India 2021 Outlook

Vaccine To Extend Rebound in FY22

GS MACRO OUTLOOK 2021 Explore >

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We expect that the broad-based availability of an effective vaccine in India could allow containment policies and mobility to normalize by mid-2022. This should allow a meaningful activity rebound in 2021 – particularly in consumer-facing services sectors, where activity remains significantly below pre-COVID levels.

The pace of the rebound will be restrained by some economic scarring and a number of factors including a weak labor market, the hit to private sector incomes and balance sheets, tighter credit supply conditions and a limited impetus from fiscal policy. Overall, we expect real GDP growth to rebound to 13% in FY22 (above consensus expectations of 10.9%), after an expected -10.3% contraction in FY21.

We expect headline inflation to decline towards the mid-point of the RBI's target band of 2%-6% by mid-2021 as food prices fall on easing supply restrictions, a benign monsoon, and favorable base effects. Core inflation could also moderate given low manufacturing capacity utilization and INR appreciation.

Easing inflationary pressures should create more room for RBI easing. The composition of the MPC committee has moved in a more dovish direction in recent months, and strengthened forward guidance introduced in October suggests that members are awaiting an easing in inflation to use available room to support the economy further. We expect RBI to cut policy rates by another 35bp early next year.

In terms of market views, we recommend buying INR 5-year bonds to position for a more dovish RBI, and continued RBI bond market support. We are also overweight Indian equities on the macro recovery and relatively higher sensitivity of Indian equities to positive vaccine outcomes. We expect INR appreciation pressures to persist. While RBI is unlikely to allow significant broad FX strength, a weaker dollar and attractive vol-adjusted-carry leave us constructive on INR total return prospects versus the USD in the coming year.

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Broad-Based Vaccine Availability To Catalyze Growth Rebound in FY22

Exhibit 1: Our main FY21 forecasts

	FY19^	FY20	FY21F		FY22F	
	Actual	Actual	GS	Consensus	GS	Consensus
Real GDP (YoY%)	6.1	4.2	-10.3	-9.7	13	10.9
CPI inflation (YoY%)	3.4	4.8	6.2	5.5	4.6	4.4
Current account (% of GDP)	-1.8	-2.1	2.3	0.9	0.3	-0.8
Repo Rate (%, EOP)	6.25	4.40	3.65	3.90	3.65	3.70
FX (USD/INR, EOP)	69.2	75.4	72	74	70	72.55

^FY19 refers to April 2018 to March 2019

Source: Bloomberg, Consensus Economics, Goldman Sachs Global Investment Research

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In India new coronavirus cases peaked at around 90,000/day in September, and have since fallen to ~50,000/day in the past few weeks. The positive testing rate has also declined slightly – to 7.1% last week, from a peak of 8.5% in September – with the country still testing ~1.1 million samples per day. These are somewhat encouraging trends for an economy that has struggled with virus containment this year.

However, it is still too early to call time on the virus. Indications are that usage of precautionary measures such as prudent distancing and mask use have fallen meaningfully as virus numbers eased. Social interactions also increased in the run-up to the Deepavali holiday on 14 November, with the ongoing wedding season and onset of colder temperatures in northern India also creating upside risks to the recent virus trajectory. Given these risks, we remain conservative on our assumptions for containment policy and mobility through early 2021.

Beyond that, however, **a pivotal assumption for our 2021 India growth outlook is broad-based availability of an effective vaccine, which could allow containment policies and mobility to normalize fully by mid-2022.** The national implementation plan on vaccine disbursement – which is currently in its draft stages – aims to immunize around 23% of the population (or ~300mn people) in the first phase by mid-2021 (Exhibit 2). The immunization will start with front-line healthcare workers, public service professionals like the police, municipal workers, teachers, transport workers and cleaners, those aged 50 years and above, and those with co-morbidity conditions.

On our India healthcare team's estimates, indigenous vaccine production capacity could reach 0.9bn doses next year – which could inoculate up to 450mn high-risk individuals by end-2021 (Exhibit 3). India's indigenous vaccine production capabilities, and administrative experience with large-scale public vaccination campaigns such as polio, could also lead to quicker disbursement of the vaccine when available.

Exhibit 2: National vaccination strategy aims to immunize 300mn high-risk individuals by mid-2021…

Priority groups for Phase 1 vaccination	Numbers mn	% total population
Healthcare Workers	5	0.4
Frontline Workers	20	1.5
Municipal Workers	15	1.2
People > 50 years / < 50 years with co-morbidities	260	19.9
Phase 1 Total	300	23.0

Source: The Times of India

Exhibit 3: …with indigenous vaccine production capacity potentially reaching 0.9bn doses by end-2021

Producer	Vaccine name	Partner	Clinical phase*	Expected dose 2021 (mn)
Bharat Biotech	COVAXIN	ICMR/ NIV	Phase 3/3	300
Serum Institute	Covishield	Astra Zeneca	Phase 2/3	300
Zydus Cadila	ZyCoV-D	--	Phase 2/3	100
Dr Reddy's	Sputnik V	RDIF	Pending trials	100
Serum Institute	NVX-CoV2373	Novavax	Pending trials	50

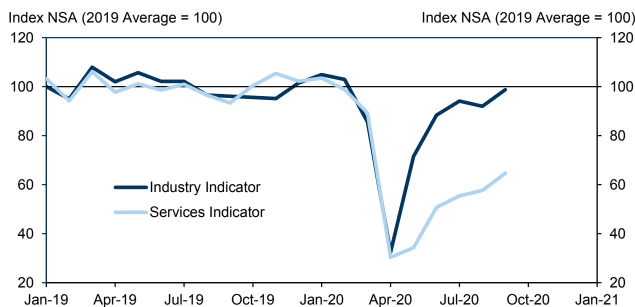
*Clinical phase refers to vaccine current clinical phase in India

Source: Indian Express, ICMR, Economic Times

Broad-based vaccine deployment should allow a meaningful activity rebound in FY22, particularly in the services sector. For now – given the risks around vaccine availability and disbursement – we make the assumption that broad-based vaccine deployment will allow full containment policy/mobility normalization – as captured by our GS effective lockdown index (ELI) – by mid-2022. This should allow a meaningful activity rebound in FY22 (which runs from April 2021 to March 2022) – particularly in the services sector, where activity levels are still significantly below pre-COVID levels (Exhibit 4).

We expect GDP growth to rebound to 13% in FY22 (above consensus expectations of 10.9%), after an expected 10.3% contraction in FY21. There is still a high degree of uncertainty around the outlook – and growth could significantly overshoot or undershoot these forecasts – depending on the course taken by the virus and vaccine-related developments in the coming year. (Exhibit 5) for instance, plots alternative growth scenarios from our ELI based regional growth model, which assumes that the ELI could either normalize two quarters earlier ("bullish"), or remain significantly tighter through mid-2021, and then normalize at a much slower pace ("bearish") relative to our baseline that ELI normalizes fully by mid-2022.

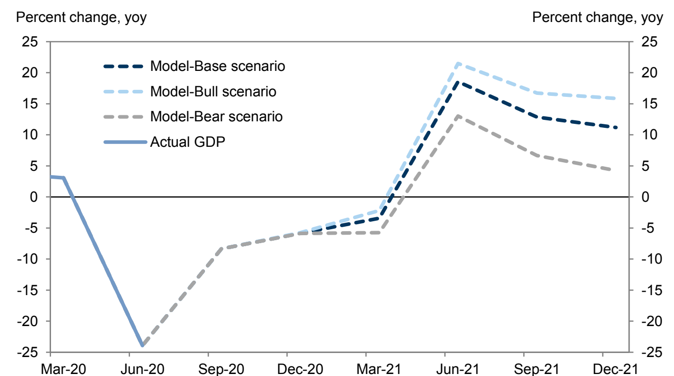
Exhibit 4: Services sector indicators still significantly below pre-virus levels



Industry indicator is simple average of Electricity consumption, E-way bills, Cement and Steel production. **Services indicator** is simple average of railway freight and passenger services, air passenger and cargo services, port volume and motor vehicle registrations.

Source: Goldman Sachs Global Investment Research, CEIC

Exhibit 5: Growth outcomes highly dependent on virus path and containment policy



Source: Goldman Sachs Global Investment Research, University of Oxford (covidtracker.bsg.ox.ac.uk), Google LLC "Google COVID-19 Community Mobility Reports", Accessed: 2020-11-10.

The pace of the rebound, however, will be restrained by some economic scarring

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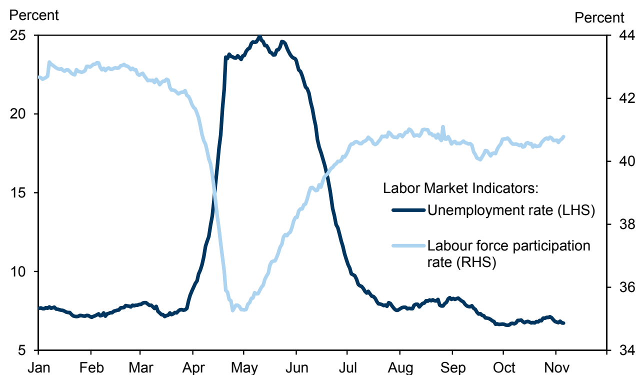
caused by a number of factors:

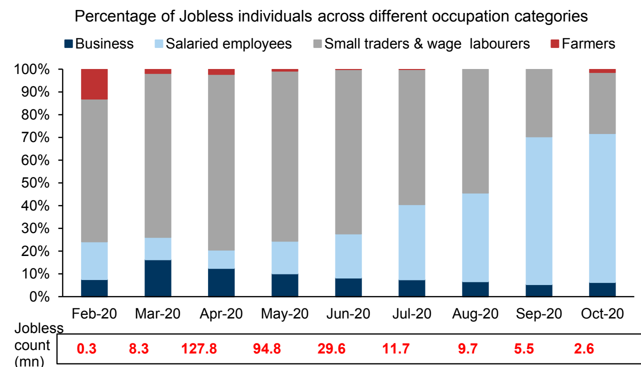
- **Weak labor market likely to weigh on pace of consumption rebound.** While the unemployment rate is already back to pre-COVID levels, the labor force participation rate is still 2pp below pre-COVID levels (Exhibit 6). On top of that, new jobs created have anecdotally been at lower wages or in lower income brackets, which is borne out by data on the composition of jobless individuals which suggests that the job recovery has been slowest for salaried employees (Exhibit 7). This coupled with weak fundamentals even prior to COVID-19 (the labor force participation rate has fallen, and unemployment rate has risen significantly since 2017), declining consumer confidence, household debt overhang and NBFC credit crunch – are likely to weigh on the pace of consumption rebound going forward.

Exhibit 6: Unemployment has normalized, but participation rate still 2pp below pre-COVID levels



Source: CMIE

Exhibit 7: Job recovery for salaried employees has been slowest



Source: CMIE

- **Hit to corporate balance sheets, low manufacturing capacity utilization to drag on private investment rebound.** A sharp rise in the corporate interest burden on the earnings contraction this year (Exhibit 8) and consequent implied decline in debt servicing capability, potential tightening in credit supply[1] on higher bank credit costs[2] (Exhibit 9), low manufacturing capacity utilization, the inventory overhang in residential housing along with entrenched business pessimism are likely to drag on the private investment rebound going forward.

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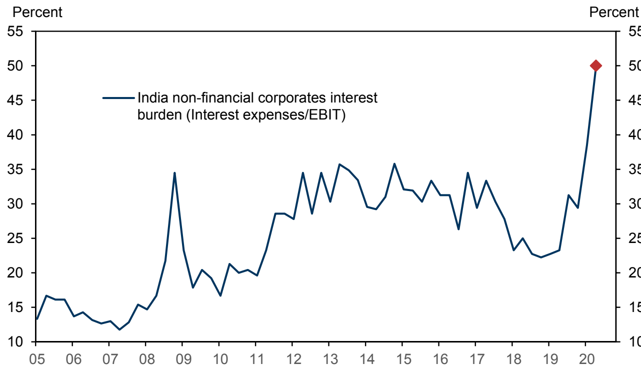
[1] We did a deep dive on how increases in non-performing loans and bank credit costs in India impact bank credit supply and investment growth in "Still no 'bank'ing on growth", Asia Economics Analyst, 28 September, 2017.

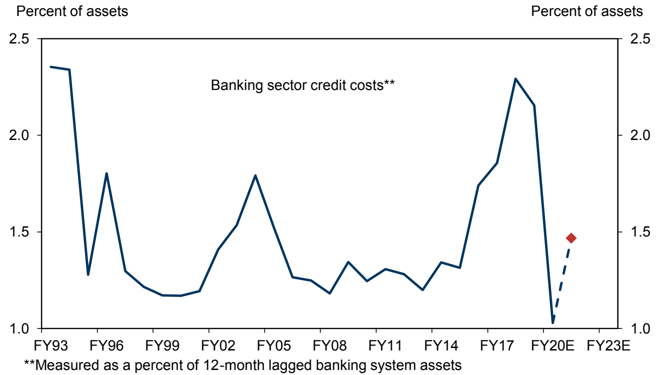
[2] The credit cost increase has been contained so far as measures by policymakers including the extension of debt moratoriums on repayment, debt restructuring, and temporary suspension of the Insolvency and Bankruptcy Code have helped ease the repayment pressure faced by corporates.

Exhibit 8: Sharp increase in corporate interest burden



Source: Reserve Bank of India, CEIC, Goldman Sachs Global Investment Research

Exhibit 9: Banks' credit costs to rise on NPL increase



Source: Goldman Sachs Global Investment Research

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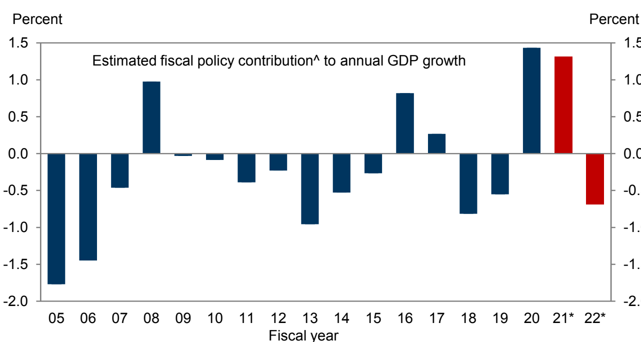
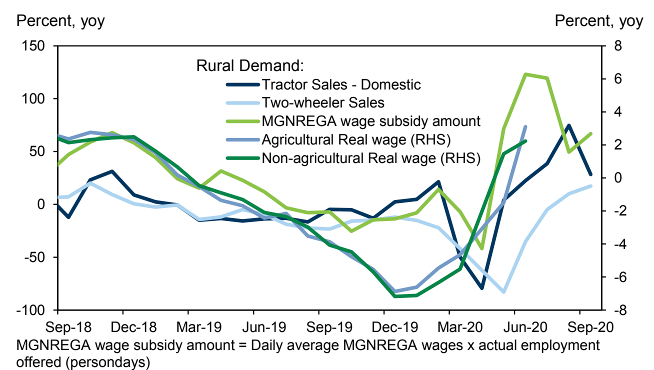
- **Appetite to dial up fiscal stimulus further appears to be quite muted**. The total discretionary component of the fiscal stimulus this year has been just over 2.5pp of 2019 GDP, which is small relative to the magnitude of the economic shock and potential for cascading income impacts due to the hit to households' and firms' earnings this year. In FY22, we expect the fiscal deficit to narrow to 6.5% of GDP, from a forecasted 8% of GDP in FY21 (versus 4.6% of GDP in FY20). We expect the general government deficit (center + states) to narrow to 9.5% of GDP in FY22, from a forecasted 11.5% of GDP in FY21 (versus 7.2% in FY20). This suggests that the total fiscal policy contribution to growth will decline further in FY22 (Exhibit 10).
- However, even after building in relatively significant assumptions for economic scarring we still have GDP growth rebounding 13% in FY22, with some upside to consensus growth expectations of a 10.9% GDP growth rebound in FY22.

Exhibit 10: Fiscal policy will turn to a growth drag in FY22



Source: Haver Analytics, CEIC, Goldman Sachs Global Investment Research

Exhibit 11: Resurgent rural demand one of only few bright spots in economy this year



Source: CEIC, Labour bureau

One of the only **bright spots this year has been rural demand** (Exhibit 11), which was relatively less impacted by COVID-related restrictions and boosted by supportive government policy in the first half of the fiscal year. The favorable terms of trade and good monsoon planting trends continue to bode well for rural demand although somewhat lower policy support in 2H FY21 and a potential swing in the terms of trade as food prices decline could moderate the pace of rural growth going forward.

In addition, **some meaningful positive medium-term catalysts emerged this year**, with momentum building behind the "Make in India" campaign with a total of US$30bn of production-linked incentives for certain industries, autos in particular, announced earlier this week. The "Make in India" self-reliance initiative will use import disincentives, production-linked incentives, tax benefits and digitization in an attempt to increase the share of manufacturing in India's GDP from 17% now to 25% in the medium term, while creating 100mn new jobs. There was also significant progress on the structural reform agenda with the administration passing three new labor bills (which make it much easier to start and scale up businesses while engendering greater formalization of the labor force – 85% of which is estimated to still be in the informal sector) and three new farm bills (which deregulate stocking of key food commodities, create more competition in wholesale food markets by allowing farmers to sell their produce to any buyer in the country, and allow contract farming).

The administration appears set to continue reform momentum, with the Minister of State for Commerce and Industry recently stating that the government is in the final stages of drafting a national logistics policy, new industrial policy, E-commerce policy and national retail trade policy.

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Easing Mobility Constraints, Good Monsoon to Push Headline Inflation Back into Target Band

A key constraint on the monetary policy response this year has been inflation, which has persisted above the target band since December last year. The key drivers of elevated inflation this year have been food, excise tax hikes on petrol/diesel/tobacco, and gold prices. Excluding these components (which constitute about half of the CPI basket) from the CPI calculation, suggests underlying inflation has been tracking at just 4.3% on average over the past 3 months, and 4.0% on average since January.

Going forward, we expect **food prices to fall on the back of the abundant monsoon,[3] continued compression of retail margins as mobility constraints ease, and favorable base effect**s (Exhibit 12). Transport and communication inflation is also projected to decline[4], although fuel inflation (mainly electricity, LPG and Kerosene) will likely pick up on higher global energy prices. Core inflation[5]– which strips out a number of volatile factors like food (including tobacco/other intoxicants), transport and fuel prices – could also decline from here on low capacity utilization, INR appreciation, and a lower forecasted pace of increase in gold prices in 2021.

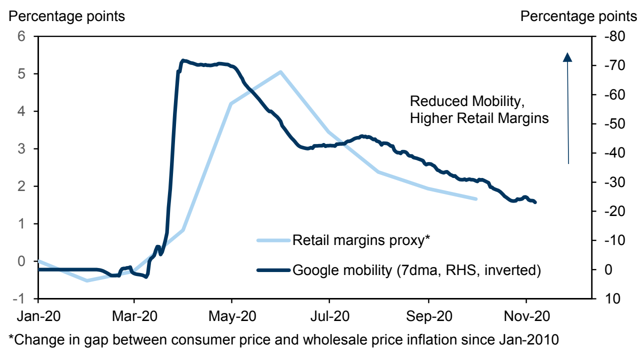
[3] Cumulative rainfall was 10% above long-term average, area sown under the summer kharif crop expanded by close to 5%, and advance kharif estimates suggest substantial increases in crop output and indications of a healthy harvest

[4] In 2020, in contrast to most other countries, retail fuel prices actually went up in India despite the fall in global energy prices, as the government refrained from lowering prices and hiked excise taxes significantly. So even though global energy prices are likely to rebound next year, we see limited domestic price increases and a decline in transportation inflation given the disappearance of large base effects from the excise tax hike earlier this year.

[5] On our estimates, around 70% of the core inflation increase this year was driven by the gold price spike, and is not a reflection of a generalization of recent elevated headline inflation prints into core inflation momentum. Recent RBI models – as highlighted by Dr Michael Patra in the recent MPC minutes – also suggest that 71% of the recent deviation of inflation from target was due to supply shocks from food and fuel prices, with only 4% of the deviation on account of money supply/easier monetary policy.

Overall, pulling all these drivers together, we expect **headline inflation** – which rose to 7.6% yoy in October – **to decline back into the RBI's target band of 2%-6% in coming months** (Exhibit 13). We think inflation could be back at the midpoint of the target band by mid-2021 on the back of lower food, transportation and core inflation. The key risks to our view are that food inflation momentum remains high in coming months, and that recent headline inflation prints and high inflation expectations begin to generalize into higher core inflationary pressures dragging inflation higher despite subdued demand pressures.

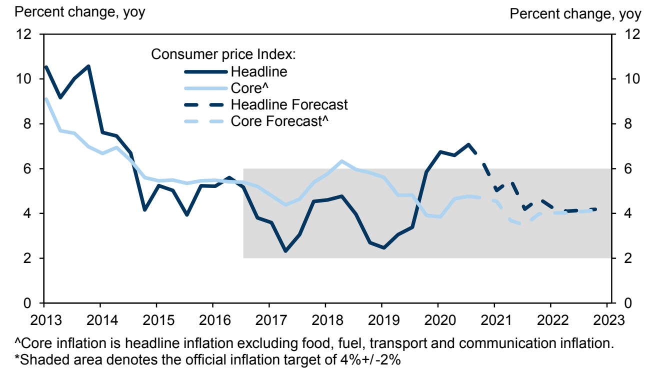
Exhibit 12: Retail margins could continue to compress as mobility constraints ease



*Change in gap between consumer price and wholesale price inflation since Jan-2010

Source: Goldman Sachs Global Investment Research, Haver Analytics, Google COVID-19 Community Mobility Reports, Accessed: 2020-11-10.

Exhibit 13: Headline inflation to fall back within RBI's inflation target band in coming months



^Core inflation is headline inflation excluding food, fuel, transport and communication inflation.
*Shaded area denotes the official inflation target of 4%+/-2%

Source: Haver Analytics, RBI, Goldman Sachs Global Investment Research

RBI to Ease Modestly as Inflation Falls Back Within Comfort Zone

Since the beginning of the year, the RBI has used three instruments – policy rates, forward guidance and liquidity – to maintain accommodative policy. While persistent inflation pressures prevented the MPC from cutting policy rates beyond the 115bp through May, strengthened forward guidance kept a lid on rate increases, and banking system liquidity injections pushed effective rates down another 60bp to the bottom of the policy band (Exhibit 15).

Going forward, as activity stays weak, we forecast that RBI could cut policy rates another 35bp early next year as inflation falls back within the target band (Exhibit 14). In addition, the surge in the banking system surplus liquidity position on RBI injections could keep effective rates pinned to the bottom end of the policy band (Exhibit 15).

While there is significant uncertainty around the inflation path, we see another cut as still being more likely than not as recent leadership/compositional shifts in the MPC – including the recent addition of new external members – skews the reaction function in a more dovish direction by placing much higher emphasis on growth versus inflation. Muted appetite to stimulate on the fiscal front, as well as the RBI's strengthened forward guidance[6] at the October meeting also argue for modest easing should inflation

[6] MPC members resolving to keep the accommodative monetary policy stance "as long as necessary, at least through the current financial year and into the next year to revive growth". The Governor emphasized the "transient" inflation trend could be "looked through at this juncture while setting the stance of monetary policy", and that MPC would "await the easing of inflationary pressures to use the space available for

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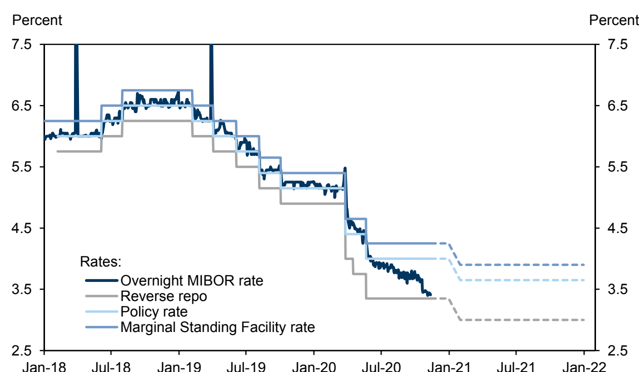
decline in coming months.

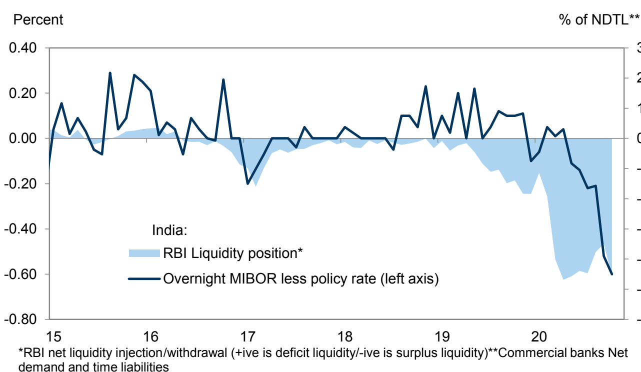
The key risk to our view is that inflation – particularly food prices – stays elevated or rises further from here over the next 2-3 months and/or if there are signs that elevated inflation prints this year are generalizing into higher core pressures via higher inflation expectations. If this transpires then further policy easing would likely be off the table next year, and RBI would have to re-think its stance on policy rates, forward guidance and liquidity.

Exhibit 14: We expect RBI to cut policy rates again in early 2021



Source: RBI, Goldman Sachs Global Investment Research

Exhibit 15: Abundant RBI liquidity could keep effective rates pinned to bottom of policy band



Source: Haver Analytics, Goldman Sachs Global Investment Research

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Lower Bond Yields, Equity Outperformance and Stronger INR

We are constructive on India bonds, and recommend being long INR 5-year government bonds. First, we expect RBI to cut policy rates another 35bp, and the market currently isn't pricing in further RBI rate cuts. Second, the RBI has been conducting more regular OMO purchases of central and state government bonds over the past month. This further supports the RBI governor's strong guidance in October, that the central bank stands ready to take any further measures as necessary to support liquidity, minimize disruptions from the government's market borrowings and to promote an orderly functioning of bond markets. We see this as a clear signal that the RBI would likely cap any increases in bond yields. Third, we expect that continued bond purchases and RBI FX market intervention will keep banking system liquidity in a large surplus, and effective rates pinned close to the bottom end of the policy band. Finally, our GS EM rates quantamental model also indicates that there is scope for INR 5-year bond yields to fall.

On the equities side, our equity portfolio strategists have just turned overweight on Indian equities as domestic growth and corporate profits rebound, and on expectations of a 'catch up' laggard rally as Indian equities are one of the most sensitive regionally to improving vaccine prospects.

RBI unlikely to allow significant broad FX strength given export competitiveness concerns. However, a weaker dollar and attractive vol-adjusted-carry leave us

supporting growth further".

constructive on the rupee's total return prospects versus the USD. A key question for INR currently is how much appreciation will RBI allow going forward. India's augmented broad balance of payments (BBoP) – the sum of the current account, FDI, portfolio inflows and external commercial borrowings – has been in a significant surplus for the past two years. The augmented BBOP surplus in 2019 was close to USD45bn. This year, the augmented BBoP surplus is on track to cross USD60bn, and could remain strong going forward. We expect the current account to stay in a surplus until late 2021. Stringent containment policy, a significant drop in activity and the weak fiscal response will weigh on the import recovery, while the export recovery could be more robust with key trade partners having less stringent containment, smaller drops in activity and much stronger fiscal responses. Moreover, going forward, the drive to be more self-reliant with import disincentives, production-linked incentives, enhancements in manufacturing competitiveness could lead to the current account balance being higher for longer. Our constructive views on bonds and equities entail strong inflows into these asset classes going forward and continuing FDI inflows – especially with building reform momentum – could keep the Broad Balance of Payments in a large surplus going forward.

Typically, as goes the augmented BBOP, so goes the INR (Exhibit 16). However, INR performance has diverged significantly from BBOP fundamentals over the past year (Exhibit 16), as RBI has been accumulating reserves (Exhibit 17). This likely stems from RBI's concerns around export competitiveness, as the lack of export growth has been a key driver of the growth slowdown over the past decade. While RBI is unlikely to step back and allow significant broad FX strength given concerns around export competitiveness, our view is that some modest trade-weighted INR appreciation may be allowed to take the edge off further gold price increases. Coupled with a weaker dollar and attractive vol-adjusted-carry, this leaves us constructive on the rupee's total return prospects versus the USD in the coming year.

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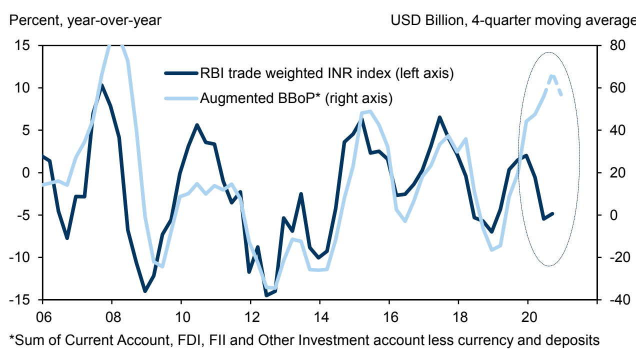
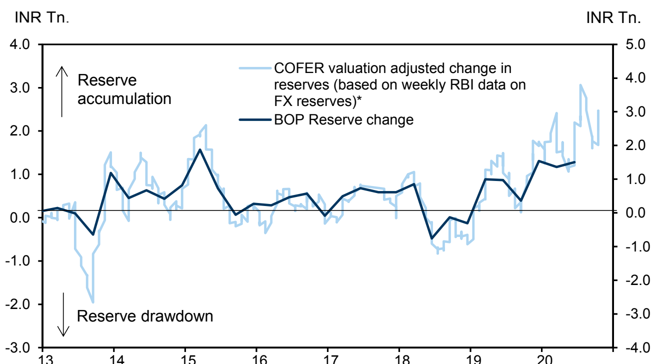
Exhibit 16: INR performance has diverged from BBoP fundamentals…



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 17: … as RBI proactively absorbs appreciation pressures via FX intervention



Source: Haver Analytics, Goldman Sachs Global Investment Research

The authors would like to thank Suraj Dhunna - an intern on the India Economics team - for his contributions to the report.

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Reg AC

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