panorama

August 2023

Key Insights:

Broad-based improvement in capital expenditure across sectors

- Healthy industrial order book also indicate strong capex momentum
- Private sector takes lead in new investments announcements, with improvement in manufacturing capex
- Chemicals and Machinery drive manufacturing capex announcements, Aircraft orders drive services capex
- Central government frontloads capital expenditure in FY24

RBI Surveys - capacity utilization improves, inflation expectations remain anchored

- Rising capacity utilization bodes well for investments in capacity expansion
- Household inflation expectations remain well anchored despite sharp increase in food inflation
- Both manufacturing and services firms expect higher selling prices and improvement in profit margins
- Forecasters delay rate cut expectations. Expect higher GDP, manageable CAD and robust credit growth

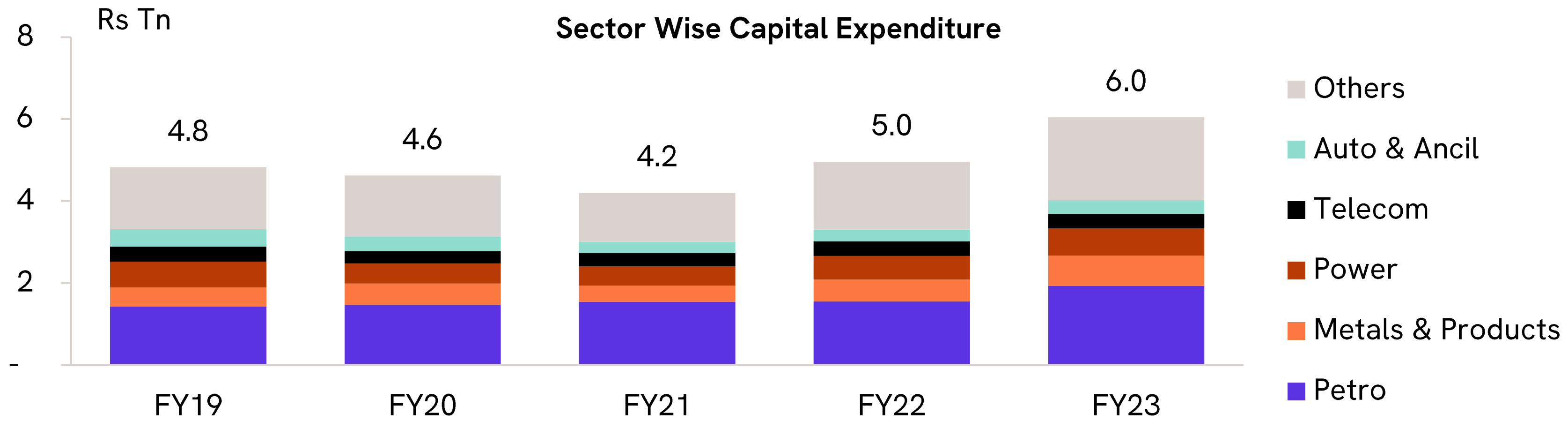
RBI introduces incremental CRR to drain excess banking liquidity

- Withdrawal of Rs 2000 denomination banknotes and RBI Fx purchases added to banking system liquidity
- Banking system liquidity falls into deficit on account of incremental CRR
- Higher seasonal demand of currency during festive season will further drain the liquidity
- Excess liquidity hampers transmission during the rate hike cycle
- Removal of excess liquidity from the system amounts to policy tightening and will improve transmission

Capex Revival

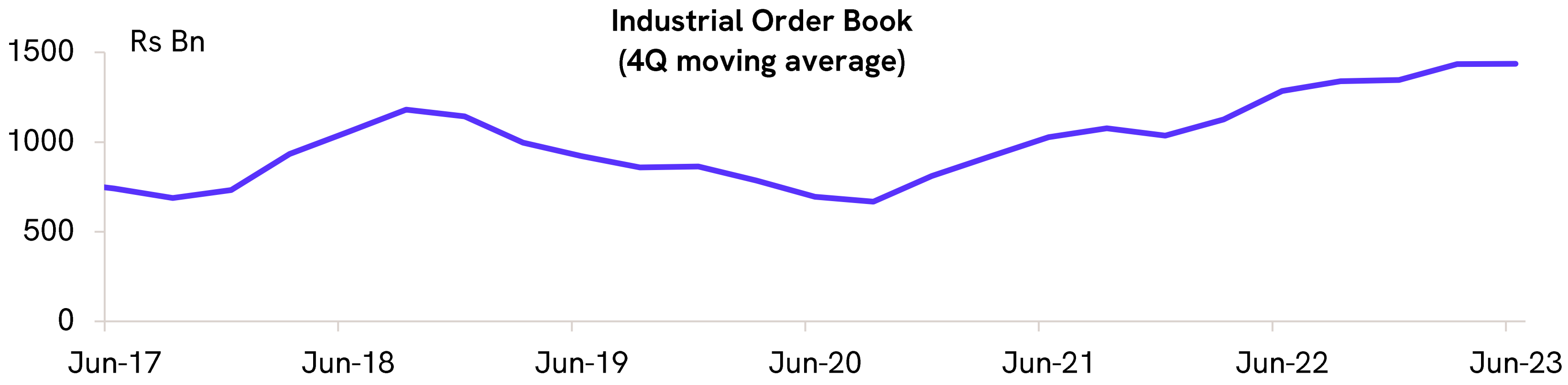
Clear signs of broad-based capex revival

Healthy industrial order book also indicates continued capex momentum in FY24



For a sample of listed companies, capital expenditure rose by 22% YoY in FY23. There has been a broad-based improvement in capital expenditure across sectors

Petro (*refer to Note*) and Metals witnessed steep increase in capex in FY23, followed by Power, Auto & Ancil, Chemicals and Construction



Healthy and broad-based industrial order book also indicates strong capex momentum

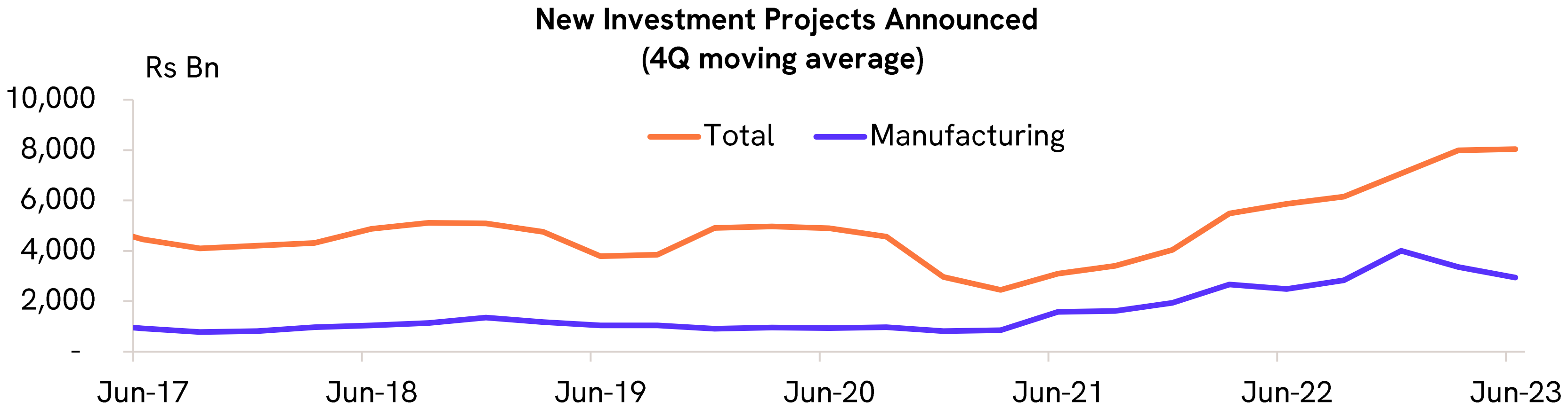
Order book led by Water & Irrigation, Roads, Building & Factories, and Power sector

Note: A conglomerate with business spanning across energy, petrochemicals, natural gas, retail, telecommunications etc. is classified under petro and account for a significantly large share of total capex

Source: Ace Equity, Investec Research, 360 ONE Asset Research

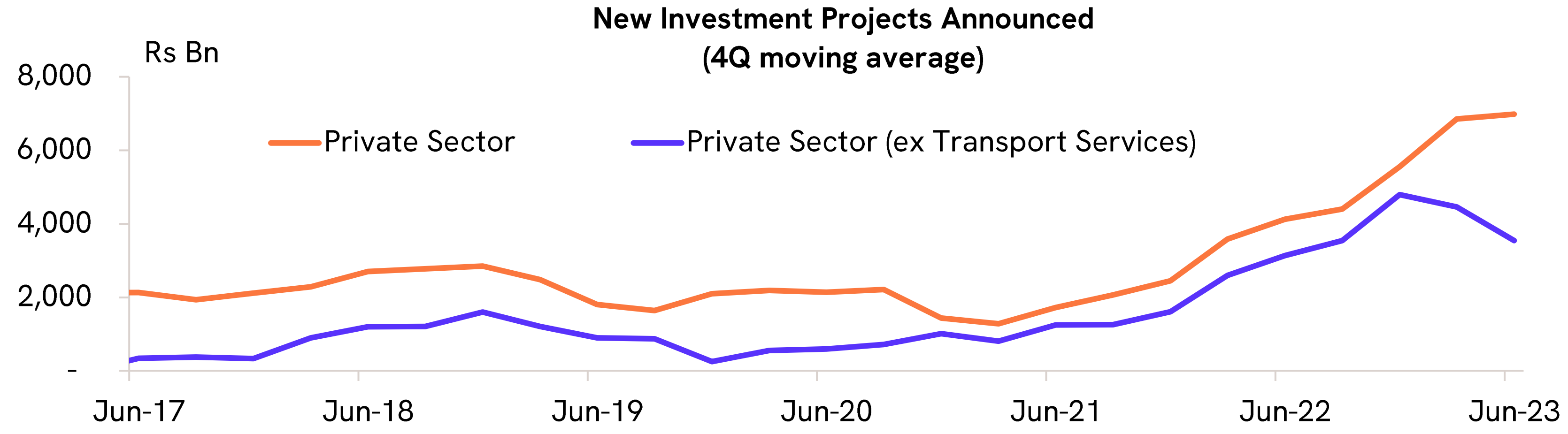
Private sector leads the charge in new capex announcements

Manufacturing sector witnesses improvement in new investments



Steady improvement in new investment project announcements over the past two years

While the services sector contributes significantly to these new investments, there has also been a consistent improvement in the manufacturing sector announcements



New investment projects are being propelled by the private sector

A substantial contribution from transport services is attributed to large aircraft orders from two airlines. However, the private sector, excluding transport services, is also displaying a recovery in capital expenditure

Source: CMIE, 360 ONE Asset Research

Chemicals and Machinery drive manufacturing sector capex

Capex announcements in the services sector are being fueled by aircraft orders from airlines

New Investment Announcements (Rs bn)	FY21	FY22	FY23	Jun-21	Jun-22	Jun-23
Manufacturing	**3,380**	**10,651**	**13,438**	**3,246**	**2,554**	**863**
Chemicals & chemical products	782	2,986	7,368	1,577	1,488	504
Consumer goods	128	122	230	28	37	2
Construction materials	102	279	225	22	21	11
Metals & metal products	1,573	2,704	880	835	246	51
Machinery	269	3,462	3,019	714	261	156
Electricity	**1,402**	**4,786**	**6,887**	**457**	**2,793**	**712**
Services (other than financial)	**3,536**	**5,431**	**11,192**	**533**	**409**	**4,515**
Transport services	1,890	3,974	9,590	287	259	4,423
Information technology	500	490	1,084	24	66	42
Construction & real estate	**790**	**667**	**259**	**59**	**103**	**28**
All Industries	**9,805**	**21,911**	**31,963**	**4,361**	**5,920**	**6,124**

Chemicals and products constitute over 50% of the share in manufacturing announcements for both FY23 and Q1FY24

Machinery also accounts for a noteworthy 22% share in the announcements for FY23. It continues to hold the position of the second-largest sector in terms of new investment announcements, following chemicals

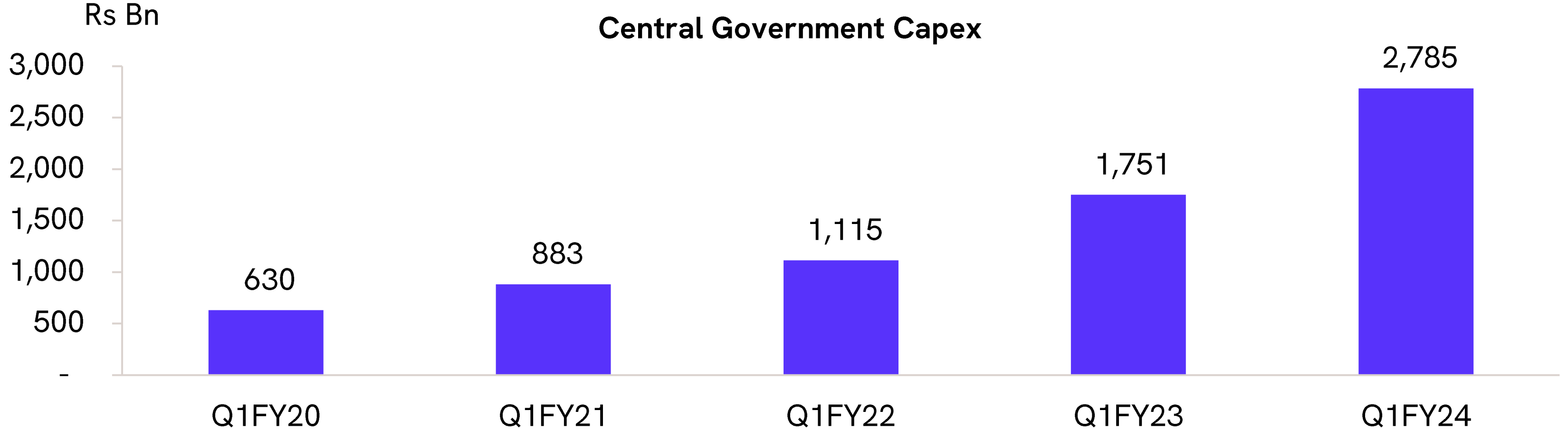
Electricity/Power sector also witnesses improvement in new investments, account for 20% of total announcements in FY22 and FY23

Robust capital expenditure in transport services is being driven by large aircraft orders from two airlines

Source: CMIE, 360 ONE Asset Research

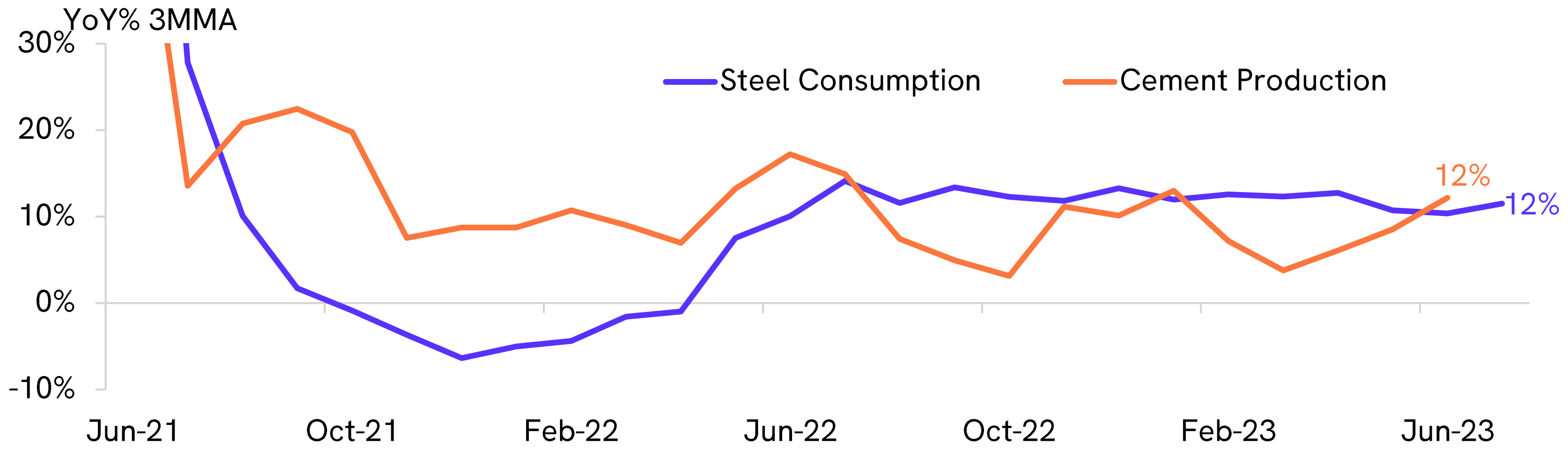
Central government frontloads capital expenditure

High frequency indicators also indicate a robust momentum in capex



Central government capital expenditure higher by 59% YoY in FY24 June quarter as government frontloads capex

Central capital expenditure is propelled by investments in roads, railways, telecommunications, and transfers to states



Several high frequency indicators also signal an improvement in capital expenditure

Steel consumption and cement production are both experiencing double-digit growth

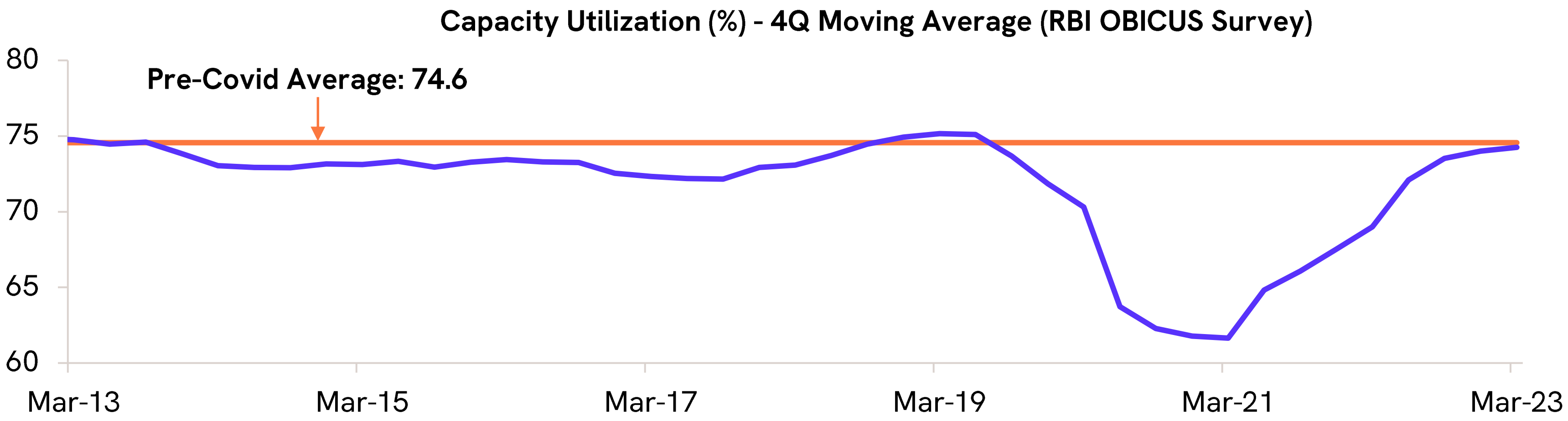
Source: CMIE, CGA, 360 ONE Asset Research

Note: 3MMA: 3 Month Moving Average

RBI Surveys

Capacity utilization back to pre-COVID levels

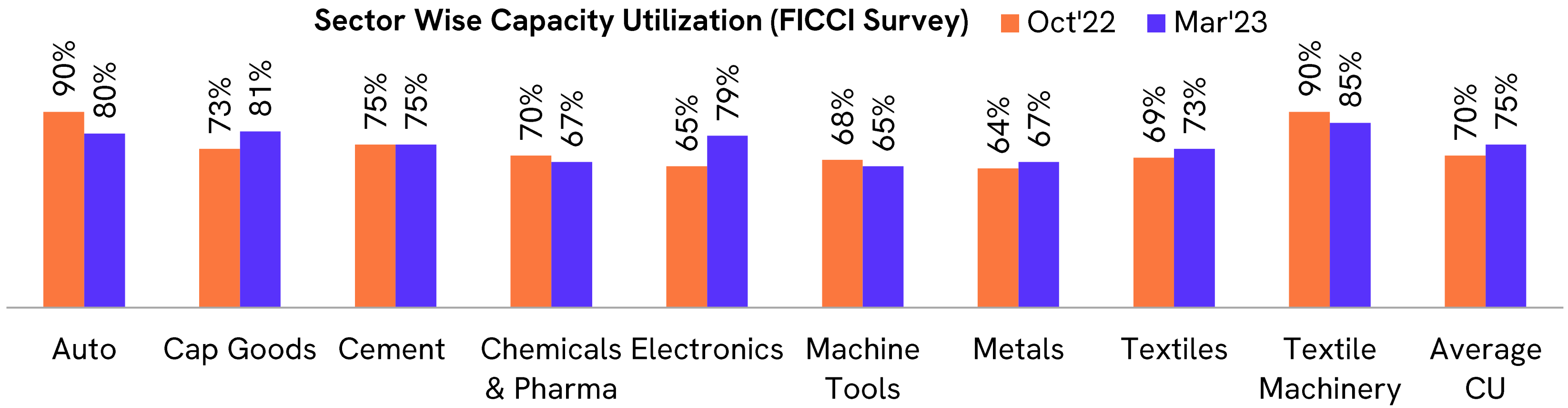
Rising capacity utilization indicates a favorable environment for capacity expansion



Capacity utilization has rebounded to pre-COVID levels

In Mar-23 quarter, capacity utilization rose to 76.3% up from 74.1% in the previous quarter as per RBI's OBICUS survey

High level of capacity utilization bodes well for further investments in capacity expansion



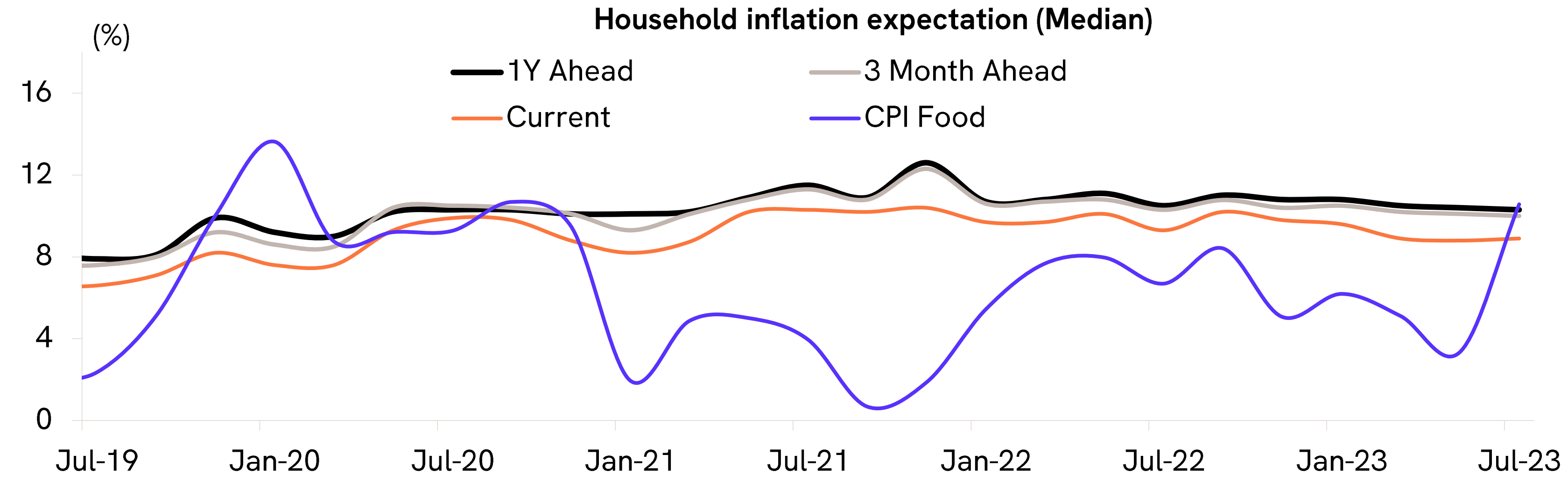
FICCI survey also point to improvement in manufacturing capacity utilization from 70% in October 2022 to 75% in March 2023, driven by capital goods and electronics sectors

Source: RBI, FICCI, 360 ONE Asset Research

Note: CU – Capacity Utilization

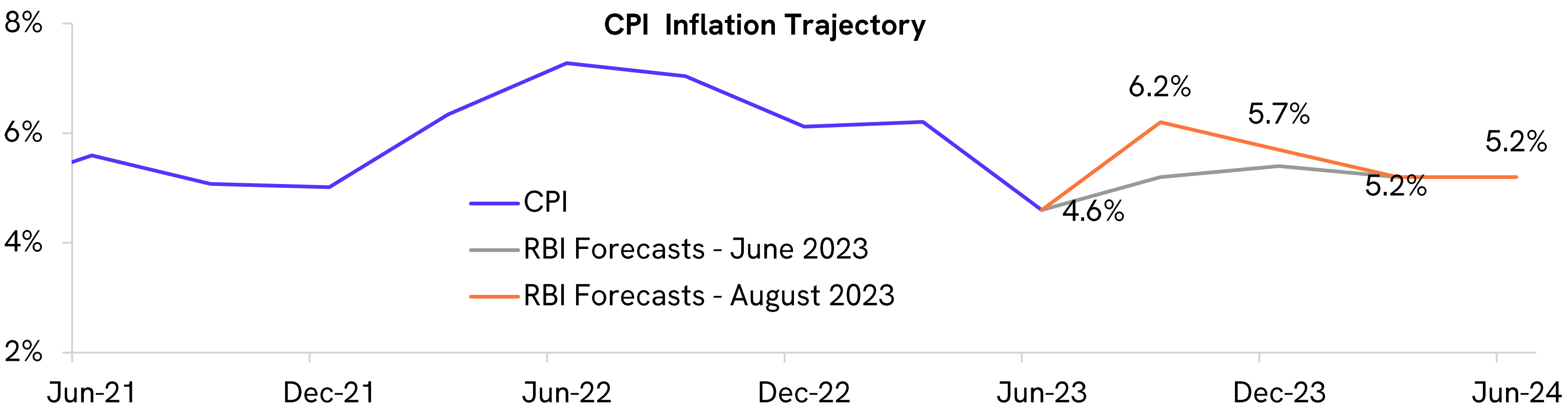
Inflation expectations remain anchored despite higher inflation

RBI to look through recent spike in food inflation if there are no signs of inflation persistence



Household perception of current inflation inched up by 10 bps in the latest round of RBI IESH survey, expectation of 3 month and 1 year ahead moderated by 10 bps each

HH inflation expectations tend to be sensitive to food and fuel prices. However, expectations remained well anchored in July 2023 despite sharp increase in food inflation



RBI revises inflation trajectory significantly upwards in August 2023 policy. RBI projects average headline inflation of 5.4 % YoY in FY24, up from 5.1% YoY in the last policy. We also expect inflation to average around 5.5% YoY in FY24

RBI to look through idiosyncratic shocks (such as the recent rise in vegetable prices), but ready to act if the shocks persist

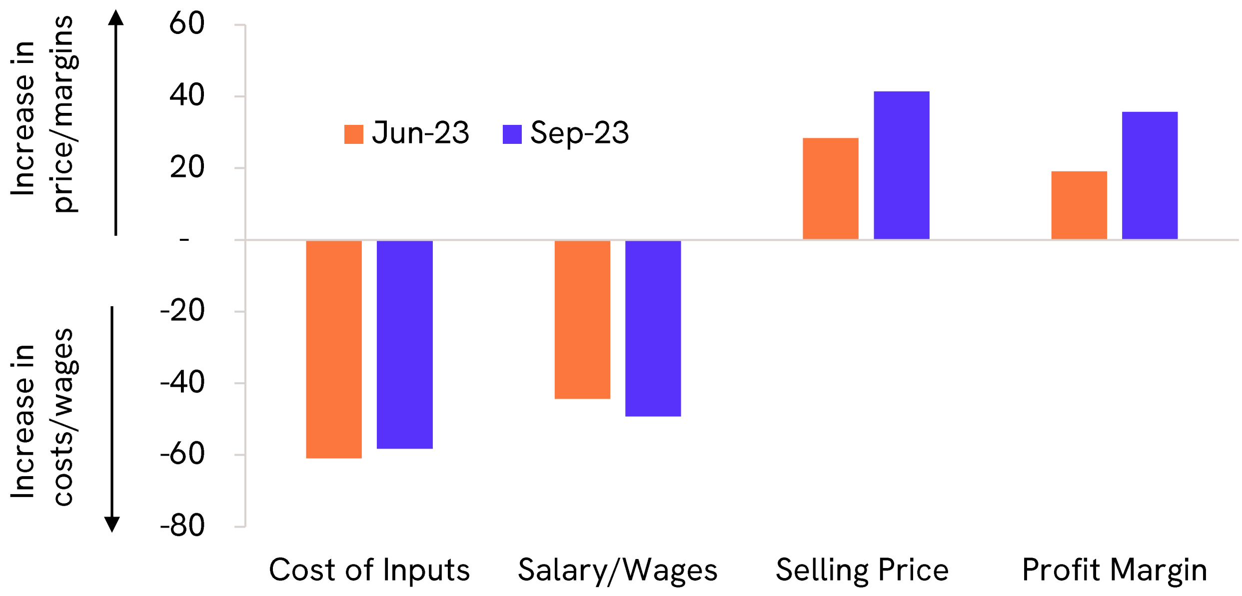
Source: RBI, 360 ONE Asset Research

Firms expect higher selling prices and profit margins

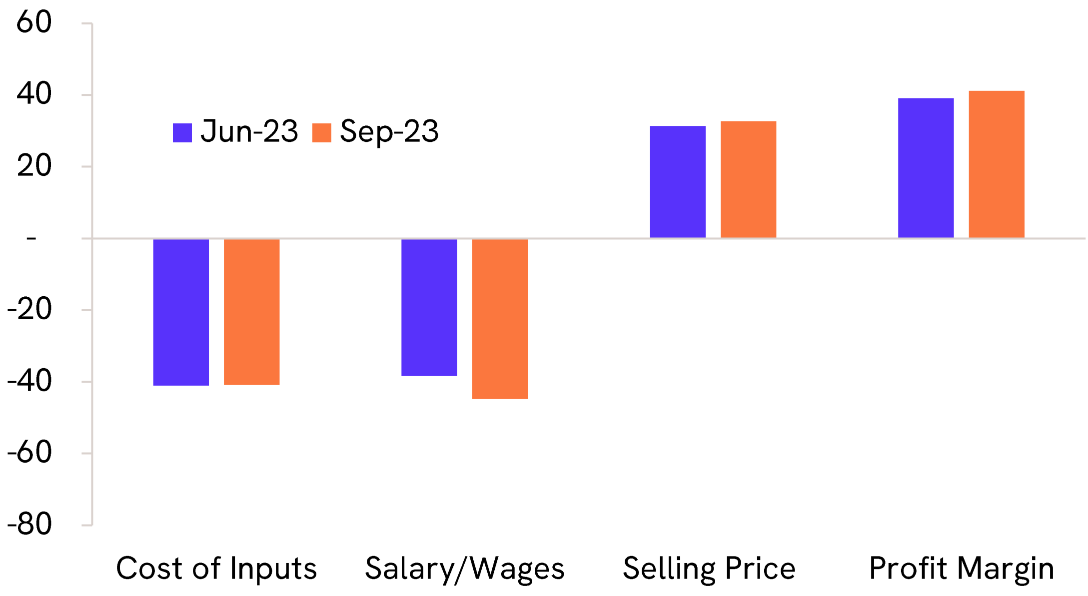
Salary and wages expected to remain a drag on profitability

RBI Industrial and Services Outlook Surveys - Expectations

Manufacturing - Net Response



Services - Net Response



Manufacturers expect easing of raw material costs while wage pressure are likely to sustain in Sep quarter

Selling prices expected to improve, driving the profit margins higher

Services firms also expect rise in selling prices to support margins

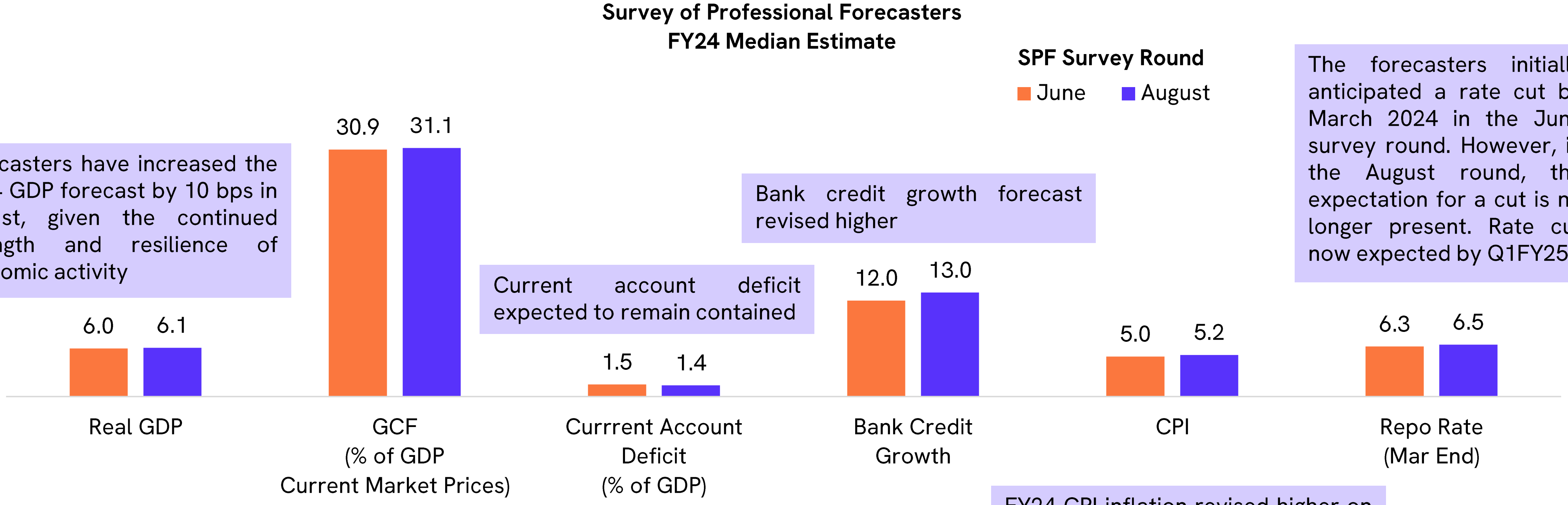
Input cost pressures to remain largely stable, while pressures from the wage bill are expected to rise

Note: Net Response (NR) is the difference between the percentage of respondents reporting optimism and those reporting pessimism. Decrease in cost of raw material and salary/wages is optimism. Increase in selling prices and profit margin is optimism

Source: RBI, 360 ONE Asset Research

Rate cut expectations have been pushed back

GDP growth revised higher, current account manageable, strong bank credit growth and improved investment outlook



Forecasters have increased the FY24 GDP forecast by 10 bps in August, given the continued strength and resilience of economic activity

Investment outlook has also marginally improved in August survey round

Current account deficit expected to remain contained

Bank credit growth forecast revised higher

FY24 CPI inflation revised higher on steep rise in food inflation, driven by vegetables

The forecasters initially anticipated a rate cut by March 2024 in the June survey round. However, in the August round, the expectation for a cut is no longer present. Rate cut now expected by Q1FY25

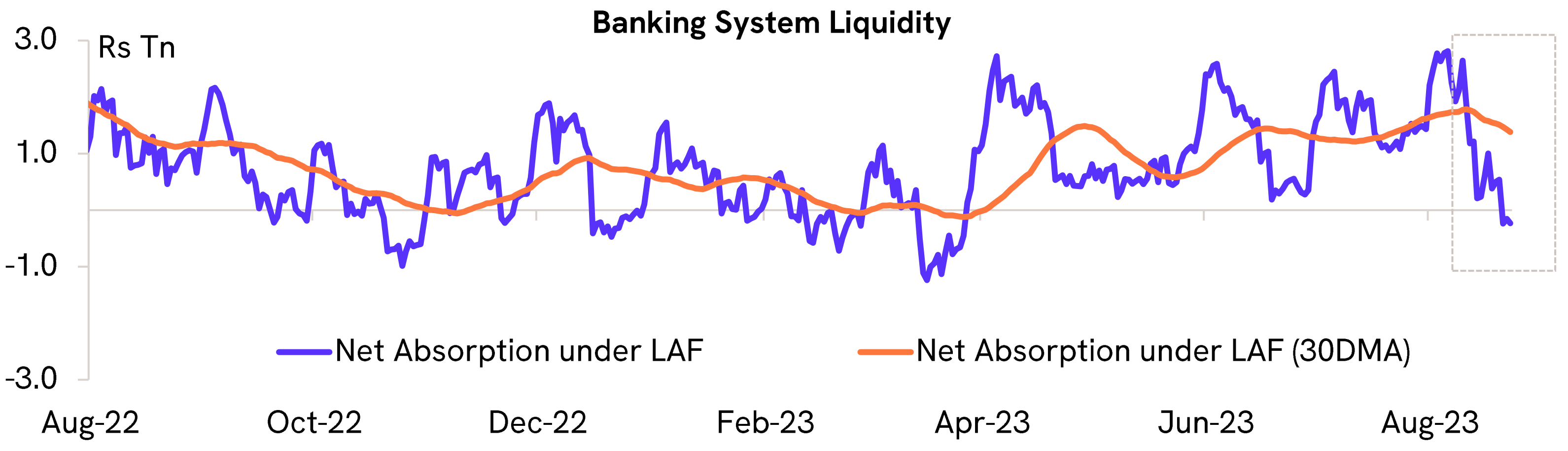
Source: RBI, 360 ONE Asset Research

Note - GCF: Gross Capital Formation

Liquidity & CRR

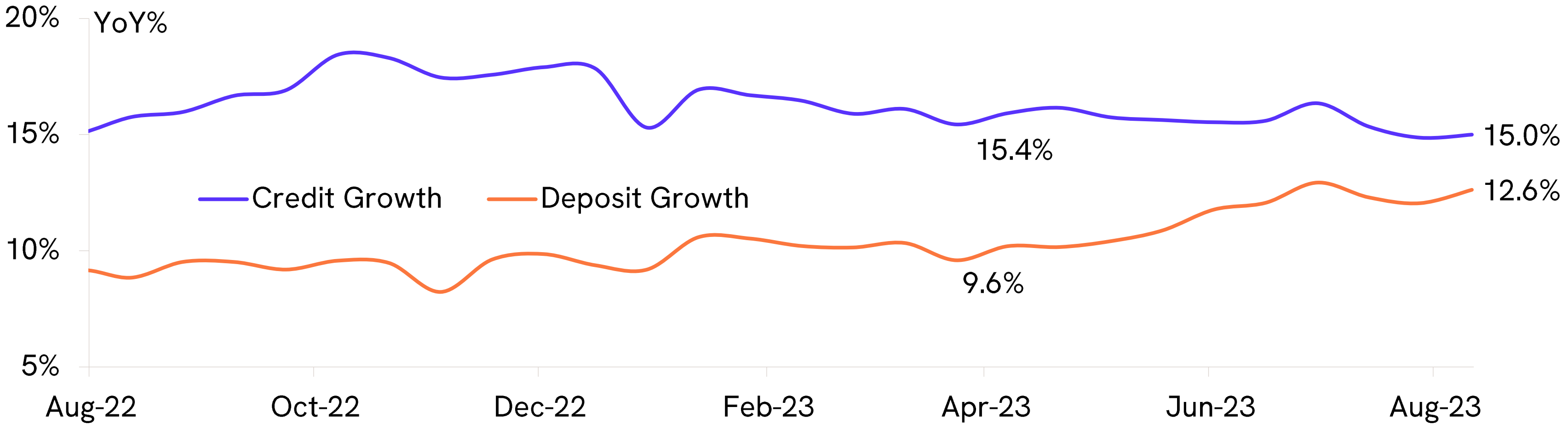
RBI introduces incremental CRR to drain excess banking liquidity

Banking system liquidity falls into deficit as banks maintain higher CRR



RBI introduces Incremental Cash Reserve Ratio (I-CRR) in August 2023 policy to absorb excess system liquidity. RBI Governor mentions that excess liquidity can pose risks to inflation and financial stability

Banking system liquidity falls into deficit on account of I-CRR



Higher liquidity in the system also reflected in improvement in deposit growth

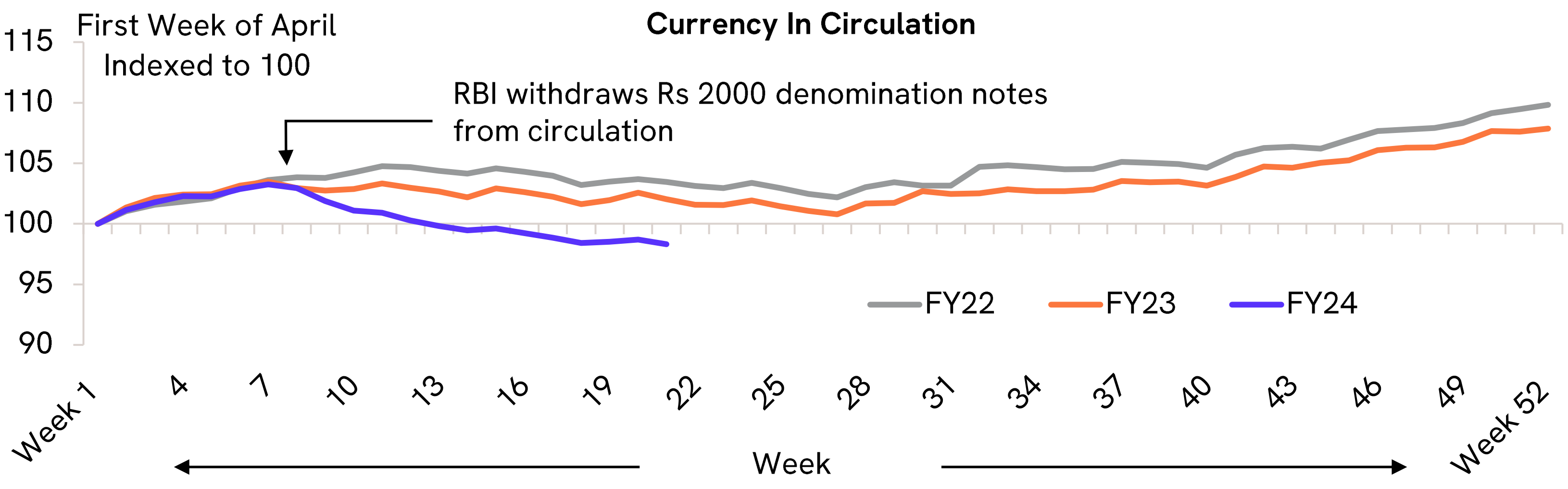
Deposit growth increased from 9.6% YoY in March to 12.6% YoY as on 11th August. Liquidity shifted from roughly neutral levels to a surplus of approx. Rs 2 trillion during the same period

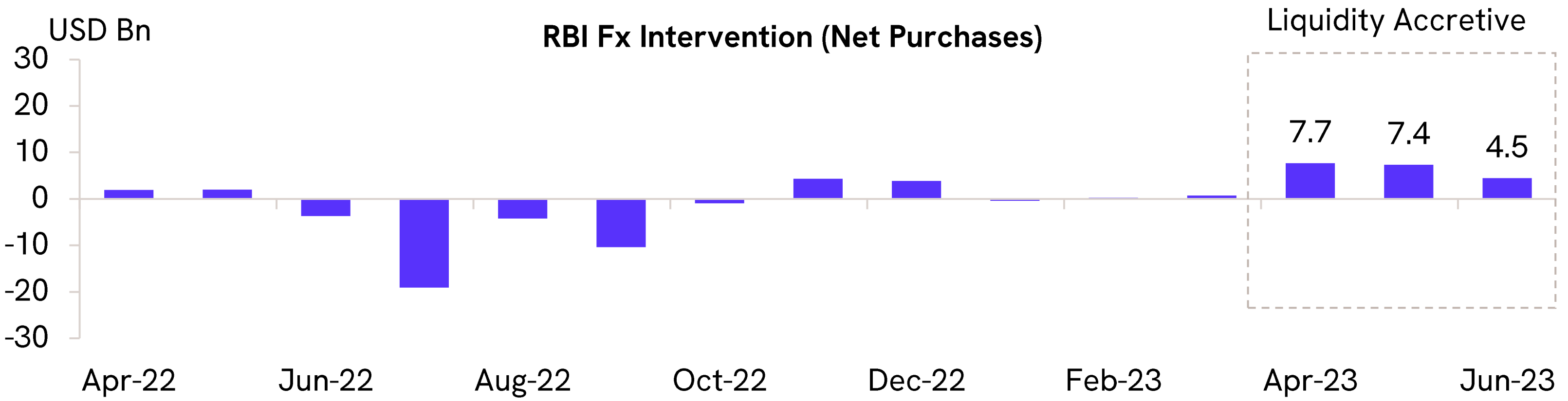
Source: CMIE, 360 ONE Asset Research

Note - LAF: Liquidity Adjustment Facility, 30DMA: 30 day moving average, Deposits and Credit growth adjusted for the impact of a bank and non–bank merger

Withdrawal of notes and RBI Fx purchases lead to liquidity surplus

Higher demand of currency during festive season to drain liquidity





Source: CMIE, 360 ONE Asset Research

Withdrawal of Rs 2000 denomination banknotes led to decline in currency in circulation. The currency so deposited in the bank led to the improvement in banking system liquidity

As of July 31st, 88% of the ₹2000 denomination banknotes that were in circulation as of May 19, 2023 (totaling Rs 3.56 trillion) have been returned

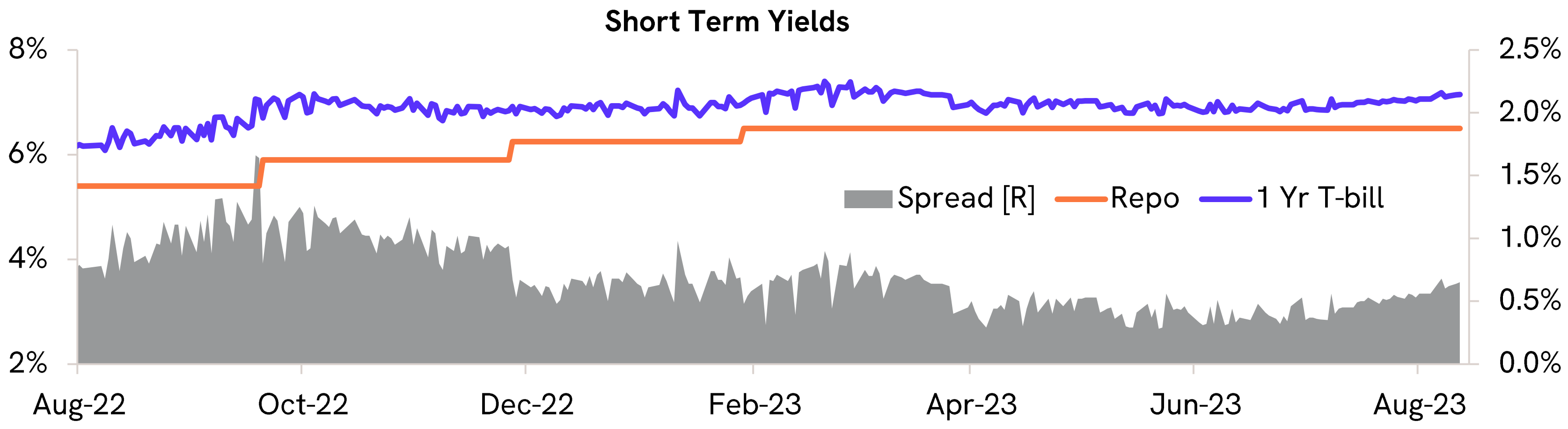
However, higher demand of currency during festive season will drain the liquidity. Hence, I-CRR is likely to be temporary measure

RBI intervened in FX market during Apr-Jun to contain rupee volatility on account of heavy FPI flows

FX spot purchases by RBI added to system liquidity

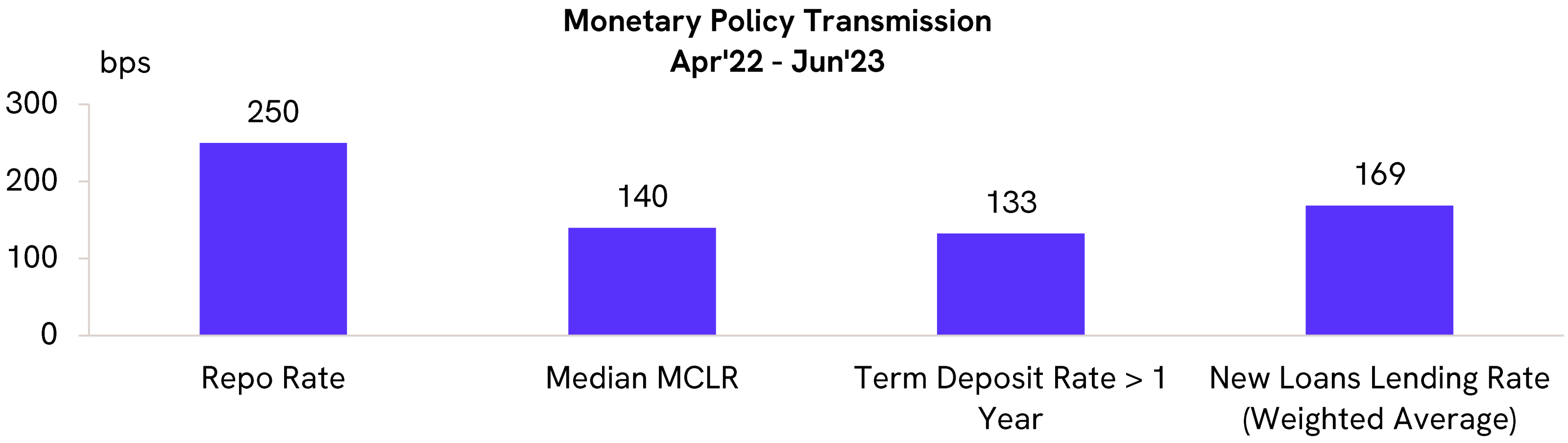
Excess liquidity in the system hampered rate transmission

Withdrawal of excess liquidity amounts to policy tightening, even if the policy rate remains unchanged



The spread between repo rate and 1-year T-bill compressed from April onwards as banking system liquidity improved

Improved system liquidity, thus, hampered transmission of rate hikes



Improvement in banking system liquidity also reduced incentives for banks to increase TD rates, owing to the concurrent improvement in deposit growth

Removal of excess liquidity from the system amounts to policy tightening and will improve transmission

Source: CMIE, RBI, 360 ONE Asset Research

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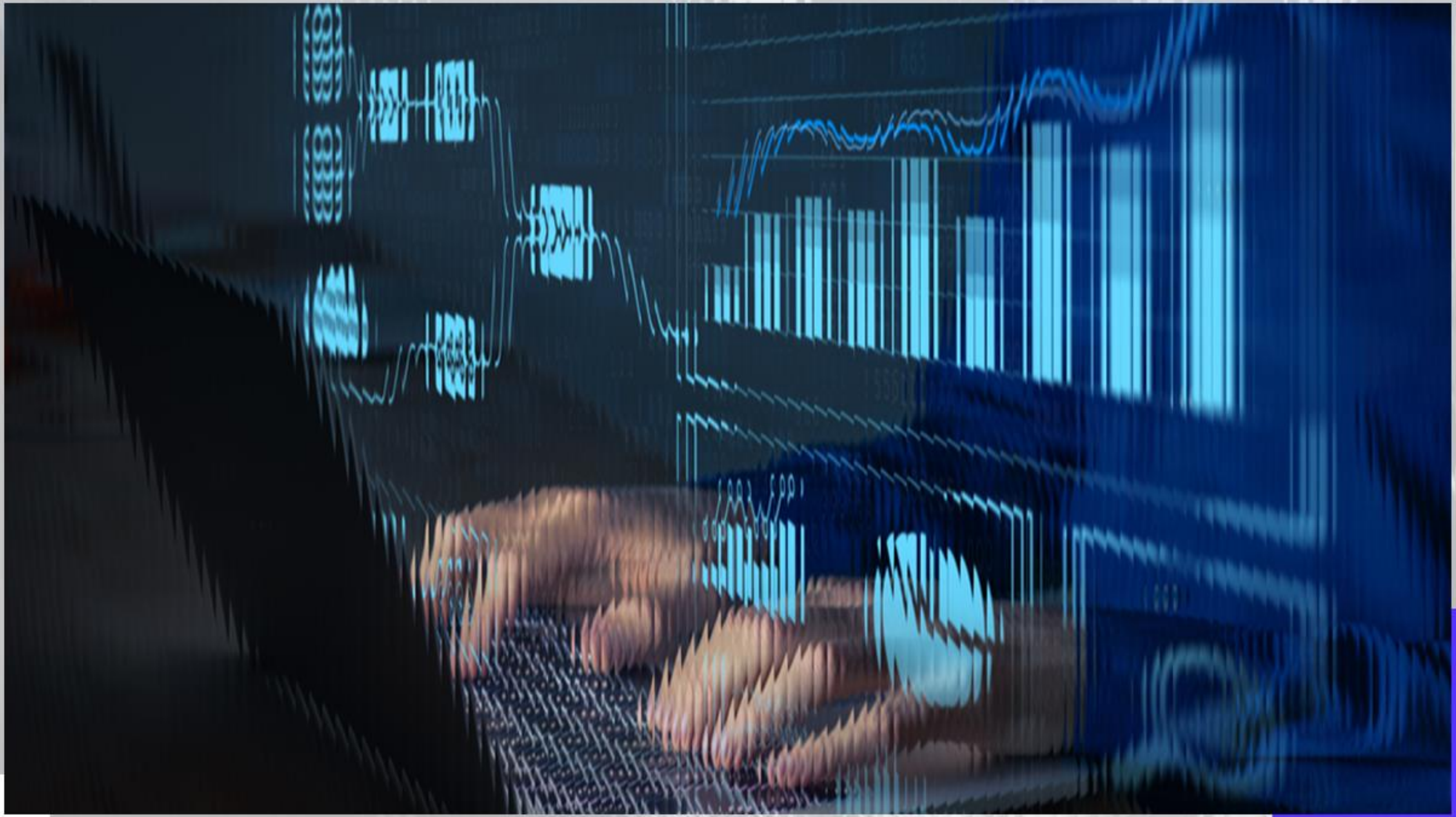

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