MONTHLY ECONOMIC BUFFET

02 September 2022

Economic Round-up: August 2022

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Following the statements by major central bankers at Jackson Hole, it is expected that global monetary conditions will continue to tighten, until inflation is brought down. This has made investors jittery as it also increases the risk of recession. Some signs slowdown are emerging from flash PMIs, increased cost of living in the UK, and drop in consumer confidence in Eurozone. China's recovery also remains uneven. Impact of PBOC/Fed/ECB/BoE decisions will be keenly watched going ahead.

Global growth: Given the indication by flash PMIs for Aug'22, both manufacturing and services activity in US and Europe seems to be facing setbacks in the wake of elevated prices. While in US CPI remains sticky and PPI has begun to come down, they remain a concern in the Eurozone and UK. Looming energy crisis and fast approaching winter season can add to the woes of Europe. In the US, impact of aggressive rate hikes by the Fed is set to hamper growth. In addition, China's industrial production, retail sales, FAI, property investment, home sales, all registered weaker than estimated growth in Jul'22. However, supported by PBOC's stimulus measures, official PMIs (both manufacturing and services) are beginning to see a turnaround in Aug'22. But, sustaining the momentum will be the key, which remains tough task if demand from US and Europe falters.

Global Central Banks: Last month, number of developments around monetary policy guidance by major central bankers impacted the mood of the market. Most important of it was US Fed Chair's Jackson Hole speech, signalling that Fed will continue to aggressively hike rates until inflation is tamed. ECB officials too hinted that monetary policy tightening will continue even if there is a risk of recession. BoE raised rate by 50bps—biggest since CY95. On the other hand, owing to signs of troubles in the domestic economy, PBOC announced stimulus measures.

Key macro data releases: India's real GDP rose by 13.5% in Q1FY23, fastest pace compared to the last three quarters, despite an elevated base (20.1% in Q1FY22). While GVA rose by 12.7% in Q1FY23 against 3.9% in Q4FY22 and compared to 18.1% in Q1FY22. Sector wise, services outperformed.

CPI came in slightly lower at 6.7% in Jul'22, down from 7% in Jun'22. Food inflation moderated further, supported by softening prices of vegetables, meat and fish, oils & fats, and milk & milk products. Core inflation edged down by 30bps to 5.7% in Jul'22 on account of sharp dip in transport and communication. We believe RBI will hike rates by another 50bps during the year. Going forward, we expect India's 10Y yield to trade in the range of 7.20-7.30% in the coming fortnight. We also expect the rupee to trade in the Rs 79.75-80.0/$ range in the near-term.

Global developments

Fears of growth slowdown linger

Fed Chair, Powell, in his speech at the Jackson Hole admitted that there will be consequences of high interest rates on labour market and economic growth. He also reiterated that Fed remains committed to bringing inflation substantially down, thus signalling continued rate hikes by the central bank in the upcoming meetings, despite running the risk of recession. Further, ECB official also indicated that the bank will have to hike rates even if it leads to a recession. ECB officials Holzmann and Knot have also signalled that a 75bps rate hike should be discussed in the Sep'22 meeting.

In the US, while CPI print for Jul'22 remained unchanged from the previous month at 8.5% versus est.: 8.7%, it remains at elevated levels, considering Fed's long run annual target remains at 2%. Moderation in PPI in Jul'22 (-0.5% MoM) versus est.: 0.2% increase also gives hope that prices might be stabilising now. Latest data indicates that after 3 consecutive month decline, consumer confidence in Aug'22 improved. Initial jobless claims also fell to 243,000 for the week ending 20 Aug 2022. However whether the momentum can be sustained or not will key to watch. Flash PMIs show that business activity slowed further in Aug'22 to 25-month low with PMI at 51.3 from 52.2 in Jul'22. Services activity contracted even more in Aug'22 with PMI registering at 44.1 (27-month low) versus 47.3 in Jul'22. This is bound to impact economic growth in Q3CY22.

Chances of growth slowdown in Eurozone are significantly higher as an ongoing energy crisis is already pinching on the pockets of consumers and businesses. Inflation in the Eurozone climbed up to a fresh record high at 9.1% in Aug'22 from 8.9% in Jul'22, driven by gas prices and a drought. Even more worrisome is the rise in services cost and 5% jump in prices of non-energy industrial goods. Flash Eurozone PMIs showed that while manufacturing activity fell deeper into contraction in Aug'22 (49.7; 49.8 in Jul'22), services activity is also slowing (50.2; 51.2 in Jul'22). Both input and output costs continued its upward trend in Aug'22 as well, and the energy crisis will become only more severe as the winter season approaches close.

Even China runs the risk of growth slowdown as key macro-economic indicators continue to exhibit weakness. Industrial production in Jul'22 rose by 3.8%, down by 3.9% in Jul'22 and est.: 4.3%. Retail sales growth was also down to 2.7% versus est.: 4.9%, while FAI cooled to 5.7% in CYTD22 compared with estimated increase of 6.2%. Within FAI, property investment has contracted by 6.4% in CYTD22 so far. In addition, youth unemployment is running at ~20%. China's property markets is under severe stress with investment down by 12.3% in Jul'22 and sales down by 28.9%. PBOC had announced lending rate cuts in Aug'22 in a bit to boost credit growth and lower the cost of credit for home buyers. Official PMI shows that stimulus measures might be showing effect as manufacturing PMI rose to 49.4 in Aug'22 from 49.0 in Jul'22. Construction PMI was up at 52.3 from 51.4 in Jul'22. However whether the momentum can be sustained is yet to be seen. Economists are now expecting a GDP of less than 4% in CY22 versus 5.5% earlier estimated by the government.

Global central bank decisions

Bank of England (BoE) raised policy rates by an expected 50bps (biggest rate hike since CY95), as it attempts to tame skyrocketing inflation. It said that CPI inflation is likely to peak at 13% in Oct'22. It further noted that UK is likely to slip into recession in Q4CY22 and emerge from it only in early CY24.

In the coming weeks, ECB and US Fed are expected to announce their monetary policy decisions and markets are expecting both central banks to continue hiking rates in order to control the elevated levels of inflations. It is expected that ECB will hike rate by 75bps and US Fed by 50-75bps. BoJ will also announce its policy decision, where decision will be taken to extend/end the pandemic-relief program beyond September, when it is scheduled to expire. Changing the language of forward guidance will also be discussed in the Sep'22 meeting.

On the other hand, PBOC announced surprised rate cut in Aug'22 to its key policy rates. Its 5Y LPR has been cut by 15bps to 4.3% from 4.45% in May'22. Earlier, both 1Y medium-term lending facility (MLF) rate, and 7-day reverse repo rate were lowered by 10bps each. While the economic impact of these rate cuts is expected to be limited, PBOC action signals that the economy is in trouble. PBOC is expected to announce more stimulus measures in the near-term.

Special studies

How have stock markets performed this year?

In CY22 so far, we observed that Indian equity markets (both Sensex and Nifty) performed relatively better than other major global equity markets. For comparison purpose, we assumed December 2021 to be the base and analysed how global markets have performed this year since then.

Compared with Dec'21, Sensex and Nifty are up by 2.3% in Aug'22, and FTSE is up by 2.8%. On the other hand, Dow Jones (-7%), S&P500 (-10.7%), Nikkei (-0.5%) and Hang Seng (-15.3%) are all considerably down compared to last year. A key reason for the performance of stock markets in the US remains concerns regarding growth slowdown and Fed's aggressive monetary policy stance. Recently at Jackson Hole too, Fed Chair Powell reasserted that Fed will continue to remain hawkish to tame currently elevated levels of inflation. This is expected to hurt growth in the near-term. Tech-heavy S&P500 has thus been impacted the most in the US.

In case of UK, FTSE is largely dominated by financial, energy and material stocks (contributing to 41% in FTSE versus 16% in S&P). These stocks have been buoyed by increase in rates and global commodity prices. Also there is limited dominance of tech stocks which acted as a drag in other market indices.

In India's case, sustained improvement in economic growth has helped its stock markets. So far in CYTD22 (till Aug), air passenger traffic growth is up by 82% (YoY), rail freight traffic by 9.3%, toll collections by 62% and diesel consumption by 13%. Corporate results for Q1FY23 rose solidly. Even looking at 3Y CAGR, sales rose by 13.3% during this period compared with 39.8% when reckoned over FY21.

In India, FPIs (equity) have also seen a turnaround in the last 2 months (Jul-Aug'22) with inflows at US$ 6.8bn, compared with outflow of US$ 28.6bn between Jan-Jun'22. In CYTD terms, FPI outflows from India stood at US$ 21.7bn (till 26 Aug), compared with outflows of US$ 85.3bn (till Jun'22) from China, US$ 38.2bn from Taiwan (till 29 Aug), US$ 211.8bn from US (till Jun'22), and US$ 133.1bn from Euro Area (till Jun'22).

Going forward, global markets will react to incoming data from US, Europe and China to assess the impact of consistent rate hikes by major central banks. Energy crisis in Europe and increasing bills of utilities, food, beverages in the UK will affect consumption demand in the area, thus increasing risk of recession. China's looming property crisis will add to global woes. In India, with festive season ahead, investors will closely monitor impact of inflation and front-loading of rate hikes by RBI on domestic demand.

Housing loan scenario in India

The real estate sector plays an important role in the economy, especially true for a developing economy like India with a huge population, implying an ever increasing demand for housing. Demand for housing comes hand-in-hand with the demand for housing credit. In this respect, we studied the housing loan segment in India and analysed the trends thereof.

The growing importance of home loans can be gauged from the fact that the ratio of outstanding individual home loans by Scheduled Commercial Banks (SCBs) and Housing Finance Companies (HFCs) in India's GDP has grown substantially in the last ten years. From about 6.8% of GDP in FY11, this ratio has risen to 9.5% in FY21. Even in FY20, despite the adverse Covid-19 shock in FY20, ratio of housing loans rose to 9.8%. In the succeeding year, the sector noted a remarkable recovery from the pandemic and the ratio of housing loans in GDP rose to 11.2%.

We observed that while SCBs remain the key player in the housing loan segment with over 60% share, other players such as HFCs have also been playing a key part in meeting the credit requirement of the sector. Despite charging higher interest rates, HFCs have been able to maintain a share of above 30% in the housing loan market, by providing quicker and simpler loan turnaround process.

Within SCBs, PSBs were the dominant market player in the housing loan segment accounting for 61.2% of the total housing loan portfolio of SCBs in FY21. However, it must be noted that the share of PSBs has seen a sequential dip in share from ~70% in FY11. Although, an interesting thing to note was that in the last two years i.e. FY20 and FY21, the market share for SCBs increased. From 64% in FY19, SCBs market share increased to 67%in FY20 and 68% in FY21. On the other hand, HFCs lost market share.

In recent times, NBFCs have also emerged as a player in the housing loan segment. Data from FY16 onwards showed that, excluding FY18 which saw a dip, NBFCs' gross advances to the housing sector has been increasing. From Rs 14,547 crore in FY16 it increased to Rs 21,478 crore in FY21. With a pickup in housing loan demand thereafter, there has been a sharp pickup in housing loans from NBFCs as the gross advances in H1FY22 (upto Sep'21) have already exceeded the level of FY21. Despite the rapid pace of expansion of NBFCs in the housing loan segment, their contribution to the overall credit requirement in this sector remained limited.

Outstanding individual housing loans by HFCs noted a sharp pickup in the last few years. From Rs. 2.6 lakh crores, the housing loan portfolio of HFCs rose to Rs. 6.6tn in FY19 and remained stagnant at the same level in FY20. In FY21, outstanding home loans by HFCs rose moderately to Rs 7.1 lakh crores as housing demand remained muted to the Covid-19 pandemic. Even so, between FY13 to FY21, the CAGR growth has been an impressive 11.8%. With easing restrictions and a resurgence in demand for housing, housing loan portfolio of HFCs has surged to Rs. 7.4 lakh crores in H1FY22 alone.

Study on turnover to asset ratio

To understand how industries have fared during FY19-22, this study focused on identifying possible alternatives to the concept of capacity utilization (CU) which is an indicator of optimal level of functioning of any company or industry. It is hence more indicative of progress than growth in production or net sales which are subject to base effects.

An indicator that signals strength in the economy or can be used to determine CU levels can be the –fixed assets turnover ratio. This ratio measures the net sales (turnover) to fixed assets and estimates the ability of a company to generate sales from the fixed assets. While there can be no ideal level, an increase in the ratio of sales/GFA will indicate that companies or industries are operating at higher levels with a given level of capital stock. The study attempted to analyse the same by comparing the ratio levels from 2019 onwards to 2022. The sample size of over 1,365 firms was taken which included over 40 sectors. To maintain parity in terms of sectors relevant for capacity utilization, banks, insurance firms and rating firms were excluded from the exercise.

The turnover to GFA ratio, which is a proxy for capacity utilization in industry, presented a picture of mixed bag for FY22 when compared with FY19. FY20 was also a year which showed a depressed corporate performance due to the Covid-19 lockdown. FY21 was the first year of the pandemic which was typified by lockdowns of various varieties which affected production. FY22 had the advantage of both, a low base statistical effect as well as recovery in the corporate sector, as restrictions were removed largely for most sectors. Therefore, in this study, turnover to GFA ratio was compared with FY19 (the pre-pandemic year when conditions were normal). An improvement in this ratio for 13 sectors indicated that the recovery has been real. Metals group along with some intermediates like chemicals as well as textiles registered higher ratios. For 25 sectors, the picture however is still a concern, as the ratio of turnover to GFA is still lower than pre-pandemic times. These sectors were more in the services segment besides consumer goods and capital goods segment.

Corporate performance in Q1-FY23

India Inc. presented a very positive performance in the first quarter of the financial year which is also in consonance with various statistical numbers that have been released at the macro level. This does tempt one to conclude that the sector is on a fast track mode with sales growth of around 40%. A deeper analysis does however reveal that just as is the case with the macros, base effects have tended to magnify the performance.

Sales of a sample of 2,598 companies covering 38 sectors witnessed growth of 39.8% in net sales compared with 43.1% last year. This does sound impressive considering that barring mining, all sectors witnessed positive growth this quarter. It must however be pointed out that interpretation of data must be qualified as the preceding two years witnessed unusual lockdowns- in 2020 there was a total lockdown for two months while in 2021 the first quarter was subject to different lockdowns imposed by various states which impeded performance. Therefore, we believe that a more pragmatic way to look at growth in turnover would be to use the CAGR concept with 2019 as the base. This gives a more moderate view of growth as after a slump in 2020 there was an equally sharp uptick in 2021.

Growth in 2021 over 2019 was just 4.1% and only 17 of the sectors had sales level higher than that in 2019. CAGR in sales was 13.3% per annum for the sample companies between 2019 and 2022, which is indicative that there is still some distance to be traversed as this number has been in the region of 15- 18% in the past.

The sectors which registered growth of less than 10% were finance and healthcare. For others, while the base effects contributed to the brighter performance, there were also some other key drivers, including: higher prices of energy benefiting crude oil sector; good sales by FMCG companies in the rural segment, supported by adequate Rabi harvest; unfulfilled orders in the auto sector due to the semi-conductor problem did get resolved to some extent this quarter which helped in sales; metals segments including iron and steel and non-ferrous metals witnessed a positive thrust from the infra spending by the government; services like hospitality witnessed a strong revival as governments across the country had fully removed curbs on movement of people; retailing also benefited with companies moving back to normal in terms of working from office.

Net profit of these sample companies increased from Rs 1.73 lakh crore in 2021 to Rs 2.04 lakh crore in 2022. Interestingly, 3 sectors i.e. banks, finance and automobiles accounted for 70% of the net increase in PAT during this quarter. Hence, while growth in net profit for the sample companies was 18.4%, several industries had been hit by higher input costs. While some h been passing on the higher cost to the consumer, it is still work in progress. It may be expected that the process will be completed in the next two quarters. Sectors that were hit hard by the pandemic like hospitality, aviation, retailing etc., have turned around the corner. Telecom still struggles with their regulatory dues and are not yet in the profit zone.

The next couple of quarters would be more indicative of the state of the corporate sector as any reinforcement of the belief that the economy is moving along at fast pace should be reflected in corporate sales in Q2 and Q3 which will coincide with the pre-festival and post-harvest cum festival seasons when demand typically increases.

Financial Highlights of Banks

We analysed the financial performance of 35 banks of which 12 were Public, 19 Private Sector Banks (PVBs) and remaining 4 were Small Finance Banks. We looked at the key indicators of profitability, margins and efficiency ratios for the consolidated groups.

NII of industry grew at a robust pace of 14.6% in Q1FY23 against 7.7% in Q1FY22. This is on account of increase in interest income to 10.2% in Q1FY23 from 3.3% decline in Q1FY22, partly because of an elevated interest rate regime and pick up in credit demand.

For both PSBs and PVBs, NII rose sharply to 11.9% and 17.2% respectively, in Q1FY23 from 5.4% and 10.5% in Q1FY22.

Non-interest income of PSBs fell sharply by 45.1% in Q1FY23 from 44% increase seen in Q1FY22, whereas for PVBs, it fell by 4.4% from 17.7% increase in Q1FY22. Notably, 10Y Gsec yield rose by 61bps in Q1FY23. Hence there is a risk of MTM loss and lower gains from treasury income in the rising interest rate cycle.

Operating Profit of the industry declined by 8.6% in Q1FY23 from 13.7% increase seen in Q1FY22.

Cost to income ratio of the industry increased to 51.2% in Q1FY23 from 45.9% in Q1FY22. For PSBs, the ratio rose to 54.1% from 48.7%. For PVBs, it rose to 47.8% from 42%. Higher inflation is further going to put pressure on cost to income ratio, on account of elevated operating expenses.

Provisions for the industry fell by 42% in Q1FY23 from 8.9% decline in Q1FY22. The decline may be attributed to the fact that banks have been making progressive provisions for NPAs in the last few years thus obviating the need for the same in the current financial year.

Net Profit of the industry rose by 37.1% to Rs 44,048 crore in Q1FY23 from Rs 32,134 crore in Q1FY22. For PSBs, net profit rose by 9.2% to Rs 15,307crore from Rs 14,012crore in Q1FY22. For PVBs, it rose at a far faster pace of 54.9% to Rs 28,165crore in Q1FY23.

GNPA ratio of the industry improved to 5.72% in Q1FY23 from 7.57% in Q1FY22. This is led by sharp improvement in GNPA ratio of PSBs to 6.94% in Q1FY23 from 9.13% in Q1FY22. For PVBs, it improved to 3.82% from 5.04%.

Return on assets (RoA) of the industry was at 0.61% in Q1FY23 from 0.50% in Q1FY22. For PSBs, it was stable at ~0.48%, for PVBs it rose to 0.73% from 0.54% in Q1FY22.

Gross advances of the industry rose to Rs 125.73lakh crore in Q1FY23 from Rs 108.66lakh crore in Q1FY22. Share of PSBs in gross advances was stable at 61%. For PVBs, the share improved slightly to 38.4% in Q1FY23 from 37.6% in Q1FY22.

What does interest cover of India Inc. indicate?

In this study, we had examined financial performance of 3,180 companies (excluding financial companies) and noted the trend in interest coverage ratio, defined as, operating profit to interest. This indicator reflects the comfort level of companies in debt servicing.

Results of our study were as follows:

In response to falling interest rate cycle, interest coverage ratio of companies had improved in FY21 following 40bps drop in repo (plus 75 bps in March 2020) and 79bps drop in WALR. In FY22 as well, interest cover of companies continued to show significant improvement to 5.76 from 4.56 in FY21. Notably, in FY22, despite a moderation in operating margin (Operating profit/Net sales), interest coverage of companies improved, clearly reinforcing the view that RBI's accommodative policy supported this trend.

Industry wise, aviation, consumer durables and hospitality are still facing considerable risk, post Covid-19 induced slowdown. However, few infra sectors such as capital goods, iron and steel, construction have better interest coverage ratio.

Small industries continued to remain vulnerable in terms of interest coverage ratio. In both the years FY21 and FY22, loss had yielded negative ratio. Even for micro enterprises, similar trend was observed. This was despite the measures taken by the government and RBI to improve credit health of the MSME sector (including the ECLGS scheme). Even the interest coverage ratio of MSME remained below 1 for FY20, 21 and 22. Notably since FY18, apart from medium enterprise, interest coverage ratio of both micro and small enterprise has been low. The same is reflected in their operating profit margin as well.

Thus it could be concluded that, falling interest rate regime helped in improving the debt servicing ability of companies. But improvement was skewed in favour of large enterprises, with MSME sector still under pressure. Going forward, in the current rising rate cycle, where RBI has already front loaded 140bps hike in policy rate, interest payment is going to increase. Further, spillover impact of tightening global financial conditions and inflationary consequences might pinch on operating profit as well. Thus, interest coverage ratio in FY23 is likely to deteriorate.

Is there a link between Indian and US interest rates?

In the present context of a synchronized global policy tightening effort in response to surging inflation, a regular talking point has been the magnitude of rate hikes. A similar sentiment also exists in the domestic market with investors/analysts alike assessing the possibility of rate hikes by the RBI, and more importantly the extent to which RBI might hike policy rates. Often it tends to get linked with the Fed even though it has been stated that the MPC looks at the global environment but takes decisions based on domestic considerations surrounding inflation.

In this context, we assess the movement of Fed funds rate (upper bound) and RBI repo rate in the past two decades and attempt to draw patterns in the relationship between the two. If such a relation does exist, it can be extended to make conjectures on how the path of repo rate could shape up as the Fed's position becomes clearer.

Barring a few exceptions, repo rate closely follows the movement in the Fed policy rate. Further, while the magnitude of rate hike/cut may be different in the US and India, the general direction of monetary policy remains the same. From the past trends it does appear that notwithstanding the inflation differentials, the difference in interest rates would be in the region of 400-500bps. This is something that can be expected to prevail in the future too. Interest rate differential has been increasing over time and while inflation accounted for a large part of the differential prior to the financial crisis, the link has gotten severed subsequently especially after 2015.

Additionally, the difference between the Fed rate and repo rate has averaged 350-400bps in the last two decades after leaving out the unusual data points. Also, while theoretically inflation differential should get reflected in the interest yields, given that the bond market is driven by several other factors, inflation impact does not always play a significant part.

Key policy developments

- The fourth advance estimates of production of major agricultural crops for the year 2021-22 have been released. The production of Foodgrains in the country is estimated at 315.72 million tonnes which is higher by 4.98 million tonnes than the production of foodgrain during 2020-21. The production during 2021-22 is higher by 25 million tonnes than the previous five years' (2016-17 to 2020-21) average production of foodgrains. Total production of Rice during 2021-22 is estimated at record 130.29 million tonnes. It is higher by 13.85 million tonnes than the last five years' average production of 116.44 million tonnes. Production of Wheat during 2021-22 is estimated at 106.84 million tonnes. It is higher by 2.96 million tonnes than the last five years' average wheat production of 103.88 million tonnes. Total Pulses production during 2021-22 is estimated at record 27.69 million tonnes which is higher by 3.87 million tonnes than the last five years' average production of 23.82 million tonne.

- Keeping in view interest of sugarcane farmers, the Cabinet Committee on Economic Affairs approved Fair and Remunerative Price (FRP) of sugarcane for sugar season 2022-23 (October - September) at Rs. 305/qtl for a basic recovery rate of 10.25%, providing a premium of Rs. 3.05/qtl for each 0.1% increase in recovery over and above 10.25%, & reduction in FRP by Rs. 3.05/qtl for every 0.1% decrease in recovery. However, the Government with a view to protect interest of sugarcane farmers has also decided that there shall not be any deduction in case of sugar mills where recovery is below 9.5%. Such farmers will get Rs. 282.125/qtl for sugarcane in ensuing sugar season 2022-23 in place of Rs. 275.50/qtl in current sugar season 2021-22.

- The Cabinet Committee on Economic Affairs, has approved the proposal for amendment of policy of exemption for Wheat or Meslin Flour (HS Code 1101) from export restrictions/ ban. This approval will allow to put a restriction on the export of Wheat Flour which will ensure a curb on rising prices of wheat flour. In normal times, Russia & Ukraine have been the major exporters of wheat accounting for around 1/4th of the global wheat trade. The conflict between them led to the global wheat supply chain disruptions increasing demand of Indian wheat. As a result, the price of wheat in domestic market also showed an increase. Thus to ensure food security, the decision was taken to put a prohibition on export of wheat in May 2022.

- The Union Cabinet has approved the proposal of Ministry of Housing and Urban Affairs (MoHUA) for continuation of Pradhan Mantri Awas Yojana-Urban (PMAY-U) up to 31stDecember 2024 wherein financial assistance is to be provided for the completion of already sanctioned 122.69 lakh houses till 31stMarch 2022. Central Assistance approved since 2015 is Rs. 2.03 lakh crore against Rs. 20,000 crore in 2004-2014. Upto 31st March 2022, Central Assistance/subsidy of Rs 1,18,020.46 crore has already been released and Rs 85,406 crore will be released as Central Assistance/subsidy till 31st December 2024.

- The Union Cabinet has approved to restore Interest Subvention on short term agriculture loans to 1.5% for all financial institutions. Thus, Interest Subvention of 1.5% will be provided to lending institutions (Public Sector Banks, Private Sector Bank, Small Finance Banks, Regional Rural Banks, Cooperative Banks and Computerized PACS directly ceded with commercial banks) for FY23-25 for lending short-term agri-loans upto Rs 3 lakh to the farmers. This increase in Interest Subvention support requires additional budgetary provisions of Rs 34,856 crore for the period of FY23-25 under the scheme.

Data Releases

Q1FY23 GDP

India's real GDP rose by 13.5% in Q1FY23, fastest pace compared to the last three quarters, despite an elevated base (20.1% in Q1FY22). While GVA rose by 12.7% in Q1FY23 against 3.9% in Q4FY22 and compared to 18.1% in Q1FY22. Sector wise, services outperformed growing by 17.6% in Q1FY23 against 5.5% in Q4FY22 and 10.5% in Q1FY22. Reopening of economic activity and financial services picking up as already reflected in the double digit credit growth, supported the services sector growth. However, industry growth stood at 8.6% in Q1FY23, which was better than 1.3% in Q4FY22 but less than 46.6% growth seen in Q1FY22. Within industry electricity, gas and other utility services as well as construction fared well. On the expenditure side, private consumption and investment demand showed buoyant pickup.

Central government finances

Centre's fiscal position in FYTD23 remains healthy, with gross tax revenue rising by 25%, supported by 43% increase in direct taxes and 11% increase in indirect taxes. Centre's net revenue receipts are also maintaining a robust 13% growth so far with collections at Rs 7.6 lakh crore versus Rs 6.7 lakh crore during the same period last year. Further, while spending by the government in FYTD23 remains higher than last year (-4.7%), it seems to have slowed in Jul'22 to 12.2% from 15% in Q1FY23. This is on account of revenue spending which registered a growth of 4.8% versus 8.8% in Q1FY23 and -7% in FYTD22. Capex spending however continues to stay firm at 62.5% in FYTD23 compared with 57% in Q1FY23 and 14.8% in FYTD22. With this, fiscal deficit (12MMA basis) was at 6.3% as of Jul'22 compared with 6.2% registered last year in the same period.

Currency outlook: INR stages a comeback

Volatility returned to the global markets this week driven largely by a more hawkish than expected commentary from the Fed Chair. In a much anticipated speech at the Annual Jackson Hole symposium, Fed Chair stated that he expects rate to remain high "for some time" while cautioning against "prematurely loosening policy". He also acknowledged that higher rates are likely to impinge on growth and labour market which will bring some "pain to households and businesses". The comments spurred a decline in global currencies against the dollar. INR too has depreciated against the dollar, briefly breaching the 80/$ mark.

Going ahead, with the Fed Chair clearly signaling higher rates are likely to stay, the dollar index may see a further uptick. This will keep global currencies, including INR under pressure. While FPI flows have remained positive in Aug'22, higher rates in the US along with a slowing global growth may spur a fresh bout of FPI withdrawals from the Indian market. On the positive side, oil prices may see some correction as higher rates tip the global economy into a slowdown if not recession.

Overall, we may expect the rupee to trade in the Rs 79.75-80.0/$ range in the near-term. However, the RBI has shown a strong intent to defend the 80/$ mark, in which case a move above that level may not materialize.

Bonds' Wrap

Global sovereign 10Y yields have shown steepest increase, post Jackson Hole conference. Fed Chair's speech focusing on reducing inflation and hinting trade off with regard to growth, led yields soaring. CME Fed watch tool data which attached 50% probability for 75bps rate hike in the Sep'22 policy, now is pricing in 75bps rate hike with 72% probability. Even US OIS 1Y rate rose by 14bps post Fed Chair's speech. Not only in the US, even in the Eurozone record high inflation was witnessed in Aug'22, and exerted pressure on Germany's 10Y yield. UK's 10Y yield registered monthly increase of 94bps in Aug'22 which is the sharpest since Sep'86. This is despite fears of sharp slowdown in growth as is reflected in PMI of major economies. India and China have shown anomalies. China's 10Y yield closed a tad lower supported by government and central bank's stimulus measures. On the other hand, sharp drop in oil prices and comments from central bank officials about inflation getting anchored, have lend support to domestic yield.

India's 10Y yield closed 10bps lower in the current fortnight. What has been an interesting observation in the current fortnight is volatility at the short end of the curve continue reflecting frontloading of rates. Going forward, we expect India's 10Y yield to trade in the range of 7.20-7.30% in the coming fortnight. Upside risk remain on account of global financial tightening and downside risk emanate from growth slowdown. Liquidity conditions are likely to be tighter and we are looking at 0.6-1% of NDTL, contingent on how RBI's forex intervention would pan out in the wake of pressure on currency

CPI moderates

Against our estimate of 6.9%, CPI came in slightly lower at 6.7% in Jul'22, also down from 7% in Jun'22. Food inflation moderated further to 6.8% from 7.7% in Jun'22. This was supported by softening prices of vegetables (10.9% in Jul'22 versus 17.3% in Jun'22), meat and fish (3% versus 8.6%), oils & fats (7.5% versus 9.4%) and milk & milk products (5.8% versus 6.1%). On the other hand, prices of fruits, cereals, sugar and spices inched even higher in Jul'22. Prices of eggs contracted less sharply and that of pulses increased after falling in the previous two months. However, outlook for food inflation in the coming months might get some comfort from retailers agreeing to reduce prices of edible oils and a normal monsoon.

Core inflation edged down by 30bps to 5.7% in Jul'22 from 6% in Jun'22, on YoY basis. Moderation was on account of sharp dip in transport and communication inflation (5.6% from 6.9% in Jun'22), followed by personal care and effects (6% versus 6.7%) and health (5.4% versus 5.5%). International gold prices too declined in Jul'22 by 2.7% (YoY), following 2.1% increase in Jun'22. On the other hand, demand side pressure continued.

Inflation in the Clothing and footwear segment inched up to 9.9% in Jul'22 from 9.5% in Jun'22. For recreation and amusement (7.1% from 7%) and education (5% versus 4.5%) as well, the uptick was visible.

While the latest print brings in relief, led by easing food and fuel inflation, it still remains above RBI's target band. However, with easing international commodity prices and normalizing of supply chain logistics, it can be expected that inflation might cool down further. However, key downside risks remain. These include geo-political tensions in the Taiwan Strait which could impact the supply of semi-conductor chips and overheating of global demand led by easing inflation which could in turn put pressure on international oil prices. In addition, with gradual easing of monsoon, we expect services to return running at full capacity in the coming months. We expect inflation to still be heated at around 6.5% in FY23.

WPI begins to cool

WPI for Jul'22 came in lower at 13.9%, down from the peak of 15.2% in Jun'22, supported by softening global commodity prices. Barring fuel & power index, other sub-heads such as manufacturing and food, registered deceleration in inflation in Jul'22.

Food inflation moderated in Jul'22 9.4% from 12.4% in Jun'22. This is owing to drop in prices of vegetables (18.3% in Jul'22 versus 56.7% in Jun'22), milk (5.5% versus 6.3%), and protein based items (5.5% versus 7.2%). On the other hand, prices of fruits (29.4% versus 20.3%), food grains (8.1% versus 5.8%) and spices (21.9% versus 17.7%), inched up.

Fuel and power inflation in Jul'22 rose to 43.8% compared with 40.4% in Jun'22. Increase in mineral oil index (59.2% in Jul'22 versus 57.5% in Jun'22) and electricity prices (32.4% versus 24.4%) contributed to this trend. Coal prices on the other hand moderated marginally to 2.7% in Jul'22 from 2.8% in Jun'22.

Core inflation eased for the third consecutive month in Jul'22 to 8.4% from 9.3% in Jun'22. Manufactured products inflation was also down at 8.2% in Jul'22 from 9.2% in Jun'22. Of the 22 commodity sub-indices, 18 indices rose at a slower pace in Jul'22 than Jun'22 led by basic metals, non-metallic mineral products, rubber products, wood and products, paper and products, textiles, tobacco, electrical equipment and other transport equipment.

IIP growth eased

Industrial output slowed to 12.3% in Jun'22 from 19.6% in May'22. This was led by moderation across sectors, manufacturing (12.5% from 20.6% in May'22), mining (7.5% from 11.2% in May'22) and electricity (16.4% from 23.5% in May'22). Within manufacturing, other transport equipment (30.2% from 128.5%), beverages (44.8% from 128.1%), motor vehicles (31.2% from 88.7%), leather products (0.9% from 48.9%) and electrical equipment (11.8% from 59.6%) registered the sharpest dip in Jun'22 compared with last year.

Within use-based, broad based moderation was noticed across all the sectors. Consumer durable (23.8% from 58.4%), capital goods (26.1% from 54.4%) and Infra goods (8% from

18.1%) registered sharp moderation in Jun'22. Output of primary (13.7% from 17.8%) and intermediate goods (11% from 17.5%) also decelerated in Jun'22. The only bright spot was FMCG production which improved by 2.9% in Jun'22 (1% in May'22).

The economy continues to ride the wave of recovery (expected to be higher in H2FY23) as has also been reflected by high frequency indicators led by manufacturing PMI soaring to 8-month high, along with surge in GST collections. However, the recovery might face global headwinds on the back of ongoing geopolitical tensions emerging between US and China-Taiwan. This might have an impact on semiconductors availability as Taiwan remains a leader with largest market share, globally.

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