

REVISING FY21 GDP ESTIMATES TO -7.0% (PREVIOUSLY: -7.4%): Q3 AT 0.3% WITH AN UPSIDE BIAS

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Based on "SBI Nowcasting Model" the forecasted **GDP growth for Q3 would be around 0.3% (with upward bias)**. Additionally, out of the 41 high frequency leading indicators, 51% are showing acceleration. We now expect GDP decline for the full year to be around 7.0% (compared to our earlier prediction of -7.4%). Apart from Q3 FY21 the Q4 growth will also be in positive territory (~2.5%). However, all projections are conditional on the absence of any rise in infections. We retain our GDP forecast for FY22 GDP at 11%, but with the caveat that 11% will be the floor below which it cannot fall. The corporate results so far also reinstate the fact that Q3 growth would be much better than the Q2 growth. The corporate GVA of 1129 companies has expanded by 14.7% in Q3 as compared to 8.6% growth in Q2 (of 3758 companies ex telecom).

Meanwhile, the proposed ARC AMC structure in the budget could facilitate recovery and resolution of stressed assets in a much better way and this could create a market for stressed assets. Given that the governance of the AMC and its independence is central to the success, there could be multiple suggestions to make it successful. This include keeping majority ownership in the private sector, putting together a strong and independent board, hiring a professional team from the market and linking AMC compensation to returns delivered to investors.

Meanwhile, we continue to hold that the 9.5% of fiscal deficit of Centre might be on the higher side. We already estimate that excluding off balance sheet liabilities, fiscal deficit of the Centre is at 8.7% of GDP. Gross tax collection estimate based on revised FY21 numbers and collections till FY21 Dec end shows that in Q4 tax collections will show a negative qoq growth of -8.9%. This seems unrealistic and thus we believe that this year ultimate gross tax collections would possibly be on the other side. Furthermore, next year nominal GDP growth is expected at double digits it is expected that tax buoyancy will be higher than FY21 (FY22 tax buoyancy projected is lower than FY21), thereby suggesting that gross tax collections next year might also be higher than the Budgeted Rs 22.17 lakh crore, or 9.9% of GDP.

Meanwhile, the cash balances of the Centre has declined from the peak level of Rs 3.4 lakh crores to around Rs 2.3 lakh crores on February 8. Given that 85-90% of such cash balances belonged to the states that was invested with the centre, it is possible that the States before the closing of accounts of FY21 wants to spend the cash rather than preserving.

FY21 GDP CONTRACTION AT 7%; Q3FY21 GDP GROWTH AT 0.3% BASED ON OUR "NOWCASTING" MODEL

- SBI 'Nowcasting Model' has been developed with 41 high frequency indicators associated with industry activity, service activity, and global economy. The model is developed in collaboration with State Bank Institute of Leadership (SBIL), Kolkata. We have used the dynamic factor model to estimate the common or representative or latent factor of all the 41 high frequency indicators from Q4 of FY13 to Q3 of FY21. The details of the full model has already been presented in **SBI Ecowrap dated 20 Nov'20**.
- The variables are used in the form of standardized year to year growth. The dynamic factor model is estimated with one lag. The estimated common factor (FACTOR) is converted to quarterly. The following structural equation is estimated to forecast the quarterly growth of GDP.

$$GDP_t = a_t + b*FACTOR_t + e_t \quad [1]$$

Where e_t follows AR1 error structure or the serial correlation at lag one. That means,

$$e_t = r * e_{t-1} + \theta_t$$

so that with the lag operator, this can be written as $(1-Lr)e_t = \theta_t$ or $e_t = (1-Lr)^{-1}\theta_t$.

- The GDP and FACTOR are transferred to V_t and U_t to adjust the AR1 error structure. So $V_t = (1-Lr)GDP_t$ and $U_t = (1-Lr)*FACTOR_t$ Hence, the induced regression estimation is

$$EV_t = 2.7 + 14.06 * U_t \quad [2]$$

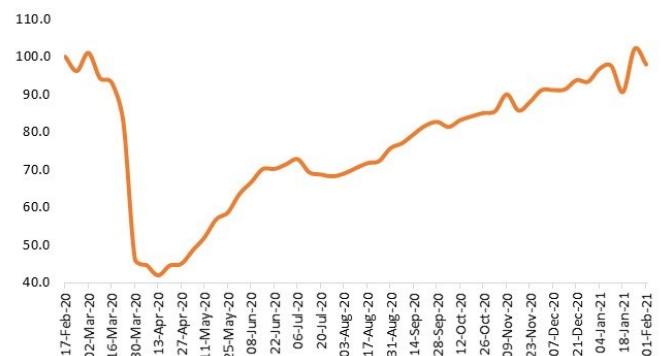
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EV_t is the estimated transferred GDP

Real GDP Growth (%)			
Quarter	FY20	FY21	FY22
Q1	5.2%	-23.9%	-
Q2	4.4%	-7.5%	
Q3 (P)	4.1%	0.3%	
Q4 (P)	3.1%	2.5%	
Annual (P)	4.0%	-7.0% (NSO: -7.7%) (RBI: -7.5%)	10-12% (RBI: 10.5%)

Source: SBI Research; (P) SBI Estimates for FY21

SBI Business Activity Index accelerating



Source: SBI Research

- Therefore, with the serial-correlation coefficient “r” of the estimated residual from the equation 2, the estimated GDP (EGDP) is as below.

$$GDP_t = EV_t + r * GDP_{t-1} \quad [3]$$

Follows from $V_t = (1-Lr)GDP_t$

- As, we have data on indicators till Q3, so the actual FACTOR estimated till Q3FY21. Back casting test that shows satisfactory results with a 5% forecasting error. Based on our model the forecasted **GDP growth for Q3 would be around 0.3% (with upward bias)**. Additionally, out of the 41 high frequency leading indicators, 51% are showing acceleration. We now expect GDP decline for the full year to be around 7.0% (compared to our earlier prediction of -7.4%). Apart from Q3 FY21 the Q4 growth will also be in positive territory (~2.5%). However, all projections are conditional on the absence of any rise in infections. We forecast FY22 GDP growth at 11%.
- The corporate results so far also reinstate the fact that Q3 growth would be much better than the Q2 growth. The corporate GVA of 1129 companies has expanded by 14.7% in Q3 as compared to 8.6% growth in Q2 (of 3758 companies ex telecom).

PROPOSED ARC/AMC COULD USHER IN A NEW ERA

- In the Budget, Government has proposed setting up of an asset reconstruction company (ARC) and an asset management company (AMC) to hive off NPAs in the banking sector into a separate entity. With the banks now holding a significant amount of provisions for the stressed assets, a wholesale transfer of the bad assets to the proposed entities is purely a technical issue and the process of recovery and resolution could be carried out much better.
- The AMC led resolution approach would apply to large accounts with exposure spread across multiple banks and with a potential for turnaround of stressed assets. The approach is to set up an AMC, which in partnership with an ARC takes over stressed assets from banks. The AMC will then conduct operational turnaround of the asset creating value for the overall system. The AMC would be the market maker and thereby ensure healthy competition, fair price and cash recovery.
- Given that the governance of the AMC and its independence is central to the success, there could be multiple suggestions to make it successful. This include keeping majority ownership in the private sector, putting together a strong and independent board, hiring a professional team from the market and linking AMC compensation to returns delivered to investors.

INTERNATIONAL SUCCESS STORIES

- Since the onset of the financial crisis, many banks have indeed taken decisive action to wind down NPAs.
- Germany:** In 2001, a Berlin based bank holding company known as the Berliner Bankgesellschaft (BB) was threatened with bankruptcy due to the returns it had guaranteed to real-estate fund investors. In 2006, the newly founded bad bank Berliner Immobilien Holding (BIH) took over several troubled real-estate funds.

Leading Indicators: Oct 2020 to Jan 2021

Indicators	Oct 20 MoM%	Nov 20 MoM%	Dec 20 MoM%	Jan 21 MoM%	Jan-21 % Change From Pre Covid Peak Level	Jan-21 % Change from Pre Covid Level (Feb-20)
Apple Mobility Index#	30.6	9.2	7.6	29.3	-	46.8
PMI Manufacturing#	2.1	-2.6	0.1	1.3	2.4	3.2
PMI Service#	4.3	-0.4	-1.4	0.5	-4.7	-4.7
SBI Yearly Index#	0.9	0.9	-0.4	0.3	-1.6	2.7
SBI Monthly Index#	1.3	2.8	-2.9	0.4	4.5	9.4
AQI (7 City Average)	66.2	36.8	15.4	1.0	-16.2	26.7
No of Transactions at RTO	11.5	1.7	0.4	1.2	-10.0	3.8
Revenue Collections at RTO	32.6	7.9	-12.5	9.2	-5.1	14.9
No of GST E way Bills Generated	11.7	-10.1	11.2	-2.1	9.9	9.9
Electricity Demand	-2.3	-11.3	9.1	3.8	-8.3	11.2
Revenue Earning Freight Traffic of Major Commodity	5.3	2.4	10.4	0.3	5.9	10.3
Tractor Sale Domestic	0.9	-24.9	-26.3	28.4	-27.1	35.1
Domestic Passenger Vehicle Sale	14.1	-8.0	-2.7	9.2	6.4	20.6
Domestic Two Wheelers Sale	11.0	-22.1	-20.0	18.3	-13.8	17.0
Fertilizer Retail	4.3	34.1	12.5	-18.1	-30.0	30.8
ASCB Deposit	0.2	0.6	0.9	1.0	7.8	9.7
ASCB Bank Credit	0.7	0.9	1.9	0.9	2.6	5.3
Weekly Food arrival in Tonnes-Average						
Cereals	32.5	13.8	-5.5	5.3	-96.5	-17.5
Pulses	7.9	-54.8	60.7	168.3	-10.9	266.8
Fruits	61.1	-36.4	-18.2	-17.9	-85.7	5.3
Vegetables	-0.6	9.0	21.9	13.5	-17.3	98.1
Retail Food Prices (Rs/Kg)-Average						
Vegetables	12.9	8.6	-19.0	-32.1	-43.4	-4.0
Cereals	-0.1	0.5	-1.0	-10.7	-9.2	-9.2
Pulses	5.8	1.9	-0.6	-1.8	12.7	13.0
Oil & Fat	1.9	2.3	3.8	3.9	21.1	21.1

Source: SBI Research, #Difference

Corporate GVA

Quarter	No of Companies	Growth (%)
Q4FY20	3751	-19.0
Q1FY21	3777	-18.4
Q2FY21	3758	8.6
Q3FY21	1129	14.7

Source: CLIne; SBI Research; listed entities; in Q2FY21 telecom excluded

- BB was thus effectively separated into a bad bank (BIH) and good bank (Landesbank Berlin). In 2007, the city-state of Berlin managed to sell its 81% stake in the Landesbank Berlin for €4.7 billion .
- Between 2003 and 2005, Dresdner Bank transferred €35.5 billion in toxic loans and shares which had lost strategic relevance to a so-called Institutional Restructuring Unit (IRU).
- Malaysia:** More than 2-decades ago, the Malaysian banking system was on the verge of collapse when a currency crisis engulfed several Asian countries. The bad loan situation was alarming and its NPAs jumped from 2-3% to double digits in a matter of four-five years. Malaysia had experienced a high growth of 9% plus for a decade leading to the currency crisis in 1997. The Malaysian Government reacted fast by setting up two asset management companies (AMCs) - one to take over bad loans named “Danaharta” with special powers and another for infusing capital into the weak banks called “Danamodal”. Danaharta was a success story and in about 7-8 years accomplished its mission.

TAX COLLECTIONS LIKELY TO SURPRISE ON THE UPSIDE

- ◆ Gross tax revenue as per revised estimate is expected at Rs 19 lakh crore or 9.8% of GDP. But gross tax revenue upto Dec'20 is already Rs 13.38 lakh crore. This means Government projects Rs 5.62 lakh crore to be collected in the last quarter. However, the amount collected in the third quarter (Rs 6.17 lakh crore) is 36.8% higher than the gross tax collected in Q2 (Rs 4.5 lakh crore). This in turn implies that the last quarter gross tax collections will show a negative qoq growth of -8.9%. This seems unrealistic and thus we believe that this year's gross tax collection would be on the higher side.
- ◆ If we assume last quarter gross tax collections grow at same rate as Q3 then the total gross tax collections for FY21 would be around Rs 21.8 lakh crore, which is Rs 2.8 lakh crore more than the revised estimate amount. Taking 42% as the share of States from this, it would mean fiscal deficit could be lower by 0.6% of GDP in FY21.
- ◆ Furthermore, next year nominal GDP growth is expected at double digits it is expected that tax buoyancy will be higher than FY21 (FY22 tax buoyancy projected is lower than FY21), thereby suggesting that gross tax collections next year will also be higher than the Budgeted Rs 22.17 lakh crore, or 9.9% of GDP.

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