INDIA

CHANGE OF POLICY MIX

At the end of the 2021/2022 fiscal year, India's real GDP exceeded its pre-crisis level, and economic activity indicators were positive in April and May 2022. Activity has been supported by a recovery in domestic demand and dynamic exports. Faced with rising inflation and downward pressure on the rupee (due to capital outflows and a widening trade deficit), the monetary authorities raised their policy rates in May and June – further increases are expected. Conversely, fiscal policy is more expansionary than anticipated. Multilateral institutions and India's Central Bank have revised their growth forecasts downwards (between 6.9% and 7.5% for the 2022/2023 fiscal year vs. 8.7% in the previous year). However, the public debt-to-GDP ratio should continue to decline thanks to the sharp rise in nominal GDP. The country is taking advantage of the embargo imposed by the US and EU on Russian oil imports to try to reduce its energy bill.

REAL GDP AT ITS PRE-CRISIS LEVEL

In fiscal year (FY) 2021/2022 that ended on 31 March 2022, real GDP growth stood at 8.7% and exceeded its pre-crisis level by 1.5%.

In the fourth quarter of FY 2021/2022 (i.e. January-March 2022), the resurgence of Covid cases and the introduction of new local restrictions in January and February led to a slight economic growth slowdown compared to the previous quarter. Between March and May, economic activity picked up again in both manufacturing and services. Business confidence remained positive in May with a PMI well above 50, and the production capacity utilisation rate in industry, though still short of the long-term average, exceeded the level it reached at the end of 2019. Growth in bank credit to both industry and services accelerated – especially loans to small and medium-sized enterprises, which were still benefiting from a favourable monetary environment. Average weighted interest rates on new loans stood at 7.5% in April 2022 (down 60 basis points compared to April 2021), while inflation, excluding energy and food, reached 7% at the same time.

Furthermore, the consumer confidence index continued its uninterrupted recovery until May from its low point in July 2021 (it remains below its pre-crisis level). In addition, the prospect of a normal monsoon, government support for farmers and an increase in minimum prices for « Kharif crops » (monsoon harvests) are all favourable factors for rural household consumption.

Nevertheless, economic growth prospects for FY 2022/2023 have been revised downwards by international organisations (OECD and World Bank) and by India's Central Bank, the Reserve Bank of India (RBI). The RBI now predicts growth of 7.2%, and projections from the OECD and World Bank are 6.9% and 7.5% respectively. Indeed, rising inflationary pressures and tighter monetary policy should bear down on domestic demand.

TIGHTER MONETARY POLICY AND FISCAL SUPPORT

In May, retail prices rose by 7% year-on-year (y/y). This rate was above the RBI's target of 4% ± 2 percentage points (pp) for the fourth consecutive month. As a result, the Central Bank brought its accommodating monetary policy to an end; it increased its policy rates by 90 basis points (bps) in May and June, bringing the repo rate to 4.9%. Furthermore, it raised the banks' reserve requirements ratio by 50 bps to 4.5% in order to reduce excess liquidity in the banking sector. Further rate rises are expected following the next monetary policy committee meeting in August. The RBI expects inflation to remain above 7% from July to September, slowing down from October to sit at an average of 6.7% over the current fiscal year.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, % (1)	4.2	-6.6	8.7	7.1	6.1
Inflation, CPI, year average, % (1)	4.8	6.1	5.5	6.7	5.5
General Gov. Balance / GDP, % (1)	-7.3	-13.7	-10.4	-10.2	-8.5
General Gov. Debt / GDP, % (1)	73.7	84.0	83.6	82.5	82.4
Current account balance / GDP, % (1)	-0.9	0.9	-1.5	-3.8	-3.1
External debt / GDP, % (1)	19.9	21.6	19.7	19.4	18.7
Forex reserves, USD bn	457	580	633	570	590
Forex reserves, in months of imports	7.7	11.0	9.1	8.0	8.3

TABLE 1

(1) Fiscal year from April 1st of year n to March 31st of year n+1
e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDIA: CPI AND INTEREST RATES

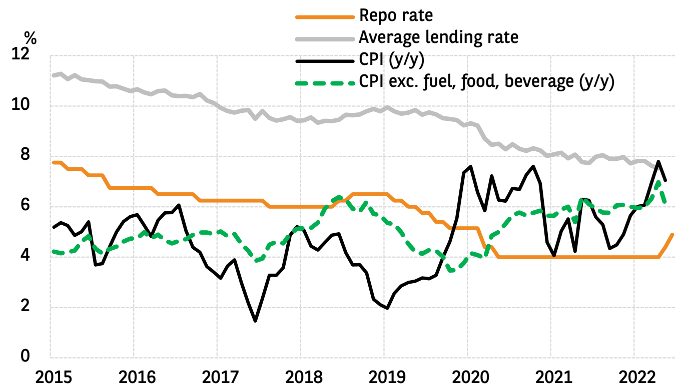

CHART 1

SOURCE: CEIC, RBI

Although this tighter monetary policy will weigh on domestic demand, it will not be enough to curb inflationary pressures that are generated by supply constraints. However, the rise in interest rates should help to shore up the rupee, and thus contain imported inflation.

In these circumstances, and in addition to the ban on wheat exports, the government adopted several budgetary measures during May in order to contain the rise in domestic prices. However, these adjustments will delay the ongoing consolidation of public finances (in FY 2021/2022, the fiscal base rose by 1.4 pp to 11.4% of GDP compared with the pre-pandemic level) as the measures introduced will weigh on both spending (up 0.7% of GDP) and revenue (down 0.7% of GDP).

To contain the rise in energy prices, the government reduced excise duty on imports of gas oil and diesel by Rs8 and Rs6 per litre respectively, largely offsetting the rise in prices of Rs10 per litre in March and April. All customs duties on coal imports were also lifted. Finally, the government increased subsidies for 90 million of the most vulnerable households to help them cope with rising gas prices (particularly gas used for household cooking).

In addition, the government doubled the amount of subsidies on fertilisers (up 0.4% of GDP) in order to limit cost increases for future harvests. The grain distribution programme for households covered by the National Food Security Act was extended until September 2022, increasing the cost of food subsidies by almost 40% compared to the initial budget (up 0.3% of GDP).

Therefore, the government's forecast of a reduction in the budget deficit from 6.7% of GDP in FY 2021/2022 to 6.4% of GDP for the current fiscal year appears optimistic, even though the increase in inflationary pressures will generate a greater increase than expected in nominal GDP. The general government debt-to-GDP ratio is expected to continue to fall gradually, while remaining above 82%.

The structure of government spending will become less favourable. The share of rigid spending (made up in particular of subsidies and interest payments on debt) is set to increase to 38%, and the government could be forced to limit infrastructure spending to rein in budgetary slippage. The rise in yields of the government's 10-year bonds (up 100 bps over the last 12 months to reach 7.4% at the end of June) will increase the interest debt burden. Interest payments stood at 36.5% of government revenue in FY 2021/2022 despite inflationary pressures (deflated by the core CPI, the yields of the government's 10-year bonds in real terms remain below their pre-crisis level but are now above the levels recorded in 2020 and 2021).

EXTERNAL ACCOUNTS UNDER PRESSURE...

In the first quarter of the 2022 calendar year, the current account deficit fell by 1.6 pp compared with the previous quarter, reaching only 1.5% of GDP on an annualised basis, despite the rise in the oil bill. The sharp increase in exports compensated for a growth in imports caused by the increase in commodity prices. At the same time, the current account deficit was fully covered by FDI inflows (which increased). However, external account pressures remained high due to large capital outflows, which reached 1.7% of GDP. Due to its strong dependence on oil imports, India was one of the Asian countries most penalised by the recent episode of distrust on the part of foreign investors.

Pressures on external accounts heightened in April and May, and financial indicators (portfolio investments, forex reserves, exchange rates) suggest that this trend continued in June. The trade deficit increased by more than 20% in April and May compared with the first quarter. The rise in US policy rates favoured the repatriation of part of the capital invested in Asia to financial centres regarded as less risky.

Tensions on the rupee remained relatively contained over the first six months of the year (down 5.1% against the dollar) thanks to FX interventions by the RBI. Although down, foreign exchange reserves (USD 590 billion in mid-June 2022) remained at very comfortable levels. They covered 1.9 times the country's short-term financing needs in mid-June 2022.

INDIA: CURRENT ACCOUNT BALANCE AND CAPITAL INFLOWS

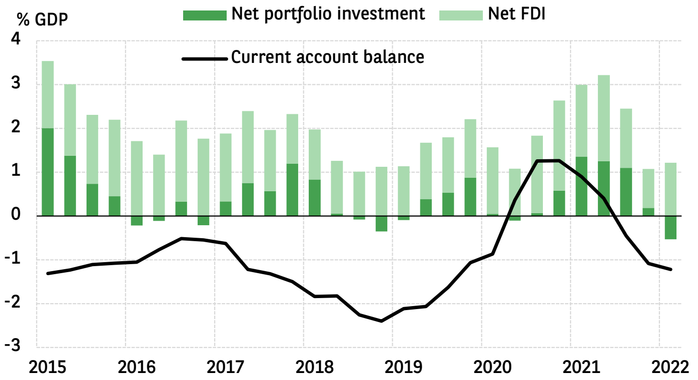

CHART 2 SOURCE: CEIC, RBI

... DESPITE PREFERENTIAL PRICES ON RUSSIAN OIL IMPORTS

To contain the impact of rising international oil prices on its domestic economy, the Indian government has stepped up its efforts to replace crude oil imports from Saudi Arabia and the United Arab Emirates with Russian oil. This restructuring of oil imports happened much faster than one could have imagined. In April 2022, Russia became India's fourth largest oil supplier, whereas it was the ninth largest in 2021. Imports of crude oil from Russia accounted for 8.3% of India's total imports compared to just 0.9% for the whole of 2021, according to data published by the Indian Ministry of Commerce. The gap between the price of a barrel of Brent and the price of Russian Urals oil (USD 35 on average in May) was sufficient to offset the additional cost incurred by insurance and the transportation of oil from Russia. Moreover, this process of replacement accelerated in May, with volumes imported from Russia up by 230% compared with April, although Iraq and Saudi Arabia remain India's leading oil suppliers. Despite this strategy, India's oil bill remains very high. Between December 2021 and April 2022, the price of a ton of imported crude oil increased by 36.8% vs an increase of 43% in the price of Brent.

Article completed on 1 July 2022

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