small savings) are also fairly higher.

**FIG 112 – MATURITY OF TERM DEPOSITS...**

Source: World Bank, Bank of Baroda Research

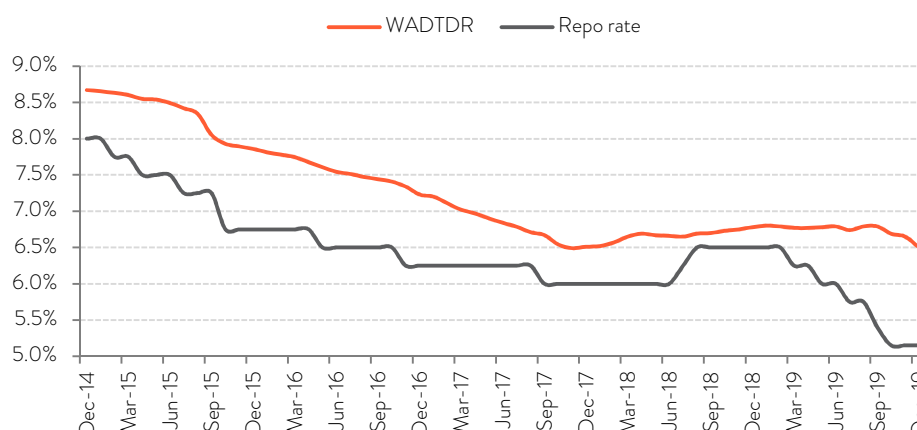
**FIG 113 – ...SHOWS CONCENTRATION IN 1-YEAR PLUS BUCKET**

Source: World Bank, Bank of Baroda Research

**FIG 114 – INTEREST RATES ON ALTERNATIVE INVESTMENTS FAIRLY HIGH...**

Instrument (%)	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	GSec Yield (3 Feb 2020)
1-year time deposit	6.9	7.0	7.0	6.9	6.9	6.9	5.62
3-year time deposit	7.2	7.0	7.0	6.9	6.9	6.9	6.13
5-year time deposit	7.8	7.8	7.8	7.7	7.7	7.7	6.49
5-year national savings certificate	8.0	8.0	8.0	7.9	7.9	7.9	6.49
Public provident fund scheme	8.0	8.0	8.0	7.9	7.9	7.9	6.50

Source: Department of Economic Affairs, Ministry of Finance, Government of India | Note: 10Y benchmark yield 6.45GS2029

**FIG 115 – ...THUS, TERM DEPOSIT RATES HAVE ALSO REMAINED STICKY**

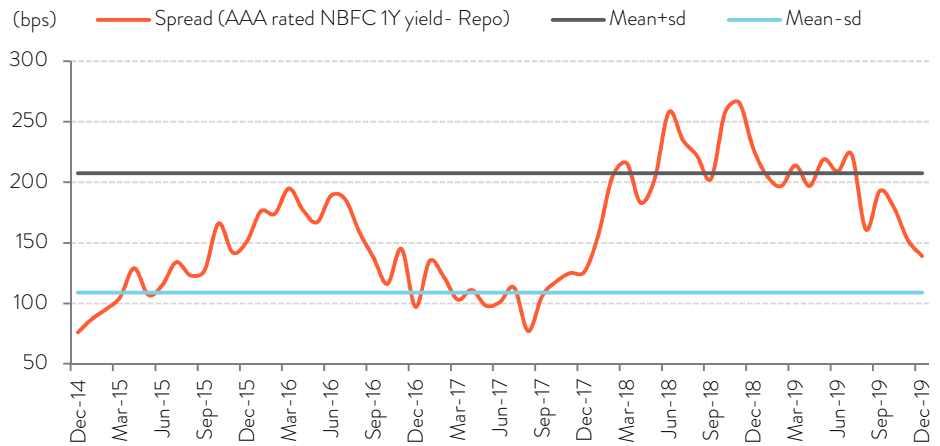
Source: CEIC, Bank of Baroda Research | Note: WADTDR – Weighted Average Domestic Term Deposit Rate

### Rate transmission in corporate securities and reduction in stress loans

Efficacy of transmission has improved in the case of AAA-rated one-year papers of NBFCs. Yields for these fell by 190bps between Feb'19 and Dec'19 and spreads against the repo rate have started easing after hitting a peak of more than 250bps

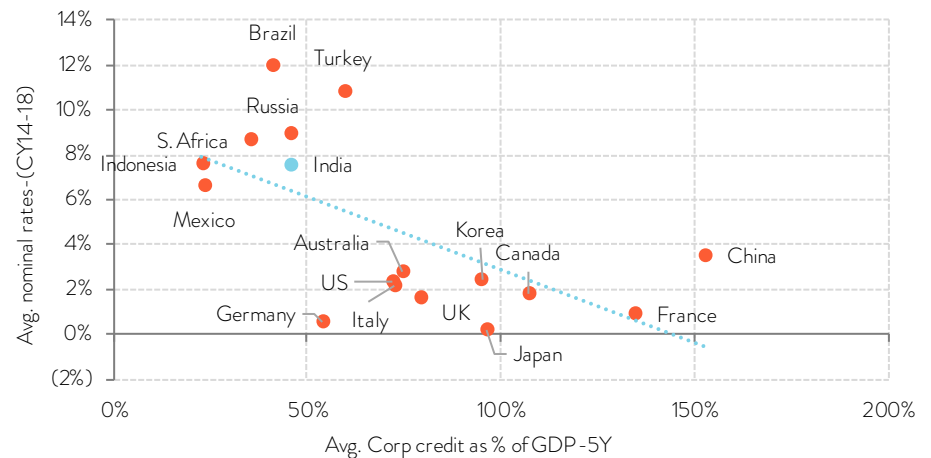
in Nov'18. We expect a further reduction in spreads, thus driving effective monetary policy transmission. We note a steady relationship between lower nominal interest rates and corporate credit in G20 countries.

**FIG 116 – CREDIT RISK SPREAD BETWEEN CORPORATE LOANS AND REPO**



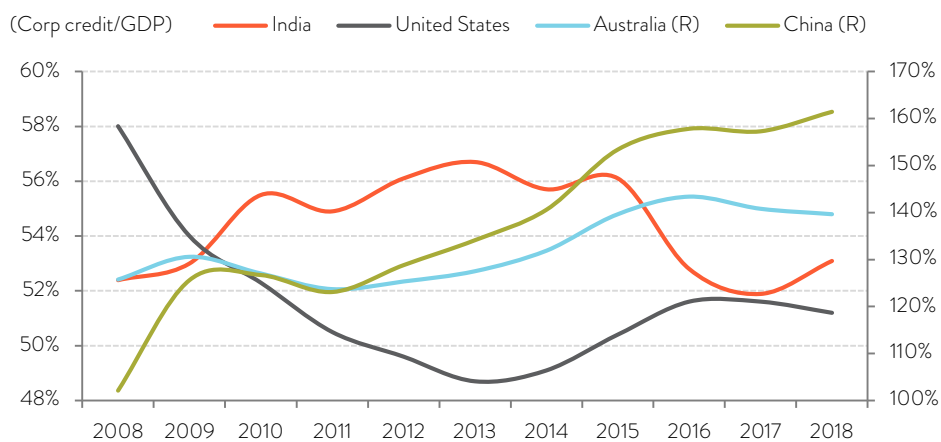
Source: CEIC, Bank of Baroda Research

**FIG 117 – NOMINAL RATES AND CREDIT TO CORPORATES AS PERCENTAGE OF GDP EXHIBITS NEGATIVE RELATIONSHIP**



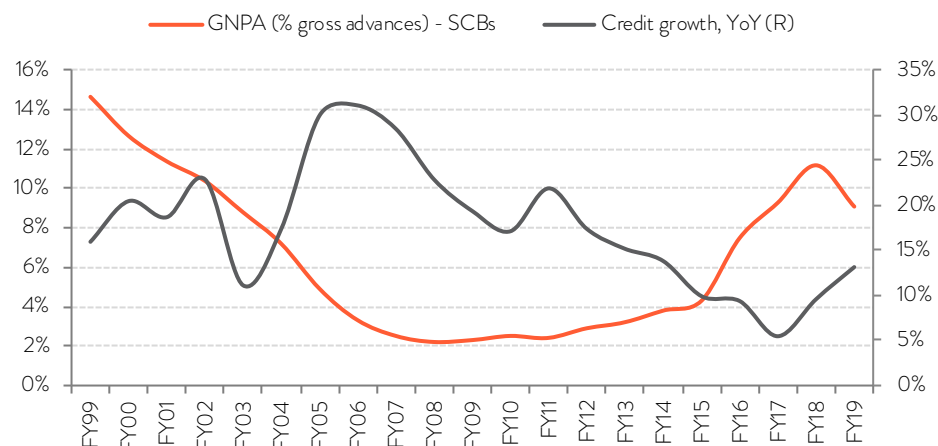
Source: BIS, Bloomberg, Bank of Baroda Research | Note: 10Y yield is taken as nominal rate and bank credit to non-financial sector is taken as corporate credit

Indian corporates have been deleveraging since 2015. Thus, the focus should be on reducing borrowing cost for the private corporate sector which may help in reducing stress. In addition, corporates will look at leveraging once again when the investment cycle carries more competitive interest rates.

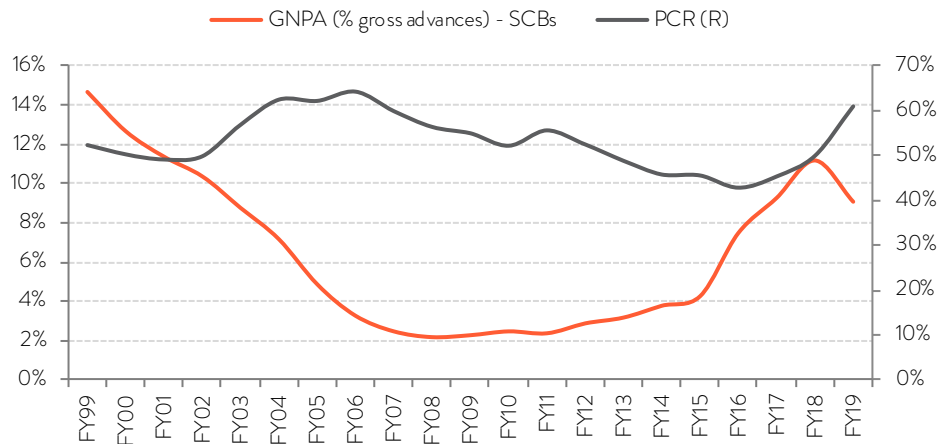
**FIG 118 – INDIA'S DELEVERAGING PHASE HAS BEEN PRONOUNCED POST 2015; US DELEVERAGED POST FINANCIAL CRISIS**


Source: BIS, Bank of Baroda Research

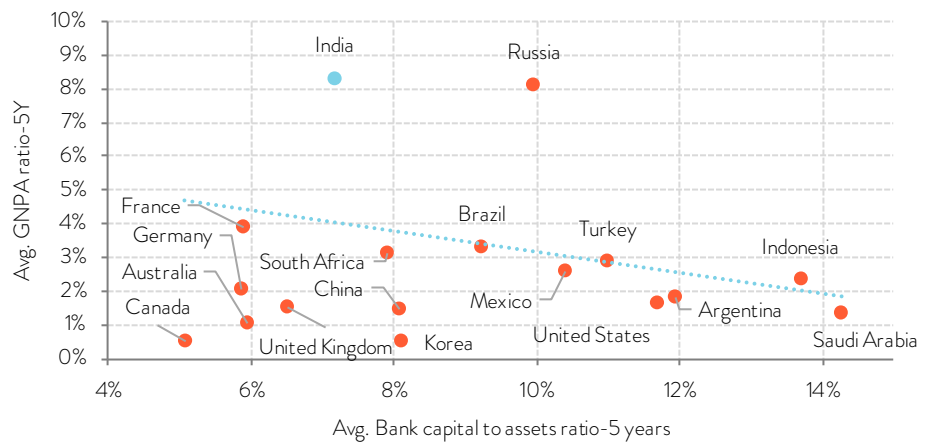
Corporate demand and lending capacity of banks will also pick up as faster resolution of NPAs leads to better asset quality ratios. An important step towards this is the IBC. The World Bank estimates that by 2020 India's insolvency resolution process will be in line with some of the major advanced countries and much better than peers (China, Brazil, Argentina, Russia).

**FIG 119 – INDIA'S GNPA VS. CREDIT GROWTH**


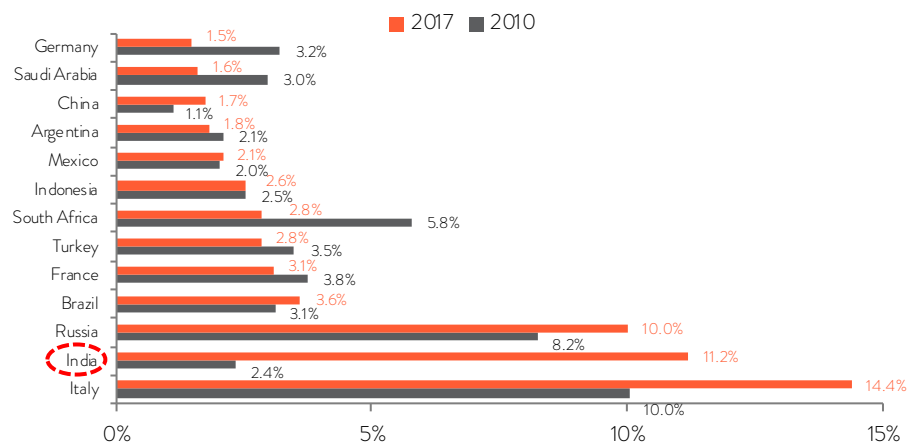
Source: IMF fiscal monitor, Bank of Baroda Research

**FIG 120 – INDIA'S GNPA VS. PCR**

Source: IMF fiscal monitor, Bank of Baroda Research

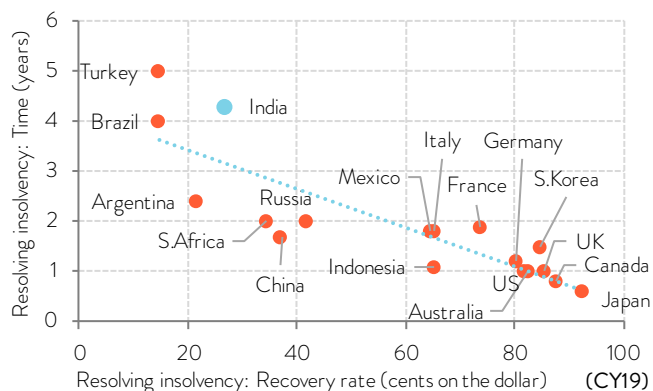
**FIG 121 – HIGHER NPA ALSO IMPAIRED BANKS' CAPITAL TO ASSETS RATIO**

Source: IMF fiscal monitor, Bank of Baroda Research

**FIG 122 – INDIA'S GNPA RATIO HAS INCREASED MARKEDLY, BUT WILL COME DOWN WITH THE HELP OF IBC**

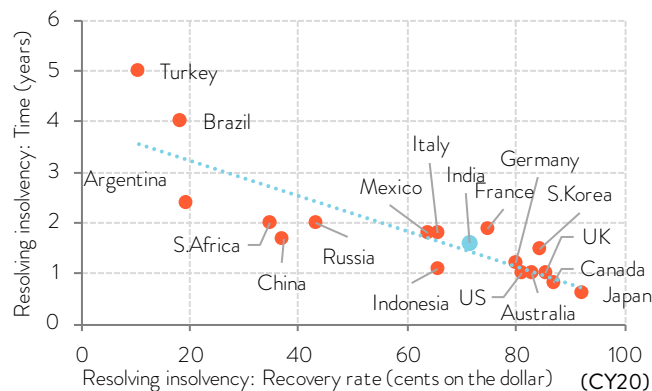
Source: IMF fiscal monitor, Bank of Baroda Research

FIG 123 – IBC RECOVERY RATE, 2019



Source: Ease of Doing Business database, Bank of Baroda Research

FIG 124 – IBC RECOVERY RATE, 2020

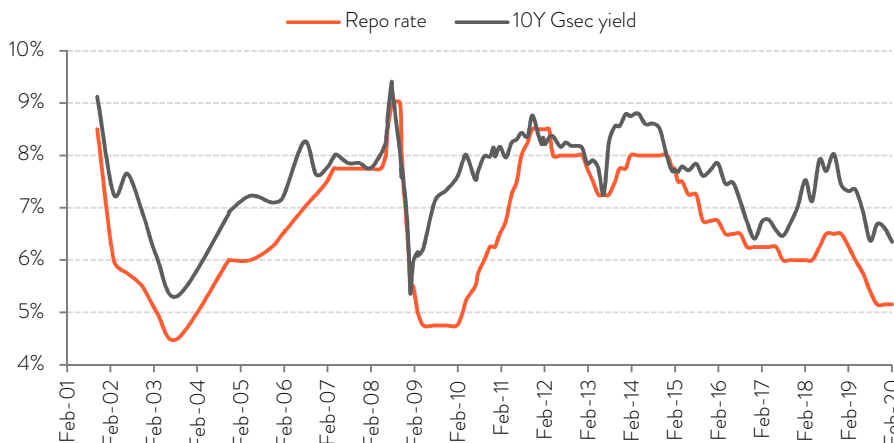


Source: Ease of Doing Business database, Bank of Baroda Research

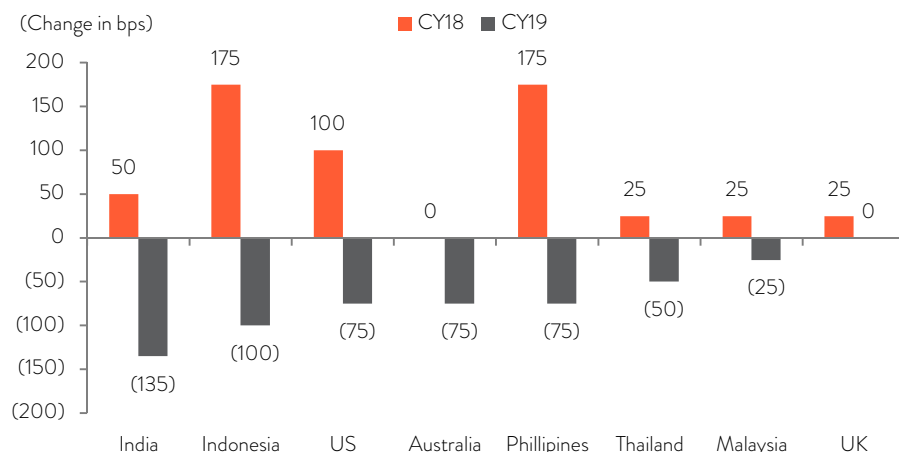
### Higher transmission of rates in G-Sec market

The transmission of repo rate cuts has been far more visible in 10-year government securities (at 99bps) than in the loan market. Apart from reduction in policy rates, several factors such as RBI's Operation Twist, range-bound oil prices (US\$ 64/bbl on average in 2019), lower global yields (especially in the US: 77bps lower), accommodative monetary policy worldwide, and liquidity surplus in the domestic market have supported lower yields. However, some upward bouts were seen as CPI inflation breached 7% in Dec'19 & Jan'20 and tax revenues remained muted.

FIG 125 – INDIA REPO RATE AND 10Y G-SEC YIELD MOVING IN SYNC



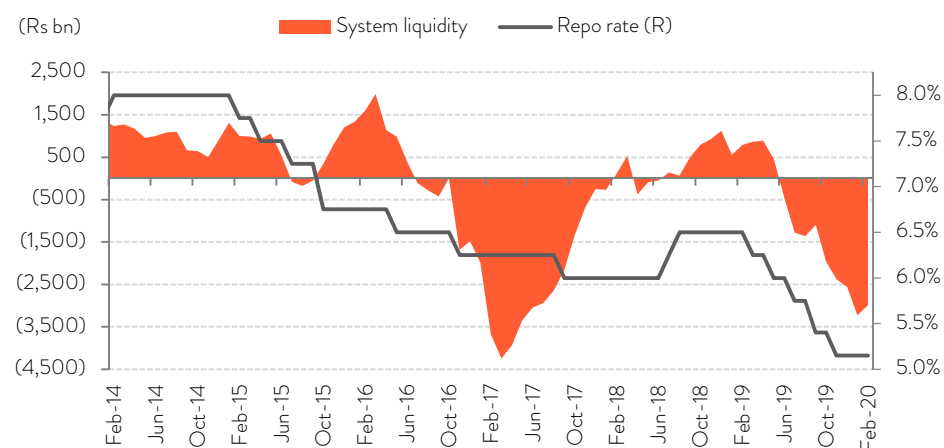
Source: IMF fiscal monitor, Bank of Baroda Research

**FIG 126 – ACCOMMODATIVE POLICY BY GLOBAL CENTRAL BANKS**

Source: Bloomberg

### Stronger liquidity to also support rates

India's liquidity surplus is currently at ~Rs 3tn on average and is expected to ensure faster transmission of rates in different markets. We note that transmission of rates has been a challenge even in government securities due to concerns over the extent of breach of fiscal deficit target. However, with RBI announcing Operation Twist to purchase long-end bonds, the 10-year yield has come down further in FY20 and will support lower yields.

**FIG 127 – HIGHER LIQUIDITY MAY SUPPORT LOWER RATES**

Source: CEIC, Bloomberg, Bank of Baroda Research | Note: Till 26 Feb 2020



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