Acuité India Economy Outlook

"Manoeuvring through domestic tailwinds and global headwinds"

March 2023

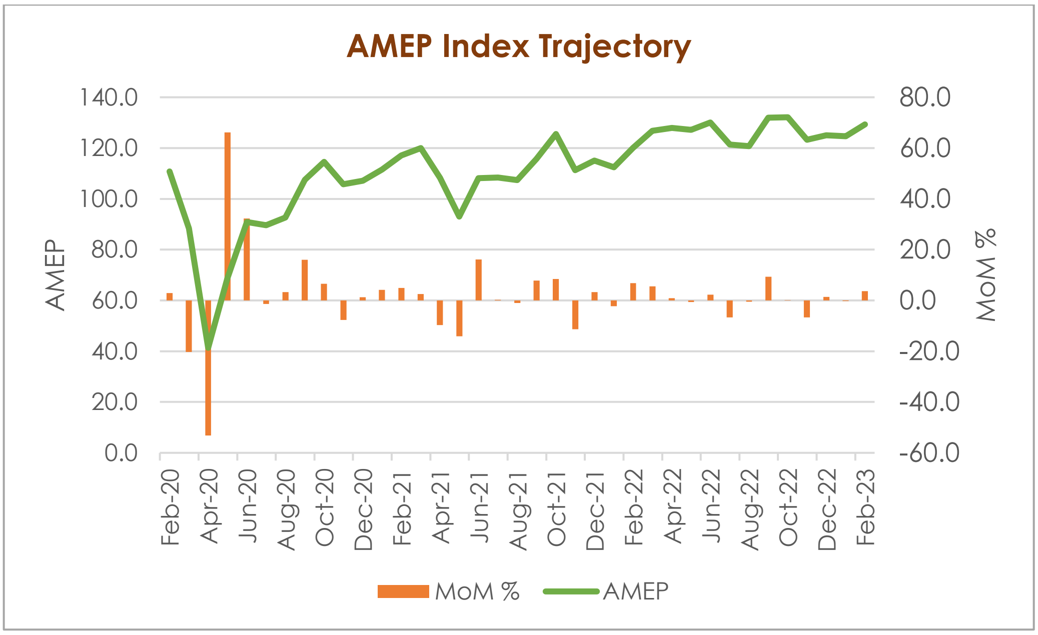
"Higher for longer" cloud hovers over the Indian growth landscape

Perhaps, there has been no such point in the past three decades except during the global financial crisis in 2008 when the global economy and markets have witnessed turbulence and volatility in such scale as in early March. The roots of such tremors lie in the chain of events starting from CY20. Global headwinds had started quite some time (actually 3 years) back with the rise of the Covid pandemic in Mar-20 and its domination throughout CY20 and CY21, closely followed by the Ukraine geo-political crisis in CY22 and the global inflationary pressures that triggered coordinated monetary tightening thereafter all over the world. While the pandemic appears to have lost its sting, the conflict in Ukraine has continued to persist for over a year now, keeping the global economy vulnerable to a further escalation of the crisis. The global inflation conundrum which has its genesis in the Covid-Ukraine induced supply chain crisis as well as in the excessively liberal fiscal and monetary policies adopted worldwide thereafter, refuses to subside in a hurry despite strong doses of rate hikes and quantitative tightening by all the key central banks in the world (except that of Japan and China). The supply cuts by OPEC+ in early April is an additional factor that will make it difficult for policy makers to keep the inflation genie inside the bottle. Furthermore, the side effects of the strong doses administered in the respective economies have started to be visible. The sharp i.e almost 5% hike in the interest rates in US and the consequent drop in bond prices have already impacted the banking sector, particularly those with higher ALM risks. The Federal Reserve has to come to the rescue of the distressed regional banks and provide backstop insurance to all the outstanding deposits. Nevertheless, the contagion risks clearly exist and has already shown its impact in Europe, where a vulnerable Credit Suisse had to be hastily merged with UBS with the blessings of Swiss National Bank. While the scenario is still a far cry from the GFC of 2008, market participants have already termed it as a "mini banking crisis".

Clearly, such a treacherous and murky global economic landscape doesn't promise an auspicious start to the new fiscal for India. One aspect which is apparent though is that the theme of "higher for longer" is set to play out for both retail inflation and interest rates. Despite the turbulence in the banking sector, three major central banks – Fed, ECB and BoE have already hiked rates in Mar-23 and have not provided any clear indication that they are over with such hikes. In our view, the stance is unlikely to be different in the case of RBI MPC when they convene in early April. Not just the headline CPI inflation which saw a fresh spurt to around 6.5% in Jan-Feb'23 due to a cereal induced fresh bout of food inflation but core inflation also continues to be well entrenched at over 6%. Not to speak about the "risk-off" theme in the global markets which increases the vulnerabilities on the currency front. In our opinion, a 25 bps hike in April is on the cards and it may also be a challenge for the MPC to announce a "pause" given the current environment.

Such persistent headwinds notwithstanding, the steady momentum in domestic economic momentum is encouraging. The latest print of **Acuité Macroeconomic Performance index (AMEP index)** in Feb-23 (adjusted for the shorter month duration), translates into a YoY growth of 5.9% and 2.0% MoM. On a cumulative basis for the first eleven months of the fiscal (Apr-Feb'23), the average AMEP index has risen by 13.6% as compared to the corresponding period of the previous fiscal which was partly supported by the base factor i.e. the lockdown from the second Covid wave.

Chart 1: AMEP index continues to demonstrate resilience



Source: CMIE, Acuité Ratings and Research, Base Month: Aug-2019: 100

Note: AMEP index has been constructed deploying sixteen high frequency indicators across four major categories– consumption demand, industrial production, external sector, and employment. The data for Feb has been adjusted for the lesser number of days in the month.

India's GDP growth decelerated to 4.4% YoY in Q3 FY23 from 6.3% YoY in Q2, performing weaker than market expectations which were closer to 5%. The downward slide in headline growth was primarily due to the absence of the hitherto favorable statistical base effect, the weakness in the manufacturing and the export sectors along with the lack of adequate strength in domestic consumption demand. Sequentially, however, we note that the GDP expanded by a robust 3.5% QoQ, better than the pre pandemic average (over a 5-year period) of 2.1% QoQ observed in Q3.

Industrial activity has seen a moderate revival towards end of Q3 with IIP growth of 5.2% YoY in Jan-23 from 4.7% in Dec-22; sequential momentum in IIP was moderately strong at 0.8% MoM in Jan-23, building on the 5.7% MoM expansion recorded in the previous month. While headline PMI manufacturing index slipped in Feb-23 from more than a 2-year high of 57.8 in Dec-22, it is still over 55. Services PMI rose sharply to 59.4 in Feb-23 after slightly slipping to 57.2 in Jan-23, reflecting the buoyancy in the sector. The average GST revenue collections continue to average more than Rs 1.5 Lakh Cr in H2FY23. Credit growth of scheduled commercial banks remains robust, clocking a growth of 15.5%YoY in the fortnight ending Feb 24, 2023 compared to 9.1% as of Feb-22. Economic factors that have shaped the recovery in FY23 include the strength in urban consumption including the pent-up demand factor and the strong pace of Government expenditure. The final GDP growth for FY23 therefore, is unlikely to deviate much from the advance estimates of 7.0%.

Looking ahead, the world economy nevertheless is poised for a slowdown although global growth outcomes are likely to fare much better given the incoming data prints. The impact of moderation in trade volume growth to 2.4% in 2023 from 5.4% in 2022 (IMF estimates) is likely to have an impact of India's exports. Growth of merchandise goods is already on a downtrend over the last 3-4 months. Strength in monthly net services exports consistently between USD 13-15 bn over the last three months, offer comfort.

Needless to mention, public sector capital expenditure will continue to be a key pillar of India's medium term growth story. Union Budget 2023 has hiked the overall budget for capital expenditure sharply to Rs. 10 Lakh Cr. Among other drivers of growth, pace of private capex recovery could remain somewhat sluggish and uneven amidst global uncertainties. In the current global environment, the access to funding particularly overseas funding may be more challenging. Urban consumption, which is still performing relatively better, may show some fatigue (especially for goods) as pent-up demand wanes and transmission of cumulative past rate hikes by RBI is completed. In our base scenario, we expect a recovery in rural demand post the Rabi season unless it is offset by adverse weather conditions that increase food prices; for now, we can hope the "El Nino" factor will not be significant enough to disrupt the consistency of the monsoon and the moderating trajectory of the inflation chart. India should be in a position to notch up a 6% GDP growth in FY24 despite the "higher for longer" phenomenon if weather gods are supportive.

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,500 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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