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RESEARCH

BOB Economics Research | Monthly Chartbook

Activity improving, inflation a cause of worry

SUMMARY

India Economics | Monthly Chartbook

India's economic recovery has gained pace with activity now 9% below Feb'20 levels from 19% below baseline in May'21. Government revenues have surprised positively. This gives room to Centre to spend. States are lagging. Even industrial activity over a 2-year horizon is holding up led by exports, FMCG, intermediate goods and construction. Capital and durable goods are lagging. Higher international demand has not only pushed exports higher but also inflation. As a result, domestic yields are inching up. While lower US yields will help, upward momentum will sustain given upward revision to inflation forecast for FY22. RBI will look at raising reverse repo rate, curtailing surplus liquidity in Q4FY22 before raising repo rate.

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Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.29	(2bps)	(28bps)	68bps
India 10Y yield (%)	6.12	(4bps)	10bps	35bps
USD/INR	74.71	(0.1)	(2.6)	0.4
Brent Crude (US$/bbl)	74.12	0.9	3.7	75.0
Dow	34,422	(0.7)	(0.6)	33.9
Shanghai	3,526	(0.8)	(2.1)	2.2
Sensex	52,569	(0.9)	0.5	43.1
India FII (US$ mn)	**07-Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	29.1	(28.7)	(3,195.5)	(1,168.3)
FII-E	88.5	(64.2)	8,020.0	693.6

Source: Bank of Baroda Economics Research

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Activity improving, inflation a cause of worry

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Covid cases drop; vaccination ramps up: India's Covid-19 daily addition in cases has seen a steady decline in Jul'21 (1-6 Jul 2021) to 40,000 compared with 70,000 increase in Jun'21. This has prompted states to re-open in a phased manner. Mobility indicators are showing reopening of the economy. Our economic activity index is now 9% below baseline (Feb'20=100) compared with 19% below baseline in May'21. Pace of vaccination has improved with more than 20% of the population receiving one dose.

Gradual recovery: While health impact of second wave has been visible, economic impact has been far muted. Notably, non-oil-non-gold imports over a 2-year period are higher by 11% in Jun'21. Exports have inched up by 29.7% over a 2-year period. Even consumer, intermediate goods and construction/ infra sectors have either grown or have been resilient. Consumer durables and capital goods have seen a contraction. The worry is a lull in monsoon rainfall which has adversely impacted Kharif sowing which is down by 21.6%. An expected pick-up in rainfall and record purchase by government is positive.

Centre's revenue holding ground: Centre's gross tax collections on FYTD basis (Apr-May) were significantly higher at Rs 3.1tn (+148%) in FY22, versus Rs 1.3tn in FY21 and Rs 2.2tn in FY20. Over a 2-year horizon, both direct and indirect tax collections have improved from Rs 0.6tn to Rs 1.2tn and from Rs 1.5tn to Rs 1.9tn, respectively. However, spending has come down (Rs 4.8tn versus Rs 5.1tn), led by revenue spending (Rs 4.2tn versus Rs 4.7tn). Notably, capex spending has not been reduced and has risen steadily to Rs 630bn from Rs 477bn. In case of states, tax receipts and capex have taken a hit over a 2-year hoizon, but overall spending is up led by revenue expenditure.

Yields inching up: India's 10Y yield has risen by 10bps since 1 Jun 2021. This is attributable to negative inflation surprise and upward revision in inflation forecast for the year, RBI's announcement of new benchmark issuance, change in price discovery mechanism to uniform from multiple bid and devolvement on PDs. While government revenues have been higher, concern over additional ~Rs 1.6tn borrowing to meet GST shortfall of States remains. The good news is sudden dip in US yields. Even so, upward bias in Indian yields will persist.

INR depreciates: INR depreciated by 2.3% in Jun'21 amidst higher oil prices and a stronger dollar. FII inflows remained muted at US$ 0.9bn. Even CAD widended to 1% of GDP in Q4FY21. We believe trade deficit will widen in FY22 on the back of higher oil prices and an improvement in domestic economic activity. Exports have remained resilient over a 2-year horizon and are likely to benefit from an imporved global outlook. As such, CAD is likely to remain contained at 1.2% of GDP in FY22. This should support INR at 73-75/$ in the near term. Higher oil prices are a key risk to our view.

Note: The source for all exhibits is 'CEIC and Bank of Baroda' unless otherwise specified

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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