Bank of Baroda

5 Dec 2024

Sonal Badhan
Economist

Economic Round-up: November 2024

Following the results of Presidential election in the US, market volatility significantly increased across the globe. While US equities and dollar benefitted, other currencies suffered a hit. US bond yields have noted a significant jump since the announcement of results. President-elect Trump's constant threat of imposing tariffs on US imports coming from China, Mexico and Canada has also sparked fears of possible risks to domestic inflation. These countries account for ~43% of US imports. In addition, prospects of tax concessions, and regulatory easing will also put pressure on fiscal math of the government. Elevated US debt levels are already a concern for the Fed. Given this backdrop, analysts now expect shallower rate cuts by Fed in CY25. In Asia, China is showing mixed signs of growth. On one hand, while industrial production was weak in Oct'24, retail sales improved further. In Nov'24, PMIs, show that manufacturing firms noted improvement in activity, while services sector slowed a tad. In India, Q2FY25 GDP data (5.4%) indicates moderation in growth versus the previous quarter (6.7%), but despite that India continues to remain one of the fastest growing major economy in the world. A rebound in activity is expected in H2FY25, which will push overall FY25 growth to 6.6-6.8% bracket. Signs of revival are already visible in Q3, with festive spending pushing GST collections, vehicle sales, air passenger traffic and services PMI higher.

Global Central Banks: In Nov'24, in line with market expectations, major central banks (US Fed, BoE) lowered their policy rates. US Fed delivered a 25bps rate cut, keeping in view softening labour market conditions. However, Fed cautioned against elevated levels of inflation and unstainable fiscal policy. Markets are now pricing in another 25bps cut in Dec'24 meeting and shallower rate cuts in CY25. BoE also lowered its policy rate by 25bps, 2nd rate cut in 4 years. Accounting for recent budget announcements, inflation projections for CY25 were raised to 2.7% from 2.5% in CY24 and growth is also estimated to be higher at 1.5% in CY25 (1% estimated earlier). As a result, no rate cut is expected in its Dec'24 meeting, and next year as well, while markets have priced in 2-3 rate cuts for now, Governor Bailey has signalled possibility of 4 cuts. In contrast, BoJ officials have indicated that given the sustained rise in inflation and wage growth, the central bank may opt for a 25bps rate hike as early as Dec'24.

Key macro data releases: India's GDP growth softened to 5.4% in Q2FY25, following 8.1% growth in Q2FY24. This was led by slowdown in government spending, investment demand and export growth. Private consumption remains robust. We expect 6.6-6.8% GDP growth in FY25. **India's merchandise trade deficit** widened to a 13-month high of US$ 27.1bn in Oct'24, led by a pickup in oil and gold imports. Exports picked up sharply by 17.3% in Oct'24, led by non-oil exports. CPI inflation came in at its highest since Sep'23 at 6.2% in Oct'24, compared to last month's reading of 5.5%. Most of the increase in headline CPI was attributable to food inflation which went up by 164bps to 10.9% in Oct'24 from 9.2% in Sep'24. **Core inflation** inched up to 3.7% in Oct'24 from 3.5% seen in Sep'24. This was driven by household goods and services, recreation and amusement and personal care items. We do not expect any repo rate cut by **RBI** tomorrow, however, there remains a possibility of CRR cut to support liquidity.

Macro developments

India’s growth: Momentum to pick up H2

India’s GDP growth softened to 5.4% in Q2FY25, following 8.1% growth in Q2FY24. This was lower than our expectation of 6.9% and the RBI estimate of 7%. Even as, this was lower than previous quarter, India continues to remain one of the fastest growing economy across the globe. In line with expectations, agriculture growth rose on the back of favourable monsoon and higher kharif output. Softness in manufacturing growth was reflected with poor earnings data. Growth in government spending was lower at 4.4% from 14% in Q2FY24. Slower growth was also noted for investment demand (5.4% from 11.6% in Q2FY24). Concerns around global growth and ongoing geopolitical tension had adversely impacted the exports which slipped to 2.8% (5% in Q2FY24) and even imports (-2.9% from 11.6%) in Q2FY25. Despite the moderation in GDP growth, private consumption recorded stupendous growth of 6.0% in Q2FY25 from 2.6% in Q2FY24. India’s growth for H1FY25 stands at 6% compared with a growth of 8.2% in H1FY24. A sharp rebound is on the card in H2 that is expected to push overall growth higher in FY25 to 6.6-6.8%. The recovery in H2 will be supported by pick up in capex both government and private, robust agriculture growth and a boost to consumption spending.

High frequency indicators are showing notable improvement in Oct-Nov’24 period. GST collections have jumped by 8.7% in Oct-Nov’24, and on FYTD basis collections have risen to Rs 14.6 lakh crore this year versus Rs 13.3 lakh crore last year, signalling sustained consumption momentum. Apart from this, helped by festive demand, other indicators of urban consumption have also improved. Air passenger air traffic registered 13.1% growth in Oct-Nov’24, leading to ~8.2mn rise in passenger movement over last year. Vehicle registrations noted a steep jump as 60.7 lakh new units were registered in Oct-Nov’24 (+20.4% YoY) alone, compared with an average of 50.4 lakh units registered in in the same period last year. Services PMI averaged 58.5 in Oct-Nov’24 period versus 57.7 in the same period last year. Commentary by corporates in their quarterly result analysis also suggest that they expect a pick-up in demand in H2.

Central bank actions

In RBI’s previous policy meeting, newly constituted MPC decide to keep the repo rate unchanged at 6.5%, with a 5-1 vote. The dissenting vote was cast by Dr. Nagesh Kumar, who voted for a 25bps cut in policy rate. The stance of the monetary policy was changed to “neutral” from “withdrawal of accommodation” by a unanimous vote. The change in stance gives the MPC room to monitor the evolving risks to inflation and can be viewed as a prelude to monetary easing. RBI remained positive on the growth outlook and kept its projection for GDP growth unchanged at 7.2% for FY25. Now given the Q2FY25 growth number has fallen much below RBI’s projection, we expect central bank to revise its GDP estimates for FY25 lower. It is also expected that RBI will begin cutting rates soon, to support growth. However, **we maintain that RBI will keep the rates unchanged** in its meeting this week and monitor inflation trajectory before cutting rates in Feb’25. However, there is a case for a CRR cut or OMOs to infuse liquidity. This can be a double edged sword in the absence of a repo rate cut. First, it will provide liquidity to the system. Second, it will indicate to the market that the central bank is easing conditions which will be a positive signal for the market.

US Fed decided to lower the policy rate by 25bps in its latest meeting in Nov’24, thus bringing the policy rate down to 4.5-4.75%. This is the second rate cut since CY20. The FOMC highlighted that “labour market conditions have generally eased, and the unemployment rate has moved up but remains low. Inflation has made progress toward the Committee's 2% objective but remains somewhat elevated". Investors now await guidance from Fed's Dec'24, wherein the central bank is expected to cut rates by another 25bps. In CY25, the pace of lowering rates is expected to be slow as there remains a significant threat to domestic inflation if President-elect Trump introduces tariffs on imported goods.

In line with market expectations, **Bank of England (BoE)** in its Nov'24 meeting, lowered the policy rate by 25bps to 4.75% with a vote of 8-1. This is the second rate cut, and it comes after first 25bps rate cut was announced in Aug'24. The policy statement continued to maintain a hawkish tone, as Governor Bailey stated that in order to lower inflation gradually, the central bank cannot cut rates too quickly or too steeply. Impact of budget announcements was also taken into account while presenting new forecasts for growth and inflation. Analysts now expect 2-3 rate cuts in CY25. However, Governor Bailey has recently signalled that the central bank may lower rates faster than expected, maybe 4 times next year.

The **ECB** is widely expected to lower rates by 25bps in its Dec'24 meeting. Notable, in its last meeting in Oct'24, the ECB had lowered its policy rates by 25bps, bringing the deposit rate to 3.25% from 3.5% earlier. Since then, price pressures in the region have moderated, with CPI inflation inching down to ECBs target of 2% in Oct'24, before inching up to 2.3% in Nov'24. Growth however remains on a weak footing with both manufacturing and services PMI dipping to a 10-month low, necessitating the need for further rate cuts. ECB officials have advocated a cautious approach to future course of monetary policy as the threat of higher US tariffs is likely to have an adverse impact on growth and inflation in the region.

Japan's headline inflation for Oct'24 moderated down to 2.3% (lowest level since Jan'24) from 2.5% in Sep'24. Core inflation too eased down to 2.3% against 2.1% in Sep'24. Additionally, core-core inflation (tracked by BoJ) was up by 2.3% (2.1% in Sep'24). **BoJ** Governor had recently warned on keeping the borrowing costs too low. Furthermore, BoJ noted in their documents that if the economy and price move in line with expectation, then the policy rate are likely to reach the 1% mark by the latter half of CY25. With investors recalibrating their strategies, the growing bets of a possible rate hike in the upcoming meet have sobered down. These expectations have impacted both the short end and long end yield.

Data Releases

Currency outlook

INR continues to remain under pressure and traded at record low in Nov'24. It depreciated by 0.5% last month, following 0.3% decline in Oct'24. It has started Dec'24 also on a weaker note, as it has fallen even lower to 84.7/$ mark. Stronger US$ has been the key driver of this trend. In Nov'24 alone, DXY rose by 1.7%, following 3.2% rise in Oct'24. Significantly elevated US yields are supporting dollar strength. Even though US10Y yields cooled off a bit towards the end of the month, they still remain much above the 4% mark. Further, there appears to be increased likelihood that Fed will opt for gradual rate cuts in 2025, against the backdrop of President-elect Trump's continuous threats of tariff hikes for China, Mexico, and Canada (accounting for ~43% of US imports). All major currencies globally have been hit as a result. In comparison to this, INR has held ground and has depreciated the least. Slowdown in FPI outflows in Nov'24 compared with Oct'24 also helped. Investors will now focus on high frequency indicators to gauge prospects of growth in Q3. We expect the currency to trade in the range of 84.2-84.7/$ in the near-term.

Bond Market Round-up

Moderation in US 10Y yield occurred because of risk alignment surrounding political developments in the region which has resulted in higher demand for sovereign debt assets. The same got reflected in yields of other major AEs (UK, Germany). The narrative of global yields hinges on the President-elect's policy discourse. Till now, the environment calls for a moderate pace of easing by Fed, going ahead. India's 10Y yield witnessed majority softening following release of Q2GDP data which surprised on the downside. In the last trading session itself, India's 10Y yield has inched down by 9bps. The trajectory of domestic yield rests on whether moderation in growth is a one-off event or not. However, we expect a downward bias to domestic yield remains from correction in FPI flows in Nov'24 due to favourable interest rate differential with the US. Apart from this, expectation reins in terms of measures from RBI to maintain adequate durable liquidity. Any development on the same would also support yields in the near term. We expect India's 10Y yield to trade in the range of 6.70-6.85% in Dec'24 and will also hinge on MPC call on repo rate and direction provided through the articulation.

Banking sector update-Oct'24

RBI's monthly data showed a moderation in credit growth across sectors in Oct'24. At 11.5%, credit growth eased to a 31-month low. While industry credit picked up on a YoY basis, credit growth to retail and services sector moderated. RBI's regulatory crackdown on NBFC credit and unsecured lending was reflected in a slowdown in retail and services sector. Housing loans, vehicle loans and education loans also witnessed some slowdown. Going ahead, we can expect some pickup in credit growth as economic activity is expected to rebound. The government is also likely to step-up its capex spending in the remaining part of the year to meet its budgeted target, which will have a multiplier effect across industries. Hence, we can expect a revival in credit growth in the coming months. We expect credit growth in the range of 13-14% in FY25.

India's Foreign Trade: FYTD25

India's merchandise trade deficit widened to a 13-month high of US$ 27.1bn in Oct'24, led by a pickup in oil and gold imports. Exports picked up sharply by 17.3% in Oct'24, led by non-oil exports. In FYTD25, trade deficit tracks higher than last year as there has been some correction in global commodity prices. Going ahead, export growth will be contingent on the direction of global trade amidst expectation of increased US protectionism. While higher commodity prices are likely to weigh on imports, the extent of the increase is likely to be muted. Oil prices at current levels are a huge positive. Overall, while we expect CAD to be within a manageable range in both FY25 and FY26, INR is likely to remain under pressure in the near-term. This is because the recent bout of weakness in INR is stemming purely from exogenous factors including a stronger dollar and capital flight from EM markets.

WPI inflation climbs up

WPI inflation rose to 2.4% in Oct'24 compared with 1.8% in Sep'24 led by elevated food inflation. Our forecast for headline WPI inflation was at 2.7%. Vegetable inflation advanced higher driven by spiralling of tomato prices. Under food grains, higher prices of wheat was noted. Fuel and power inflation remained in deflation at 5.8% supported by dip in oil prices. Manufactured products inflation edged up to 1.5% from 1% in Sep'24. The first advance estimates have projected higher projection for Kharif crops which bodes well for easing pressure. Improvement in reservoir levels bodes well for Rabi sowing which is expected to pick up pace. However, the trajectory of food inflation needs to be monitored amidst the adverse weather related events, volatility in global commodity price and firmer dollar. Given the evolving geo-political dynamics and financial conditions, RBI is expected to remain data dependent with the possibility of rate action only likely in Q4FY25.

Food inflation: a continued discomfort

CPI surprised on the upside led by food inflation. Sharp spiral in vegetable inflation coupled with increase in oils and fat inflation resulted in the same. The latter showed the impact of elevated international prices and an increase in customs duty to support domestic production. Core inflation showed upward correction with frontloading of festival demand. Higher gold prices also impacted subcomponent of personal care and effects. Some correction in prices especially tomatoes are already visible in Nov'24 high frequency price data. This couple with a favourable base in Q3 will lend support to CPI. On rate action, there seems to be a delay as growth recovery is visible in sub segments and inflation, especially items of daily food consumption, are getting entrenched. Thus, we expect a nimble data dependent approach by RBI on the back of elevated global food prices, climate shocks and a stronger dollar. Our estimate of CPI remains at 4.5-5%, with risks tilted to the upside.

Industrial production rebounds

IIP growth rose by 3.1% in Sep'24, following (-) 0.1% decline in Aug'24. Manufacturing growth improved to 3.9%. Mining and electricity sector output rebounded, helped by withdrawal of monsoon and onset of festive season, respectively. Within manufacturing, jump was led by sectors such pharma, machinery, fabricated metals, motor vehicles and other transport equipment. In terms of use-based classification, both output of both primary and consumer non-durables registered a rebound. Other sub-heads also noted improvement, led by consumer durables and capital goods. However on FYTD basis, in H1FY25, growth eased to 4% from 6.2% last year. Going forward, led by festive demand and onset of harvest season, we expect further improvement in production in the coming months. In addition, as government spending recovers, we expect private investment to also follow. With the end of the monsoon season, construction activity will also pick up pace. Overall, we expect headline IIP growth to perform better in H2 compared with H1.

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com