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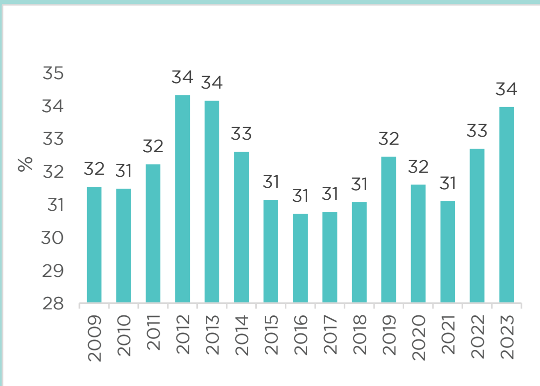
INDIA'S CAPEX STORY

A DEEP DIVE INTO **INDIA'S CAPEX STORY**

Investment plays a pivotal role in driving the economy. Overall Gross Fixed Capital Formation has risen to 34% of the GDP in FY23, levels last seen in 2013. Capital Expenditure (capex) substantially augments the economy's productive capacity and exerts a more profound influence on long-term growth and productivity in contrast to revenue expenditure. This heightened impact can be attributed to capex's capacity to generate a more pronounced multiplier effect on the overall growth prospects. When capex is allocated for new projects, expansion of existing ventures, or enhancement of technology and infrastructure, it fosters opportunities for economic growth through heightened productivity, increased demand for allied industries, and the creation of job opportunities. The budget announcements by the government reflect a concerted effort to reinvigorate the Keynesian' animal spirit', with the expectation that heightened public capex will act as a catalyst for increased private sector investments.

Gross Fixed Capital Formation (% of GDP)



Source: CMIE, CareEdge

PUBLIC CAPEX

Central Capex Continues to Perform Well

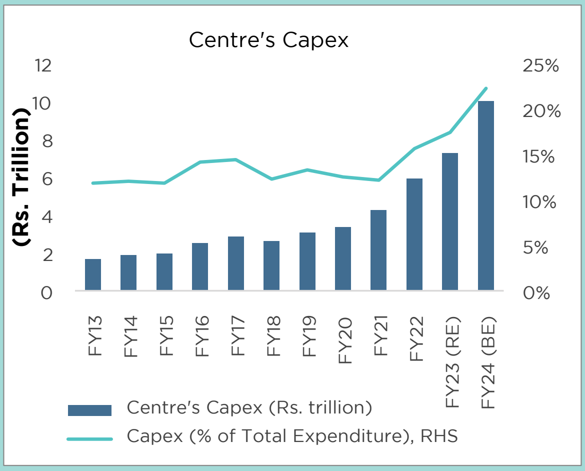
Over the past few years, the public capex has remained strong mainly led by the centre. The Government's steadfast commitment to capex is reflected in its budgetary priorities. Notably, the share of capex within the total expenditure has undergone a substantial increase, rising from 12.1% in FY21 to 22.2% in the budget estimate for FY24. Centre's capex witnessed a growth of 48.1%YoY in the April-August FY24, with spending of 37.3% of the budgeted value of Rs 10 trillion which is higher than the spending of 34.6% of the budgeted value in the same period in FY23.

Among the major ministries and departments, utilisation of the budgeted amount remains high for the Ministry of Railways, MoRTH, and Ministry of Communication with budgetary utilisation above 40% till August. Ministry of Finance's higher capex is driven by an increase in transfer to states for capital expenditure. The government's focus on infrastructure development continues to remain high in the fields of connectivity, physical infrastructure, and energy.

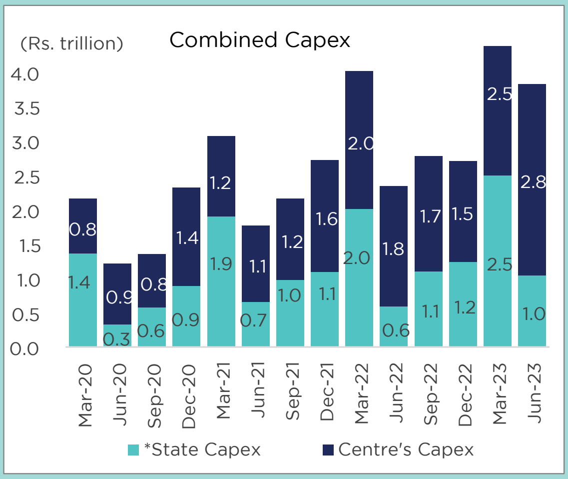
Capex by ministries

	April -August FY24 (Rs Billion)	Utilisation (% of BE)
Ministry of Railways	1127.1	47.0
Ministry of Road Transport and Highways	1101.7	42.6
Ministry of Defence	479.0	28.0
Ministry of Finance	423.4	29.1
Ministry of Communications	284.8	45.1

Combined Capex remains strong in Q1 FY24



Source: CMIE, CareEdge



Source: CEIC, CareEdge, * Excludes North-Eastern States, Sikkim and Goa

State Capex has performed better than last year

Analysis of the state budgets of 19 major Indian states reveals that the total budgeted capex of these Indian states will grow 19.6% in FY24 compared to FY23. This growth in the budgeted capex is primarily driven by notable increases in states like Gujarat (95%), Chhattisgarh (81%), Karnataka (34%), Odisha (29%), and Jharkhand (28%). Nevertheless, it is imperative to note that historically, states have often encountered challenges in fully deploying their budgeted capex allocations. Consequently, a more comprehensive assessment necessitates an examination of the utilisation rates.

As of the end of August, the collective utilisation of budgeted capex by the 19 major states has risen to 25%, reflecting an improvement from the 20% recorded in the same period in FY23. Notably, states such as Andhra Pradesh (51%), Telangana (49%), and Madhya Pradesh (42%) maintain robust capex utilisation rates. Conversely, certain states such as Maharashtra (15%), Karnataka (12%), and Punjab (12%) continue to display a low utilisation rate. This sluggish progress in capex implementation, particularly in states with relatively higher per capita incomes, remains a cause for concern. However, overall state capex remains strong as it witnessed a growth of 45% YoY in the April- August period FY24 which is higher than the budgeted growth of 19.6% and the growth of 9.9% YoY witnessed in the similar period last fiscal year.

Combined Capex remains strong in Q1 FY24

	(Rs Billion)				(%)		
	FY23 BE	FY24 BE	FTYD 23	FYTD 24	% Utilisation FY23	% Utilisation FY24	April-August Growth (YoY)
Andhra Pradesh	306.8	310.6	61.3	158.8	20%	51%	159%
Telangana	297.3	375.2	62.9	184.3	21%	49%	193%
Madhya Pradesh	456.9	540.6	158.7	227.2	35%	42%	43%
Kerala	148.9	146.1	51.0	47.4	34%	32%	-7%
Bihar	309.4	303.6	55.6	93.2	18%	31%	68%
Rajasthan	348.1	380.6	70.2	109.6	20%	29%	56%
Himachal Pradesh	56.5	52.0	15.9	14.3	28%	27%	-10%
Gujarat	359.0	701.0	102.4	191.0	29%	27%	86%
Haryana	223.4	184.6	27.1	46.6	12%	25%	72%
West Bengal	331.4	340.3	66.3	81.4	20%	24%	23%
Odisha	400.1	516.8	59.1	122.3	15%	24%	107%
Tamil Nadu	430.7	443.8	107.5	99.5	25%	22%	-7%
Jharkhand	166.1	212.5	26.5	44.3	16%	21%	67%
Uttarakhand	108.4	131.3	15.2	27.2	14%	21%	79%
Chhattisgarh	152.4	275.1	32.9	52.6	22%	19%	60%
Uttar Pradesh	1239.2	1474.9	188.6	233.4	15%	16%	24%
Maharashtra	652.1	739.0	96.6	110.0	15%	15%	14%
Punjab	109.8	103.5	14.8	12.3	14%	12%	-17%
Karnataka	435.7	583.3	116.2	69.1	27%	12%	-41%
19 Major States*	**6532.3**	**7814.9**	**1328.8**	**1924.6**	**20%**	**25%**	**45%**

Source: State Budgets, CAG and Care Ratings   * Excludes North Eastern States, Sikkim and Goa

Centre's interest-free loans boost State Capex

To encourage states to uphold their share of capex spending, the Centre has imposed conditions for disbursement under the 'Special Assistance to States for Capital Investment' scheme. Under this scheme, the Centre aims to provide state governments with an interest-free loan for capex purposes, spanning a 50-year period, with an overall sum of up to Rs 1.3 trillion allocated for this purpose in FY24.

Of the Rs 1.3 trillion, Rs 300 billion is the conditional part and will be disbursed subject to states meeting certain conditions while Rs 1 trillion is untied that would be disbursed in proportion to the state's share under the 15th Finance Commission. Till Q1 FY24, Rs 546 billion has been disbursed under the scheme with West Bengal, Rajasthan, Odisha and Tamil Nadu as the top recipients. In the previous fiscal year (FY23), the Centre disbursed Rs 812 billion to the states under this program as against the budgeted allocation of Rs 1 trillion.

The conditional part of these disbursements are tied to certain conditions, including the requirement that state governments utilise 75% of the amount released earlier and achieve 45% of their budgeted capex by September 2023. As of August, major states like Karnataka, Punjab, Maharashtra and Uttar Pradesh continue to have utilisation of budgeted capex amount below 20%. Due to challenges associated with capex expansion, particularlyduring the monsoon months, the Centre may consider relaxing or extending these conditions, recognizing that a significant number of states may face difficulties in meeting these targets within the specified timeframe.

Allocation under Special Assistance to States for Capex

State	Amount Approved (Rs Billion)
Bihar	96.4
Madhya Pradesh	78.5
West Bengal	75.23
Rajasthan	60.26
Odisha	45.28
Tamil Nadu	40.79
Karnataka	36.47
Gujarat	34.78
Chhattisgarh	31.95
Telangana	21.02
Arunachal Pradesh	12.55
Haryana	10.93
Himachal Pradesh	8.26
Mizoram	3.99
Sikkim	3.88
Goa	3.86
Total	**564.15**

Source: Ministry of Finance, Data as of June

To summarise, public capex remains robust, primarily due to the Centre's proactive efforts. State capex has shown improvement compared to the previous fiscal year, but its performance varies significantly, with some states lagging in terms of utilisation when compared with the budgeted amount. A sustained collaborative effort on capex expansion by both the central and state governments is imperative to provide the required impetus to foster India's growth.

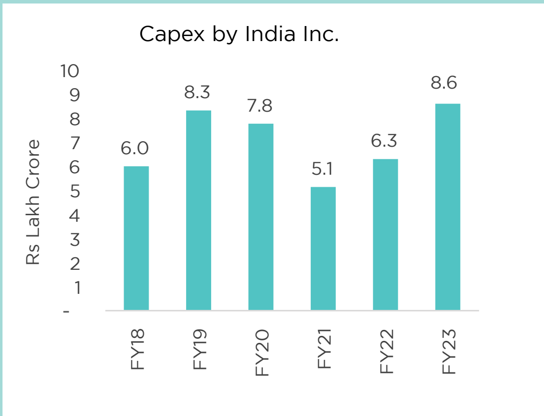
CAPEX BY INDIA INC. CLIMBS ABOVE PRE-PANDEMIC LEVELS

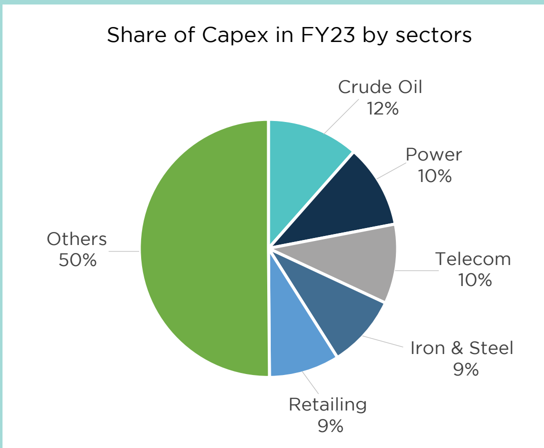
To assess the directional trends in capex within India's corporate sector, a detailed analysis was conducted on the annual financial statements of 1,299 non-financial companies. The data reveals that all non-financial companies witnessed a strong capex growth of 36.5% YoY during FY23, much higher than the 22.6% YoY growth recorded in FY22. In a noteworthy development, the aggregate capex undertaken by Indian non-financial firms in 2023 surpassed pre-pandemic levels for the first time, with 3.3% above the pre-pandemic baseline of 2019.

The top five sectors in which capital expenditure was concentrated in FY23 were crude oil (12%), power (10%), telecom (10%), iron & steel (9%) and retailing (9%). Among the major sectors, Iron & Steel and Retailing witnessed the strongest growth in FY23 with an expansion of 187.6% YoY and 106.3% YoY respectively. However, investments in crude oil contracted by 15.8% YoY in the same period. Some of the major players incurring capex in these five sectors were the Reliance Industries, Oil and Natural Gas Corporation Ltd (ONGC), Bharti Airtel, NTPC, Tata Motors, Vodafone Idea Ltd, Indian Oil Corporation Ltd (IOCL) and Vedanta Ltd.

Major CPSEs (capex target of above Rs 1 billion) have met the Capex target in FY23 with a total capex of Rs 6.48 trillion against a budgeted capex of Rs 6.46 trillion. Even in this fiscal year from April to August, major CPSEs have achieved a capex of Rs 3.1 trillion, which is 42.3% of the budgetary estimate of Rs 7.3 trillion, with a growth of 36.6% YoY.

Capex by India Inc. remains strong led by private non-financial corporations





Source: Ace Equity, CareEdge. Based on the analysis of 1299 non-financial companies

RBI's Order Books, Inventories and Capacity Utilisation Survey (OBICUS) data shows that the capacity utilisation in the manufacturing sector has increased to 76.3% in Q4FY23 up from 74.3% in the previous quarter and LPA of 74%.

The rise in capacity utilisation was mainly due to a sequential uptick in the new order book. However, the recent downside risks to domestic as well as global demand can impact capacity utilisation adversely.

Table 2: Performance of Capex in Major Sectors in FY23

	Amount (INR bn)	Share (%)	Growth (%)
Crude Oil	988	11.5	-15.8
Power	900	10.5	8.7
Telecom	857	10.0	-24.9
Iron & Steel	780	9.1	187.6
Retailing	759	8.8	106.3
Others	4,306	50.1	82

Source: Ace Equity and CareEdge

Though India's private capex cycle has shown early signs of a revival, the outlook over the medium term looks positive. With capacity utilisation rising above 75% coupled with a deleveraged balance sheet, we could expect the private investment cycle to accelerate. First quarter data shows improving profitability driven by the easing of input prices. The improvement in corporates' profitability will aid private capex cycle revival. Globally, the monetary policy cycle has neared its peak with inflationary pressures gradually receding. The cost of money is expected to start falling from the next year as major central banks are expected to start their rate-cutting journey. Recent budget announcements by the government reflect a concerted effort to reinvigorate the Keynesian' animal spirit', with the expectation that heightened public capex will act as a catalyst for increased private sector investments. Global reorganisation of the supply chain away from China will also support investment in India.

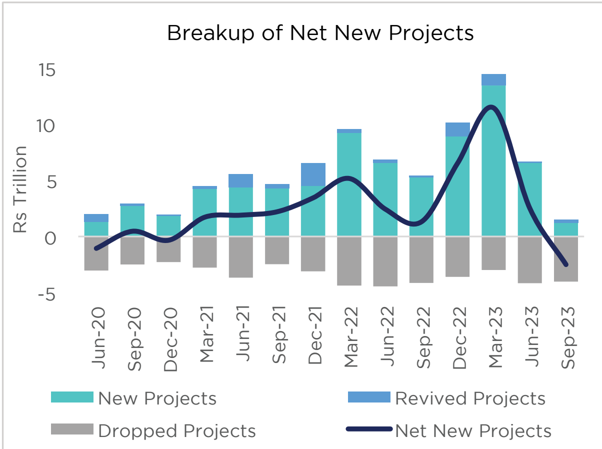
Note: Formula used for capex calculation is (Gross Block + CWIP) of current year – (Gross Block + CWIP) of previous year. In this total capex calculation, there would be some instances where Gross Block would have gone up because of Capex by these players outside India, but such cases in overall calculation will not be significant. This calculation could also have some instances where Gross Block has gone up simply because of an acquisition, but again this number will not be significant in aggregate capex calculation.

SLOWDOWN IN INVESTMENT **PROJECTS IN H1 FY24**

CMIE's data on projects show a steep slowdown in net new projects in the first half of FY24. The value of new projects announced fell to Rs 1.2 trillion in Q2 FY24 from Rs 6.6 trillion in Q1 FY24 and Rs 13.4 trillion in Q4 FY23. It's important to note that a substantial portion of the new investment projects in Q4 FY23 and Q1 FY24 were driven by Air India's and InterGlobe Aviation's aircraft purchases, a factor absent in Q2 FY24.

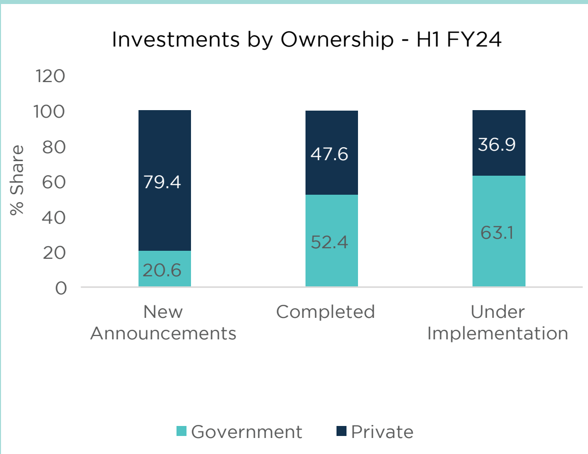
Additionally, the value of dropped projects rose from Rs 3 trillion in the Q4 FY23 to Rs 4.2 trillion in Q1 FY24 and Rs 4 trillion in Q2 FY24. A rise in the value of dropped projects along with a slowdown in announcements of new projects also pushed net new projects in the negative territory H1 FY24. Net new projects fell into negative territory for the first time since March 2021.

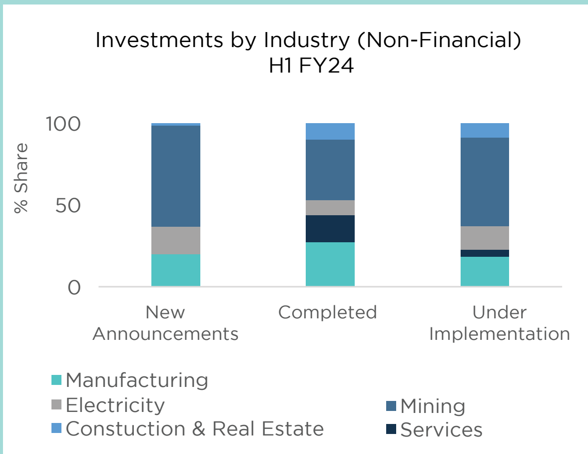
Exhibit 3: Investment Projects slows in H1 FY24



Source: CMIE, CareEdge
Net New Projects = New Projects + Revived Projects -Dropped Projects

Exhibit 4: Private sector shows intent to undertake capex but implementation and completion lags





Source: CMIE, CareEdge

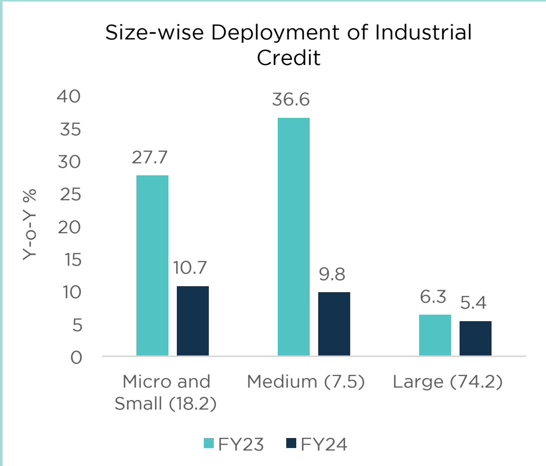
Private sector has outpaced the government in terms of announcements of new projects in the H1 FY24. However, it has lagged the government sector in terms of completed projects and projects under implementation. In terms of industries, the services sector continues to perform well with the highest share in all three categories – new announcements, completed and under-implementation projects mainly led by the transportation services.

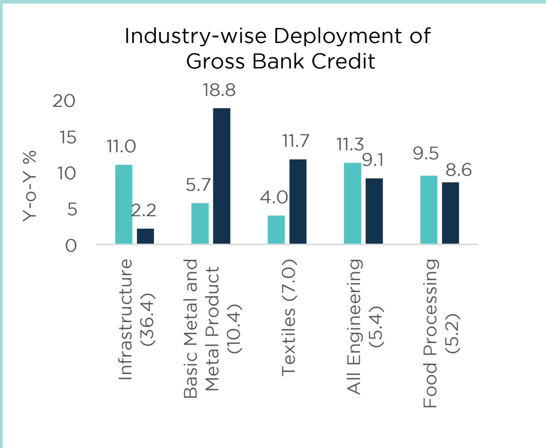
SOURCES OF FINANCING

Bank Credit: Credit expansion in the industrial sector experienced a deceleration during the period of April to August in FY24 mainly due to an adverse base effect. Excluding the effects stemming from the HDFC twin merger, industrial credit in the same April to August period of FY24 witnessed a modest growth rate of 6.1% as against an 11.4% growth recorded during the corresponding period in FY23. Despite this deceleration which is driven by the base effect, sequential momentum continues to remain robust. The deceleration was also observed in infrastructure credit, accounting for 36.4% of the total industrial credit portfolio.

The most pronounced decline in credit growth was observed within the Micro, Small, and Medium Enterprises (MSME) sector. This contraction can be attributed to the closure of the Emergency Credit Line Guarantee Scheme (ECLGS) initiated during the pandemic, resulting in a sharp moderation of credit expansion. However, credit extended to large industrial entities, constituting approximately 74% of the overall industrial credit portfolio, managed to register a growth rate of 5.4% in the April to August period of FY24, albeit slightly lower than the 6.3% growth recorded in the same period of the previous fiscal year.

Credit to Industry slows in FY24 in the April- August period due to base effect

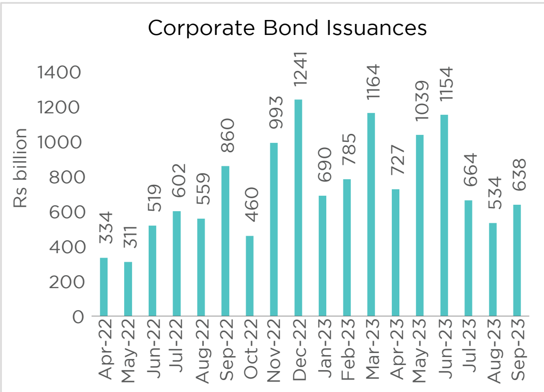




Source: CEIC, CareEdge. Figures in bracket represent respective weightage in each category.

Corporate bond issuances: Total commercial paper issuances in H1 FY24 stands at Rs 4.8 trillion which is 49.3% higher than the total issuances in H1 FY23. Even though the H1 corporate bond issuances remain higher than last year, it has slowed down significantly over the past few months. The growth in corporate bond issuances slipped into the negative territory in August and September with a contraction of 4.4% YoY and 25.8% YoY respectively. The shift in preference away from corporate bonds over the past couple of months can be attributed to higher yield on these instruments which rose due to a high inflation prints, hawkish commentary of global central banks and a rise in Brent crude prices. A gradual pick-up in the investment cycle should improve the prospects of the bond market.

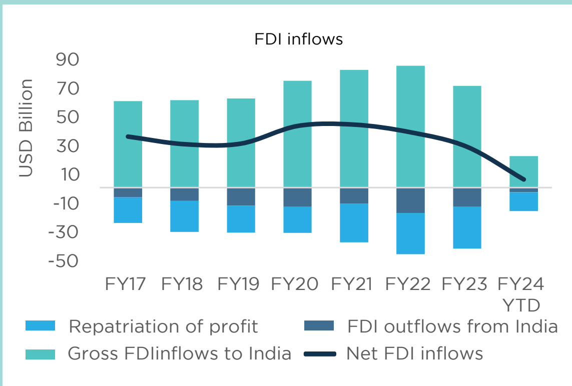
Corporate Bond Issuances slows

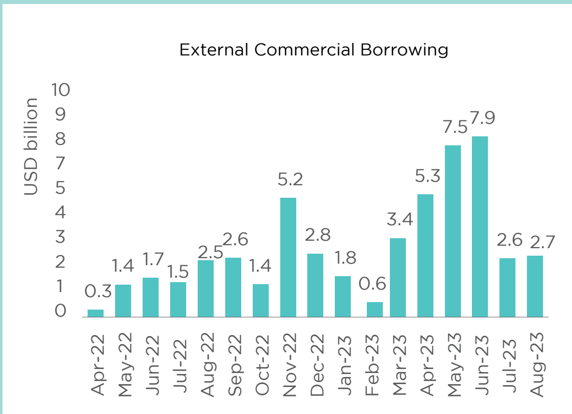


Source: Prime database, CareEdge

External Sources: On the external front, Gross FDI inflows in the April- July period of FY24 slowed 25.9% compared to the corresponding period in the last fiscal year. The contraction is even higher at for net FDI inflows due to a 49.7% growth in the repatriation of profit. The external commercial borrowing has fallen to a four-year low of USD 27.3 billion in FY23 after a contraction of 33.8% YoY. However, the ECB borrowing rose five times to USD 20.7 billion in Q1 FY24 as compared to the previous fiscal year. Revival in ECB borrowing is a positive signal for a revival in private capex. However, it has again slowed in July and August.

FDI inflow slows but overseas borrowing bounces back





Source: CEIC, CareEdge

THE WAY FORWARD

So far in the year, the public capex has performed well. Till August, the Centre's capex has seen a promising growth of 48.1% YoY. The state governments have also budgeted for strong capital expenditure, with the aggregate budgeted capex for 19 major states at Rs 7.8 trillion – 19.6% higher than the budgeted capex of last year. However, unlike last year, the state capex has maintained its momentum with the April-August period witnessing a growth of ~45% as compared to last year. The Centre's disbursement of conditional interest-free loans tied to actual capex spending has aided in the rebound of the capex cycle by states.

As far as the private sector is concerned, India Inc's investment shows a good recovery in FY23 with total capex rising above pre-pandemic level for the first time. However, project announcements show a moderation in capex in H1 FY24. Even though there are downside risks to domestic as well as external demand and higher cost of money which can lead to firms postponing their capex plans, the conditions continue to remain suitable for a strong uptick in private capex with improvement in capacity utilisation levels and a deleveraged balance sheet. Even though the cost of money remains high, the global monetary policy cycle has neared its peak and the major central banks are expected to start their rate-cutting journey in the next calendar year. Thus, we remain hopeful that the private capex will gather momentum in the upcoming quarters.

CareEdge
RATINGS

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