INDIA

FIRM RESISTANCE AGAINST STRONG PRESSURES

Although it remains dynamic, economic growth slowed in the first quarter of the current fiscal year. Monetary policy tightening, a very mixed monsoon season and disruption to global value chains are expected to weigh on activity during the next two quarters. The central bank has revised its economic growth forecasts downwards for the current fiscal year as a whole. At the same time, pressures on external accounts and the rupee are set to remain strong. Despite this rather unfavourable environment, enterprises and banks are holding up well.

SLOWER ECONOMIC GROWTH

In the first quarter of the fiscal year 2022/2023 (April to June 2022), real GDP increased by 13.5% compared to the same period the previous year, but contracted by 3.3% in seasonally-adjusted terms compared to the previous quarter. All GDP growth components fell back slightly compared to the previous quarter (with the exception of imports). The contribution of net exports to growth deteriorated further; it had already been negative for six quarters.

The latest leading indicators reveal that the slowdown in activity continued in the second quarter of the fiscal year 2022/2023 in industry (electricity, cement and coal) and services. Disruption to global value chains and rising production costs are worsening the outlook for industry. Higher prices and a tighter monetary policy are likely to affect the consumption of urban households. In August, the inflation rate again reached 7% year-on-year, whereas the target set by the monetary authorities is 4% +/-2 percentage points. Furthermore, the core inflation (excluding food and energy prices) remains very high, even though it slowed to 5.8% year-on-year in August (from a peak of 7% in April 2022).

The agricultural sector has also experienced a very variable monsoon. Sales of tractors already fell in July and August. Throughout the country, the monsoon should be slightly better than the average recorded between 1970–2020. On the other hand, while the north-east and east of the country seem to have a water shortage, rainfalls in central and western regions were heavier than usual. The water deficit in four states (Uttar Pradesh, Bihar, Jharkhand and West Bengal) is estimated at between 18% and 46%, and these states produce almost a third of the country's cereals. Anomalies weighed on the cotton and soybean harvests in the west of the country, but should also reduce rice harvests, particularly in the main producer states such as West Bengal, Bihar and Uttar Pradesh. In September, against this backdrop, the government announced a ban on broken rice exports and imposed a customs duty of 20% on sales of other categories of rice (excluding basmati rice). As a result of these measures, the country's rice exports are expected to fall by 25% during the fiscal year 2022/2023.

For the whole fiscal year 2022/2023, real GDP growth is not expected to exceed 7.0%, according to the latest forecasts from the Reserve Bank of India (RBI).

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	-11.0	-9.1	-8.6
General Gov. Debt / GDP, % (1)	74.7	84.0	82.3	81.1	81.0
Current account balance / GDP, % (1)	-0.9	0.9	-1.2	-4.2	-3.1
External debt / GDP, % (1)	19.9	21.6	19.7	19.4	18.7
Forex reserves, USD bn	457	580	633	520	535
Forex reserves, in months of imports	7.7	11.0	9.1	7.5	8.0

TABLEAU 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: INDUSTRIAL PRODUCTION

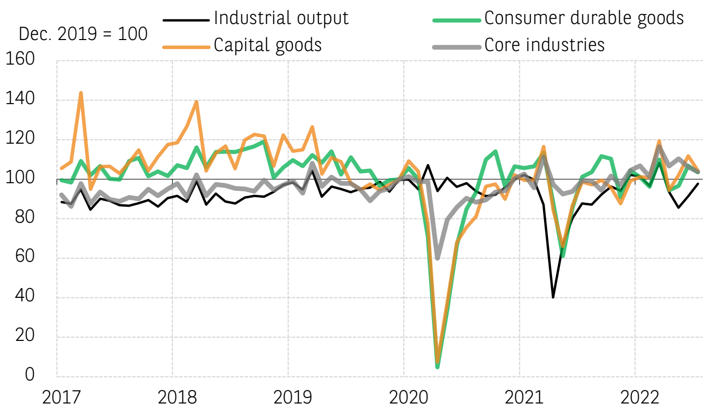

CHART 1

SOURCE: CEIC, RBI, BNP PARIBAS

THE RUPEE UNDER PRESSURE

Between January and September 2022, the sharp widening of the trade deficit and capital outflows caused the rupee to fall by 8.9% against the dollar, and a drop in foreign exchange reserves of over 15% (to USD 537 billion at the end of September 2022).

The trade deficit reached 7.9% of GDP over the first eight months of 2022 (compared to 4.6% last year), and net portfolio investments posted a deficit of 1.7% of GDP over the first half of the year. The central bank's interventions to support the currency have gathered pace since the summer. Between January and July 2022, the RBI sold USD 38.8 bn in foreign exchange reserves (including almost USD 20 bn for July 2022 alone). By way of a comparison, it sold USD 14 bn between June and September 2013 during the 'Taper Tantrum' episode.

In the short term, the rupee looks set to remain under pressure. Although the drop in international commodity prices should help reduce the energy bill, the global economic slowdown is likely to have a negative impact on exports. These had already fallen by 11.6% in July and August compared to the first half of the year. The trade deficit is therefore expected to remain particularly high. Over the entire fiscal year 2022/2023, the current account deficit could reach 4.2% of GDP (compared to 1.2% of GDP in 2021/2022).

Regarding investment flows, the country could benefit from the increase in India's weighting in the MSCI Emerging Markets Index (up from 12.45% to 14.483%). However, the decision to include the Indian government debt securities in global bond indices, originally scheduled for October, was delayed to 2023.

Pressures on external accounts are expected to remain strong during the fourth quarter and throughout 2023, but foreign exchange reserves remain sufficient. They covered 1.8 times the country's short-term financing needs at end-September 2022.

A MORE SOLID BANKING SECTOR

The latest financial stability report published by the RBI describes a consolidation of the banking sector during the fiscal year 2021/2022. Although public banks remain much more fragile than private banks, their financial situation has continued to strengthen, and they should all be able to cope with monetary tightening and the deterioration of the economic environment.

Banking asset quality has improved: across the entire banking sector, the non-performing loan (NPL) ratio fell by 1.6 points during the past 12 months, to 5.9% in March 2022. The NPL ratio for public banks remains higher but yet recorded a fall from 9.5% to 7.6% over the same period. The construction sector remains the most fragile of all. Its non-performing loan ratio was still as high as 19.4% in March 2022. Nevertheless, the risks for the banking sector remain under control, since loans to the construction sector only represent 3.7% of total credit granted by the banking sector as a whole.

Furthermore, although provisions are still insufficient across the banking sector as a whole, they improved slightly, covering 70.9% of risky assets in March 2022 compared with 68.9% a year earlier.

Solvency ratios have continued to strengthen, reaching 16.5% for the entire banking sector (14.7% for public banks). Lastly, banks' profits have continued to grow, though at a more modest rate than in the previous six months. Their return on assets and return on equity stood at 0.9% and 9.7% respectively in March 2022.

Supported by their more comfortable financial situation, banks have been more inclined to respond to rising credit demand. Credit growth, which has been up since April 2021, continued to accelerate and reached 14.5% year-on-year in July 2022 (compared to +5% a year earlier). This growth spans all categories of borrowing, including loans to households and companies, and all sectors of activity. However, this upward momentum is expected to be affected by the rise in key rates (up 140 basis points since April 2022). Average interest rates for new loans only rose by 70 bps in nominal terms between April and July 2022, but the rise in real terms is much greater given the slowdown in inflationary pressures over the same period. Deflated by the consumer price index excluding energy and food ("core inflation"), interest rates rose by 190 bps. Yet they remain at relatively low levels (the average real rate for new loans was 2.4% in July).

INDIA: BALANCE OF PAYMENTS

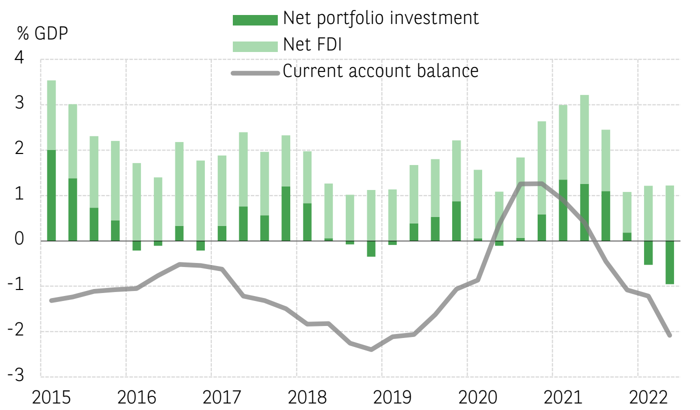

CHART 2 SOURCE: CEIC, RBI, BNP PARIBAS

Despite the expected slowdown in activity in the next few quarters, credit risks should remain contained, according to the RBI. In its baseline[1] scenario, the central bank foresees a strengthening of the quality of bank assets by the end of the 2022/2023 fiscal year. The non-performing loan ratio should fall to 5.3%. However, it also predicts a drop in solvency ratios from 16.5% in March 2022 to 15% in March 2023. In the event of an extreme shock (contraction of economic activity), the NPL ratio would increase to 8.3% and the average solvency ratio would drop to 13.3%. Nevertheless, the 46 banks tested would not need to be recapitalised in order to comply with solvency ratios.

ENTERPRISES IN A GOOD POSITION

Despite the increase in production costs (up by 45% year-on-year in Q2 2022) and, to a lesser extent, in debt interest payments (up by 9.4% in Q2 2022), the financial situation of enterprises remains comfortable overall. They have passed the increase in their costs on to their sales prices, as can be seen by their profit growth. Their profits continued to grow compared to the same period last year, albeit at a more modest rate (net profits increased by a rate of 24.6% year-on-year in Q2 2022). The level of corporate debt decreased: the ratio of debt to equity stood at 35% in Q2 2022 compared to 45.8% two years earlier. Furthermore, in June 2022, pre-tax profits were still enough to cover 4.9 times the amount of debt interest payments.

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1 In its baseline scenario produced in June 2022, the RBI forecast growth of 7.2% and average inflation of 6.6% over the year 2022/2023.