Acuite
RATINGS & RESEARCH

Macro Pulse
Report

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Contents

From the desk of the Chief Economist

Greetings from Acuité Ratings & Research!

This is the **twenty seventh** edition of **Acuité Macro Pulse (AMP)**, our monthly commentary on the global and the domestic economy.

As we step into FY24, we are surrounded by an increasing number of macroeconomic uncertainties both on the global and the domestic front. The global turmoil doesn't show any significant signs of trending down – be it persistent geo political risks and the volatility in crude prices, the extent of global slowdown including recession in some economies, sharply increased interest rates across countries and its implications on financial stability. On the domestic side, the impact of El Nino on the monsoon will be known only late into the season and therefore presents, upside risks to the moderating inflation trend. While domestic demand has been largely resilient till Mar-23 as indicated by our proprietary AMEP index, urban consumption demand may take a hit in the current fiscal due to increased interest rates and rural demand, as always, will continue to be dependent on the timeliness of rains and the consequent agricultural output.

Such a turbulent environment, needless to say, will present challenges to economic forecasting. While we have pegged our GDP growth forecast for FY24 at a healthy 6.0%, we note the emergence of downside risks to that print if monsoons fail us this year and the global slowdown is more pronounced than what is expected by IMF i.e. a growth of 2.8% in CY23 vs 3.4% in CY2022. The expected moderation in inflation will not only be linked to the growth currents in the economy but also on supply side factors in categories such as food. As we put forward our estimate of an average headline CPI inflation of 5.3% in FY24 given the base factor of previous year, we are well aware of the vulnerability of the print to the food and fuel price scenario.

Nevertheless, there is a broader consensus developing around the peaking of interest rates around the world, as we have explained in our report. RBI has also taken up the early cues of that trend and opted for a "pause" in the interest rates as against our expectation of a 25 bps hike in Apr-23, partly supported by the drop in CPI inflation by 80 bps in Mar-23. In all likelihood, the current repo rate of 6.5% is set to be the terminal rate in the current cycle unless the inflation print goes berserk again or another phase of global "risk-off" sentiment is sparked off. As regards the next question on the timelines for a pivot or a cut in interest rates in India, we believe that the MPC will not act in haste on the matter unless there is a large negative surprise on growth in the ensuing quarters.

As regards the twin deficits – fiscal and current account (CAD), the degree of variability is likely to be significantly less and therefor, is one of the comfort factors in the macro landscape. While central elections are not that distant away, we believe that the government will have enough wherewithal to hold the fiscal deficit at less than 6.0% in FY24. On the other side, the CAD is likely to slip down to 1.4% given the buoyancy in services exports and the price advantages in increased crude sourcing from Russia. These factors will hold the economy relatively steady despite the persistent global headwinds.

The summer vacation is here and hope some of you are going to take a much deserved break to not only reset yourselves but also contribute to the domestic demand for travel and tourism!

Cheers,

Suman Chowdhury
Chief Economist & Head – Acuité Research

Growth

Moderation on the cards in FY24

KEY TAKEAWAYS

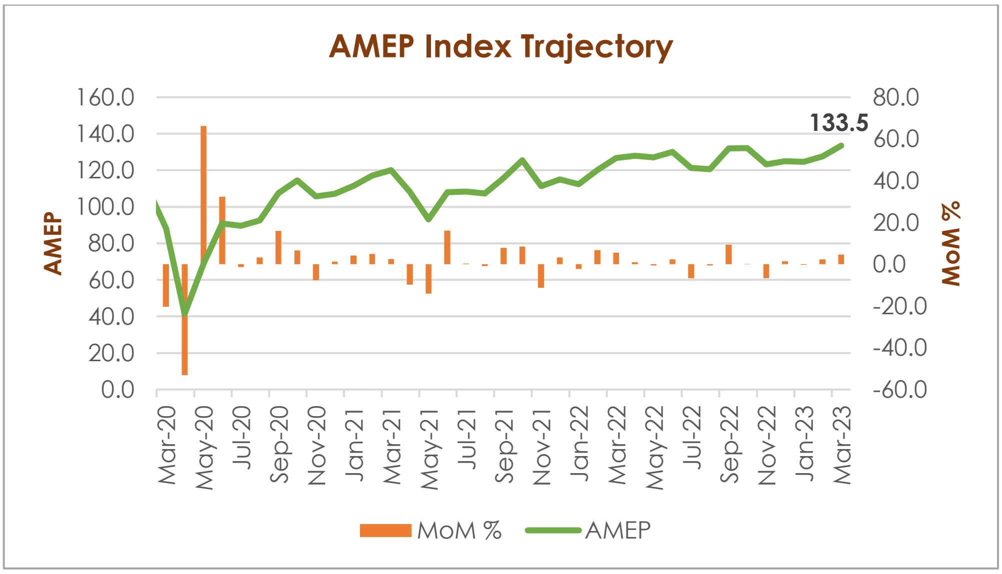
- Despite global macro economy remaining characterized by contradictions and financial system instability risks coming to the fore, Indian economy continues to demonstrate strength and stability.
- Most lead indicators at the start of 2023 continue to display resilience, with incremental data Feb-23/Mar-23 faring better than Jan-23.
- That said, there is a clear distinction emerging with respect to strength of domestic demand – which continues to display vigour, as against the impact of slowing external demand getting captured in reduced run-rate of merchandise exports (albeit in part also due to moderation in commodity prices), waning export orders within PMI and services exports coming off their Dec-22 peak (though still above trend).
- Looking ahead, challenges for domestic growth are expected to intensify in FY24 owing to – 1) Slowdown in global growth, with the added dimension of tightness in credit conditions post the banking sector turmoil 2) Climate risks especially a warmer summer along with El Nino risks 3) Private capex remaining uneven and sluggish and 4) downside in urban leveraged consumption owing to pass-through of higher borrowing costs
- Nevertheless, the moderation in inflationary pressures and the step up in public capital expenditure should continue to drive a healthy momentum in the domestic economy
- We expect GDP growth to moderate but still remain healthy at 6.0% in FY24.

Despite global macro economy remaining characterized by contradictions (tight labour markets and strength in consumer demand, despite aggressive rate tightening) and financial system instability coming to fore, Indian economy continues to demonstrate strength and stability. Most lead indicators at the start of 2023 continue to display resilience, with incremental data in Feb-23/Mar-23 faring better than Jan-23. That said, there is a clear distinction emerging with respect to strength of domestic demand – which continues to display vigour, as against the impact of slowing external demand getting captured in reduced run-rate of merchandise exports (though in part also due to correction in commodity prices), lesser export orders within PMI and services exports coming off their Dec-22 peak (though still above trend).

Q3 and Second Advance Estimate (SAE) for FY23 GDP

- As per the NSO's SAE released on 28th Feb-23, GDP growth is pegged at 7.0% in FY23 – in line with the first advance estimate.
- For Q3, growth decelerated sharply to 4.4%YoY from 6.3% in Q2, performing weaker than market expectations (Refinitiv consensus: 4.7%). The downside in headline growth was primarily due to reduction of favorable statistical base, slight contraction in manufacturing (1.1%), along with a slowdown in domestic consumption demand.
- Sequentially, 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. This sequential expansion is in sync with the signals derived from most high frequency indicators in Q3 FY23, such as PMI manufacturing and services, generation of E-way bills, tractor sales among others.

<u>Chart 1: AMEP index has seen a largely steady and upward trajectory in FY23</u>



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.

Recent data releases

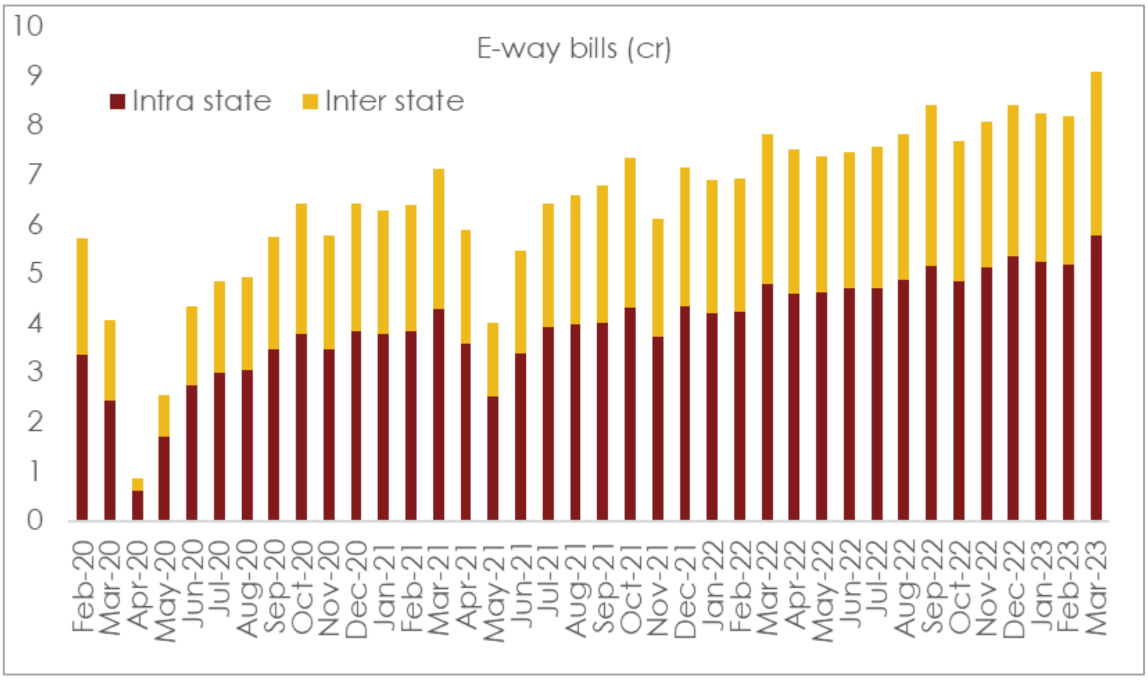
Turning attention to more recent data releases, we find that the sequential momentum continued to remain firm in Q4 FY23, though the pace is seen to be marginally lower vs. Q3.

- **Acuité Macroeconomic Performance index (AMEP index)** has climbed to a new high in March-23, reflecting the heightened economic activity at the fiscal year end and the continuing resilience in domestic demand despite the increased global headwinds. The index print has risen by 5.3% YoY as compared to Mar-22 and 4.6% MoM over the seasonally adjusted value reported in Feb-23. For the past financial year as a whole (FY23, Apr-Mar'23), the average AMEP index has grown in double digits by 12.8% as compared to that in FY22, given the significant base advantage with some Covid lockdown impact in the latter year.
- Growth in industrial activity rose to 5.6%YoY in Feb-23 from an upwardly revised 5.5% in Jan-23 broadly in line with market expectations. Sequential momentum was relatively weak with IIP index clocking 5.6% MoM contraction, largely expected due to the shorter month duration but worse than the pre-Covid average sequential moderation of 4.9% usually seen in the month of February.
- Gross GST revenue collection in Mar-23 (i.e., for transactions in Feb-23) rose to Rs 1.60 lakh crore, to mark the second highest level on record. At Rs 0.83 lakh crore, IGST collections were also at a record high. Total collections stood 13% higher on an annualised basis. At a granular level, revenues from import of goods were 8% higher and the revenues from domestic transactions (including import of services) were 14% higher compared to Mar-22.
- Headline PMI manufacturing index rose to a 3-month high in Mar-23 of 56.4 from 55.3 in Feb-23, led by both, growth in new orders and production. In addition, input cost eased to the lowest level in nearly 2-1/2 years.
- In contrast, services PMI eased from a 12-year high of 59.4 in Feb-23, to 57.8 in Mar-23. While increase in new business was supported by international demand, service producers also indicated a continued increase in both input and output costs.
- As such, Composite PMI Output Index eased to 58.4 in Mar-23 from 59.0 in Feb-23, though continuing to remain firmly above its long-run average of 54.1.
- E-way bills generation rose to a record high of 9.1 Cr. in Mar-23, a sizeable upside from 8.2 Cr. in Feb-23 and a previous high of 8.4 Cr.(as of Dec-22), led by growth in both inter and intra-state movement of goods.
- Merchandise exports expanded sequentially by 3.7% MoM to a 9-month high of USD 38.4 bn in Mar-23, a typical year-end phenomenon. However, the

sequential expansion was subdued compared to a robust 20.0% MoM jump seen in Mar-22 amidst the increased global headwinds and the ongoing global slowdown. As such, on annualized basis, growth in exports weakened to a 34-month low of -13.9% YoY.

- Non-food credit growth of Scheduled Commercial Banks continued to remain robust, clocking a growth of 15.7%YoY in the fortnight ending April 7, 2023 compared to 15.3% as of end Dec-22.
- As per FADA, passenger vehicle retail sales increased by 14.0%YoY in Mar-23, amidst broad-based strength across all segments especially on the back of improved supply of electronic components

Chart 2: E-way bills generated rose to a record high in Mar-23



Outlook

Domestic demand is emerging as a strong growth anchor for the Indian economy.

- Despite climate related concerns, rural economy is displaying signs of gradual improvement. In addition to recovering two-wheeler sales, tractor volumes have clocked a robust growth of 34.7%YoY in the last quarter of FY23 (Jan-Mar'23). Rabi sowing stood 3.3% higher versus last year and 13.7% above normal area sown. Wheat procurement has begun on a favorable note, and in other anecdotal evidence, demand for FMCG goods rose in Feb-23 and Mar-23 owing to inventory build-up ahead of summer demand.
- Government capex is continuing as a pillar of support, with FYTD23 (Apr-Feb) annualized growth of 21.7% surpassing an expansion 19.7% over the same period in FY22. Encouragingly, this drove GDP investment growth of 8.3%YoY in Q3 FY23 over and above the 9.7% expansion of Q2.

- Services demand continues to benefit from pent-up demand remaining strong especially in contact-intensive sectors of tourism, hospitality etc.
- For FY23, we have maintained our growth estimate at 7.0% in line with the NSO's estimate.

Looking ahead, challenges for economic growth are expected to mount in FY24.

- Moderation in global trade volume growth to 2.4% in 2023 from 5.4% in 2022 (IMF estimates) is likely can have a further impact on India's exports. Growth in merchandise goods exports, esp. manufacturing goods, has seen a weak momentum in H2FY23 with the cumulative merchandise exports contracting by 1.0% YoY.
- In its latest update to the World Economic Outlook report, the IMF does call for balance of risks to global growth being titled on the downside amidst still simmering Ukraine-Russia war and tighter financial conditions globally. Add to this, credit conditions are expected to tighten post the banking sector turmoil seen in both US and Europe in Mar-23.
- Among other factors influencing growth, pace of private capex recovery could remain somewhat sluggish and uneven amidst global uncertainties and broader challenges to fund raising. Urban goods consumption, which is still holding up, could experience some moderation as pent-up demand fades and transmission of cumulative past rate hikes by RBI takes place.
- Predictions of higher-than-normal maximum temperature in Apr-May'23 and possibility of El Nino conditions developing later in summer, could have ramifications for rural demand.

Against these pulls and pressures, we continue to anticipate GDP growth to moderate to 6.0% in FY24.

Inflation

Upside risks on watch

KEY TAKEAWAYS

- India's CPI and WPI inflation moderated in Mar-23 to 5.66% YoY (15-month low) and 1.34% YoY (29-month low) respectively.
- After a hiatus of 2-months, headline CPI inflation reverted to RBI's target range (2-6%).
- Lower commodity costs, favourable statistical base effects and government interventions to ease price pressures in food articles helped both WPI and CPI inflation drift lower in Mar-23.
- In addition, as per RBI's latest round, inflation expectations saw a broad-based decline across the time horizon of current, 3-months and 1-year ahead by 70 bps, 30 bps and 30 bps respectively.
- The silver lining also emerges from the sharp deceleration in core wholesale inflation, which bodes well for further easing of input price pressures. This could get more prominently reflected in pass through to core retail inflation with a lag.
- Nevertheless, upside risks to inflation remain from El Nino conditions likely evolving during the later summer months and possibility of a firmness in crude oil prices due to the production cuts announced by OPEC+ to be implemented from May-23 onwards.
- From monetary policy perspective, we expect the central bank to maintain a prolonged pause and gradually scale back liquidity surplus to push monetary policy transmission. However, the impact of global economic uncertainties on growth-inflation dynamics keeps the door open for incremental rate hikes in the near future.
- We maintain our FY24 CPI inflation projection of 5.3%.

Overview

India's CPI and WPI inflation moderated in Mar-23 to a 15-month low and a 29-month low of 5.66% YoY and 1.34% YoY respectively. More importantly:

- Annualised headline CPI and WPI inflation eased by 78 bps and 251 bps respectively over the previous month.
- Notwithstanding the consistent moderation at headline level, both inflation metrics diverged sequentially in Mar-23 with CPI rising to 0.23% MoM and WPI remaining unchanged (0.00% MoM).
- After a hiatus of 2-months, headline CPI inflation reverted to RBI's target range (2-6%).

In addition, as per RBI's latest round, inflation expectations saw a broad-based decline across the time horizon of current, 3-months and 1-year ahead by 70 bps, 30 bps and 30 bps respectively. Though the expectations on general prices and inflation remained elevated, relatively lower share of households now expect prices to rise, when compared to the previous survey rounds.

Key highlights of CPI inflation

- The 0.23% MoM momentum in Mar-23 is broadly in line with the pre-Covid average sequential increase of 0.22% MoM usually seen in the month of March typically due to a seasonal firmness in perishable food items.
- Food and Beverages index also rose by 0.23% MoM in Mar-23 from a contraction of 0.06% MoM in Feb-23. Along with the unfavourable summer seasonality, the acceleration in food prices was also due to the adverse impact of the heatwave followed by unseasonal rains/ hailstorms in certain parts of the country. The top 3 sub-categories contributing to the sequential upturn were mostly perishables like Fruits (3.67% MoM), Vegetables (1.73% MoM), and Milk (0.62% MoM). On the other hand, the bottom 3 sub-categories contributing to easing price pressures were Eggs (-4.42% MoM), Edible Oils (-2.55% MoM), and Cereals (-0.40% MoM).
- The moderation in the increased cereal prices can be attributed to the steps taken by the Central Government such as the open market sale of wheat from the buffer stocks to cool down market prices. The ban on wheat exports have persisted since May 2022, given the continuing risks of a lower wheat harvest in the concluding rabi season.
- Milk and milk products inflation continue to be near double digit at 9.3% YoY in Mar-23 and on a sequential basis, the inflation has been higher than 0.5% MoM since Mar-22.
- Spices inflation has cooled down to 0.1% MoM in Mar-23 though the annualized print continued to be high at 18.2%.
- Consolidated fuel and housing index remained unchanged on sequential basis (0.0% MoM for both). Despite this, housing inflation, rose to over a 4-year high of 4.96% YoY in Mar-23 from 4.83% in Feb-23.
- Sequential momentum in core inflation (CPI ex indices of Food & Beverages, Fuel & Light, and petrol and diesel items within Miscellaneous) moderated to a 21-month low of 0.28% MoM in Mar-23 from 0.40% in Feb-23. The annualized rate

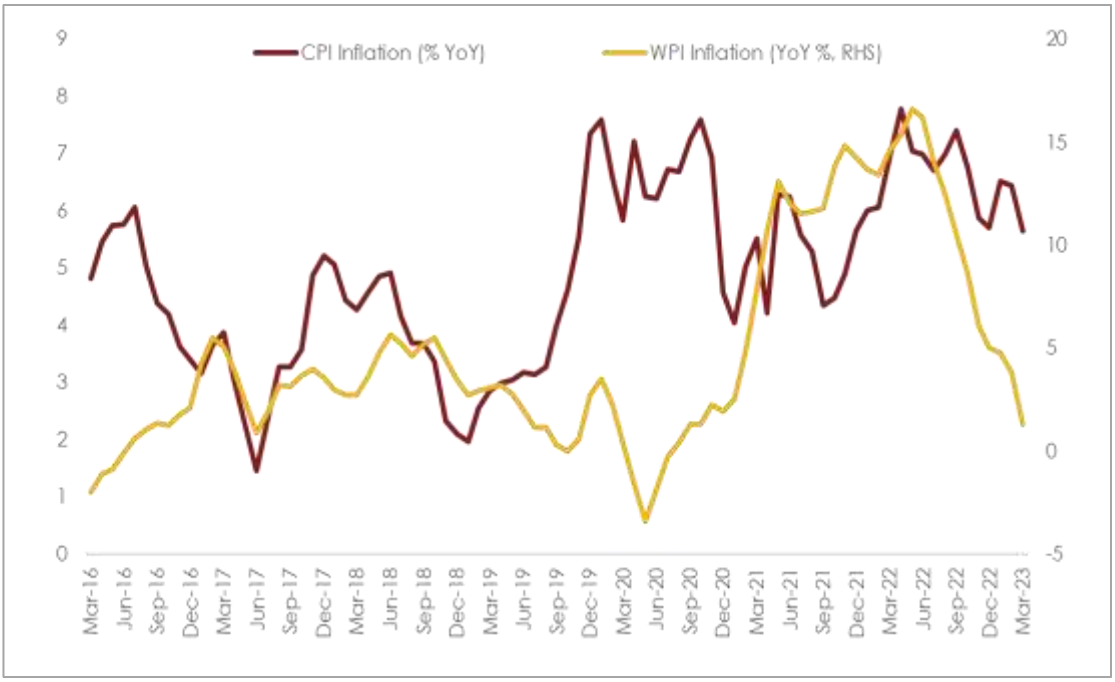
of inflation under this category posted a moderation to 6.00% in Mar-23 from 6.34% in Feb-23.

- Clothing and Footwear inflation moderated to a 16-month low of 8.18% YoY in Mar-23 from 8.79% in Feb-23.

Key highlights of WPI inflation

- WPI inflation has been on a consistent decline since last fiscal and moderated to a 29-month low of 1.34%YoY in Mar-23 from 3.85% in Feb-23, the steepest decline in 4 months.
- Sequentially, WPI remained flat (0.00% MoM) in Mar-23 vs. an increase of 0.13% MoM seen in Feb-23.
- At a granular level, gain in the Primary article index (1.16% MoM) was offset by moderation in Fuel and Power (-1.26% MoM) and Manufacturing indices (-0.28% MoM).
- Price pressures in the primary index were led by a sequential increase across all sub-categories barring Non-food. The sub-categories contributing to the sequential upturn were Minerals (14-month high at +8.16% MoM), Crude & natural gas (+4.61% MoM) and Food (+1.13% MoM). The non-food sub-category witnessed a contraction of 2.05% MoM in Mar-23, over and above a contraction of 1.90% in Feb-23.
- The consolidated Food & Beverages index rose by 0.47% MoM in Mar-23 from a contraction of 0.13% in Jan-23.
- Core WPI (WPI ex indices of Primary: Food, Mfg: Food, Mfg: Beverages, Fuel & Power, and Primary: Crude Petroleum & Natural Gas) slipped into a contraction of -0.84% YoY in Mar-23, a 33-month low, from 1.65% in Feb-23.

<u>Chart 1: CPI and WPI inflation have been decelerating after peaking out in Q1 FY23</u>



Outlook

Favourable statistical base effects coupled with lower input costs helped both CPI and WPI inflation drift lower in Mar-23. Easing of food inflation seems encouraging along with the ongoing decline in global food prices and IMD predictions of a largely 'normal' monsoon outturn in the upcoming Jun-Sep season. Moreover, core retail and wholesale inflation are exhibiting early signs of moderation on account of incremental softness in most commodity prices along with a slowdown in global demand. Overall, it is comforting that headline CPI inflation has reverted to the RBI's target range (2-6%) after a gap of 2 months.

The silver lining emerges from the sharp deceleration in core wholesale inflation. Incremental softness in most commodity prices amidst a slowdown in global demand bodes well for further easing of input price pressures. Within manufacturing PMI, input cost index eased to the lowest level in nearly 2-1/2 years in Mar-23. This could get more prominently reflected in pass through to core retail inflation albeit with a lag.

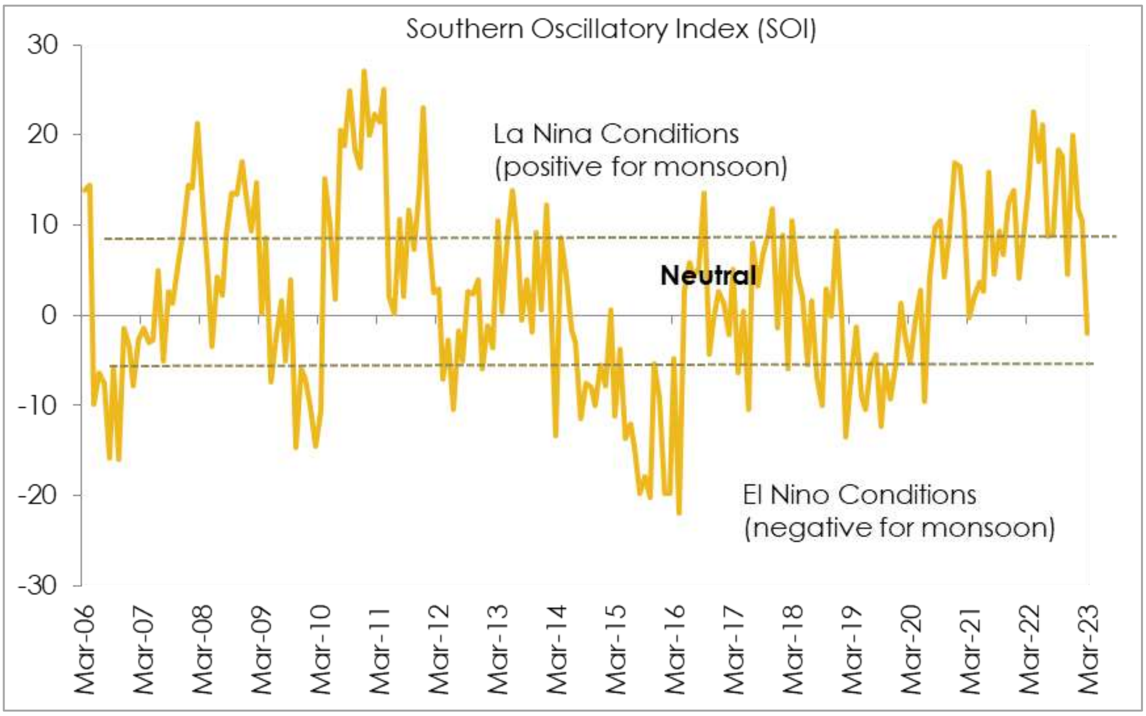
Nevertheless, while easing of food inflation seems encouraging along with the ongoing decline in global food prices and expectations of Rabi output at a record high, one cannot draw a durable comfort on food inflation outlook. Predictions of warmer summer in Apr-May'23, impact of unseasonal rains of Mar-23 and early prognosis of a likely below-normal Southwest monsoon due to El Nino phenomenon could potentially push up food prices.

In addition, the recent rally in crude oil prices following the surprise announcement of a cut in product by OPEC+ if were to sustain or see further upside, could serve as an upside risk to inflation.

From monetary policy perspective, we expect the central bank to maintain a prolonged pause and gradually scale back liquidity surplus to push monetary policy transmission. However, impact of global economic uncertainties on growth-inflation dynamics keeps the door open for incremental rate hikes in the near future.

Potential risks notwithstanding, we see a faster moderation in headline CPI inflation (led by non-core components of food and fuel) in FY24 than core inflation. We maintain our FY24 CPI inflation projection of 5.3%.

Chart 2: Weather agencies expect El Nino conditions to develop in late summer



Government Finances

Largely under control, limited slippage risks in FY23

KEY TAKEAWAYS

- India's central government fiscal deficit for the period Apr-Feb stood at 82.8% of revised estimates (RE) for FY23, marginally lower than the level of 83.0% of actuals in the corresponding period in FY22.
- Total receipt collection has slightly eased on account of signs of moderation in direct tax collections and trailing of disinvestment revenues.
- Expenditure disbursal remains strong on the back of thrust on capital expenditure.
- Incremental information since the presentation of RE reveals the likelihood of slippage in headline fiscal deficit to 6.6% of GDP (vs. the target of 6.4%) on account of a shortfall in disinvestment revenue, higher expenditure on account of fertilizer subsidy, and a marginal downward revision to the nominal GDP base.
- However, we believe the government would prefer to stick to the headline target by rationalizing year end spending and CSS (Centrally Sponsored Schemes) allocation for states.
- For FY24, the fiscal deficit target of 5.9% of GDP appears achievable, with risks appearing neutral at this stage.

India’s central government fiscal deficit for the period Apr-Feb stood at 82.8% of revised estimates (RE) for FY23, marginally lower than 83.0% of actuals seen in the corresponding period in FY22. The marginally lower accretion to fiscal deficit this year reflects relatively stronger pace of realization of tax and non-tax revenues, even though expenditure disbursal too remains somewhat higher than last year’s momentum.

Receipts: Signs of moderation

- On FYTD (Apr-Feb) basis, gross tax revenue clocked 83.7% of RE, marginally lower than 84.0% of actuals in the corresponding period in FY22.
    - Compared to RE up to Feb, customs duty collection is the only category that is maintaining momentum ahead of last year’s collections corresponding to the same period (90.0% of RE vs. 83.0% of actuals).
    - Nevertheless, GST collections continue to remain healthy with total monthly collections averaging at Rs 1.51 trillion during FY23 vis-à-vis the average monthly collection of Rs 1.24 trillion seen in FY22. This implies a growth of 21.5% in total GST collections in FY23.

Non-tax revenue collections accelerated to 95.0% of RE during Apr-Feb FY23 from 89.1% of actuals in the corresponding period in FY22. Pick-up in dividend pay-out from PSEs along with support from telecom spectrum revenue has managed to offset the drag on account of lower dividend transfer from the RBI in FY23.

Non-debt capital receipts clocked just 70.5% of RE during Apr-Feb FY23, lower than the level of 92.5% of actuals in the corresponding period in FY22 on account of the sluggish pace of disinvestment activity in FY23. There was no significant realization of disinvestment revenue in the months of Feb-Mar’23.

Expenditure: Superior quality of spending being maintained

On FYTD (Apr-Feb) basis, total expenditure disbursal stood at 83.4% of RE, higher than 82.9% of actuals in the corresponding period in FY22.

- Capital expenditure clocked 81.0% of BE during Apr-Feb FY23 vis-à-vis 81.8% of actuals in the corresponding period in FY22. Bulk of this was incurred on defence, railways and urban housing. In addition, to facilitate capex by states, the FY23 Union Budget had made provision for disbursing Rs 1.1 tn as interest-free loans to states with attached conditionalities for targeted spending. In this context, we note that loans disbursed under central government’s capex grew by a whopping 67.8% YoY during Apr-Feb FY23 vis-à-vis a contraction of 64.7% in the corresponding period in FY22.
- Revenue expenditure firmed up to 83.9% of RE during Apr-Feb FY23 from 83.0% of actuals in the corresponding period in FY22.
    - Interest payments and subsidies have accounted for 43.3% of revex disbursals in 11-months of this fiscal.
    - Excluding interest payments and subsidies, revex grew by a modest pace of 1.9% YoY during Apr-Feb FY23.

Outlook

The central government had used available levers to ensure adherence to FY23 fiscal deficit target of 6.4% of GDP while presenting the revised estimates in Feb-23. However, incremental information points towards the need for further rationalization and fine-tuning efforts to avoid any headline slippage.

- Between the first and the second advance estimates of national account, the nominal GDP base for FY23 now stands revised lower by Rs 1.04 trillion. Although this is not a significant amount, it could nevertheless push the fiscal deficit ratio to 6.5% of GDP (vs. RE of 6.4%) due to rounding off impact.
- The government has been able to collect Rs 353 bn in disinvestment revenue in FY23, lower than the RE of Rs 500 bn.
- On the expenditure side, we note that the central government presented the second supplementary demand for grants on Mar 13, 2023 for spending an additional Rs 1.48 trillion (on net basis). While bulk of this has been accounted for in RE, the provision of additional Rs 297 bn on fertilizer subsidy appears to be an addendum.

Taking into account the above-mentioned factors, FY23 fiscal deficit could potentially get pushed towards 6.6% of GDP (vs. the RE of 6.4%). However, we believe the government would prefer to stick to the headline target by rationalizing year end spending and CSS (centrally sponsored schemes) allocation for states.

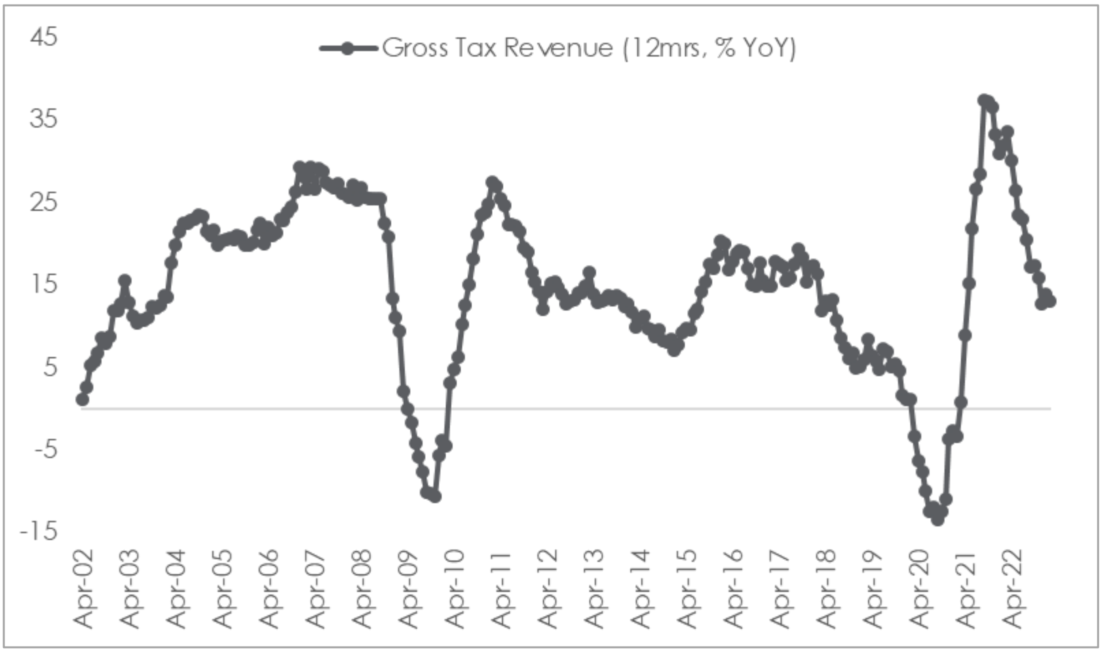
As for the FY24 outlook, the budget arithmetic appears credible with reasonable growth assumptions for Nominal GDP (10.5%) and gross tax collections (10.4%). The disinvestment target is not lofty (at Rs 510 bn) and could be achieved if traction is maintained through the year; however, upcoming central elections in 2024 may continue to slow down the disinvestment momentum. Total expenditure is budgeted for a moderate growth of 7.5% as revex is slated for a subdued expansion of 1.2% (on account of savings generated from cut in subsidy budget). Encouragingly, the government doubled down on its focus for capex, which saw the total outlay increasing by 37.4% (with continued emphasis on railways, roads, and defence).

Overall, we expect the headline fiscal deficit target of 5.9% of GDP for FY24 to be met with risks appearing neutral at this stage.

Table1: Comparison of key drivers of fiscal deficit

Key Fiscal Variables (Cumulative Position, Apr-Feb)				
	% of FY Actual/Target		%YoY	
	FY22	FY23	FY22	FY23
Revenue Receipts	82.6	84.3	30.7	10.6
Net Tax	81.4	83.0	21.8	17.0
Non-Tax	89.1	95.0	101.1	-19.8
Non-Debt Capital Receipts	92.5	70.5	-15.3	62.4
Total Receipts	82.8	83.9	29.3	11.6
Revenue Expenditure	83.0	83.9	10.2	9.2
of which, Interest Payment	83.4	84.9	20.1	18.9
of which, Major Subsidies	86.0	88.1	1.8	23.4
Capital Expenditure	81.8	81.0	19.7	21.7
Total Expenditure	82.9	83.4	11.5	11.1
Fiscal Deficit	**83.0**	**82.8**	**-**	**-**

Chart 1: Growth in gross tax collection has been moderating



Rates

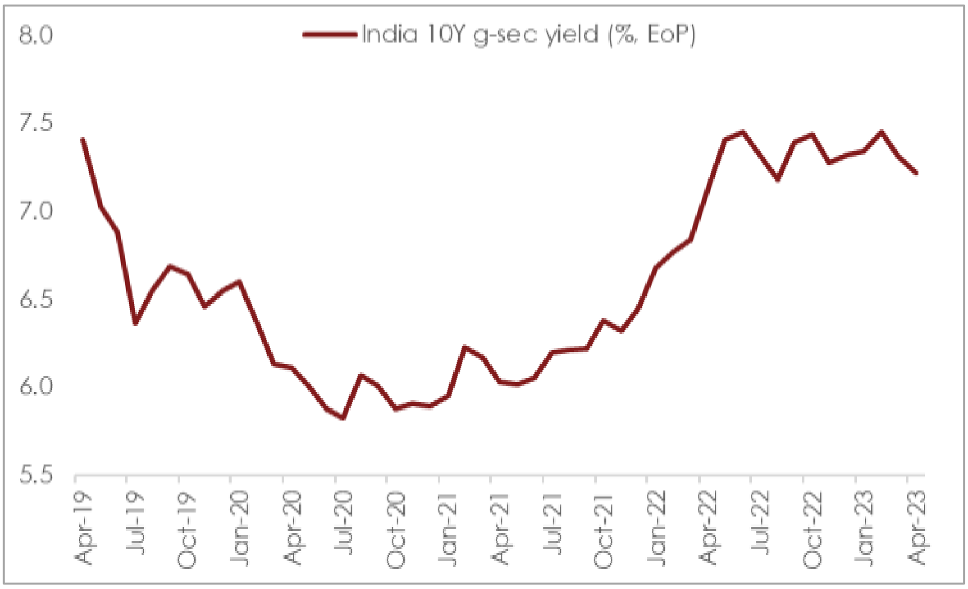
Benign outlook in the near term

KEY TAKEAWAYS

- After touching a high of 7.46% in early part of Mar-23, India's 10Y g-sec yield has eased to 7.1%-7.2% in mid Apr-23.
- Banking sector turmoil in US and Europe coupled with market expectation of ~75 bps cut by the US Fed before the end of 2023 provides strong comfort to the domestic bond market.
- RBI's surprise pause vis-à-vis market expectation of 25 bps hike in Apr-23 may lead to the current repo rate of 6.50% to stand as the cyclical peak in the current hike cycle.
- This takes away the uncertainty on terminal rate with the risk of fresh supply concerns in some food categories as the only major sentiment dampener.
- Nevertheless, the broader anticipated macro backdrop of moderation in growth and core inflation would help pull yields lower during the course of FY24.
- We maintain our 10Y g-sec view of 7.00% before Mar-24.

After touching a high of 7.46% in early part of Mar-23, India's 10Y g-sec yield has eased to 7.1% in the third week of Apr-23. The decline in yields to 8-month low levels is on account of both global and domestic factors.

Chart 1: 10Y g-sec yield has fallen to 8-month low levels

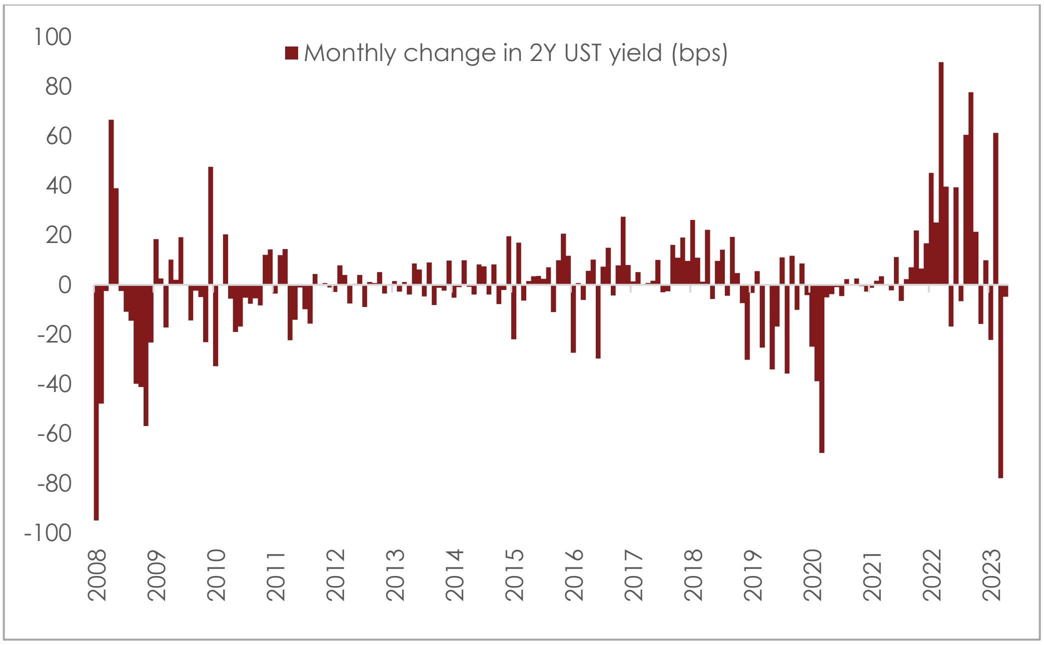


Global factors turning benign

Aggressive monetary tightening by the US Fed in last one year always carried an element of concern. While market participants were focussed on the risk of a hard landing, what caught everyone by surprise was the extent of lurking risk of asset liability mismatch for small and regional banks in the US. With Silicon Valley Bank going bust (followed soon by the failure of New York's Signature Bank), market participants started lowering their estimate of Fed's terminal rate. Global risk aversion took a stronger turn as deposit outflows that started from smaller and regional banks, also struck somewhat weak but large entities like the Switzerland based Credit Suisse which found itself in an untenable situation and had to be merged with UBS.

In a knee jerk reaction, the 2Y UST yield fell from its cyclical peak of 5.01% on March 7, 2023 to 3.76% on March 24, 2023, marking a gigantic fall of 125 bps in a span of 17-days. The nervousness was manifested across other asset classes, with sell-off in equities, widening of credit spreads, and slump in crude oil prices accompanied by a jump in gold prices. While the yields have seen a comeback since then to around 4%, it's still down by around 100 bps from the highs seen in early Mar-23, reflecting the proximity to a pivot in Fed's rate cycle.

Chart 2: In Mar-23, US short tenor yields slumped most since Global Financial Crisis



Although the banking sector turmoil appeared to be US and Europe centric, the second order contagion impact for India appeared relatively contained due to reduced external vulnerabilities and improvement in the domestic banking sector's balance sheet in recent years. Nevertheless, g-sec yields moderated (2Y yield fell by 25 bps between Mar 7 – Mar 24) in an environment of heightened global risk aversion marked by lower commodity prices in general.

Global spill overs and role of domestic factors

While market sentiment has currently stabilized with provision of targeted liquidity by systemically important central banks (like the US Fed, the ECB, etc.) and government aided M&A of weaker banking entities by relatively stronger ones, it nevertheless leaves behind an accentuated risk of global economic slowdown (assuming US and European banking sector to turn cautious post the recent turmoil).

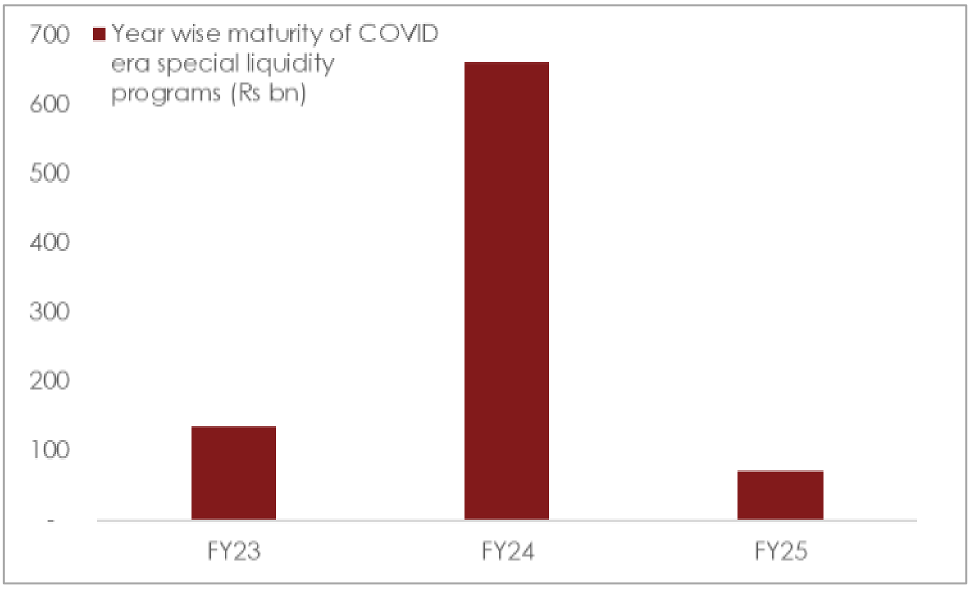
Indeed, one of the key fallouts is now reflected in market participants' repricing of early rate cuts by the US Fed. Notwithstanding Fed's Mar-23 dot plot pointing towards the likelihood of one final round of rate hike in May-23, followed by a status quo in the remaining months of 2023, market participants in contrast are pricing in as much as 75 bps rate cut before the end of 2023 now.

This clearly reduces the burden on other central banks, esp. ones in emerging market economies. From India's perspective, the surprise pause by the MPC of the RBI in its Apr-23 policy review (against market consensus of a 25 bps hike) can be contextualized from this perspective.

However, global factors provide just the operative backdrop for policymakers, with domestic factors having a larger weight on decision making. On this count, the MPC now seems to be taking a collective view on the following:

- Projection of Mar-24 quarter CPI inflation at 5.2%, down from 5.6% earlier, appears to have increased the comfort on real interest rates.
- Further, the bi-annual Monetary Policy Report projects FY25 CPI inflation at 4.5%, down from RBI's forecast of 5.2% inflation in FY24. Although FY25 figure is not yet an official forecast from the RBI, the projection by its Monetary Policy Department of inflation gradually aligning with the 4% target provides additional comfort.
- The MPC has now adopted a data dependent "wait and watch" approach instead of signalling continued tightening in a bid to assess the impact of the aggressive monetary tightening done since Apr-22 (the effective monetary policy rate has jumped sharply from 3.35% at the beginning of Apr-22 to 6.50% currently).
- The MPC is getting cognizant of the declining levels of surplus liquidity in the money market.
  - Core liquidity surplus stood at Rs 1.28 trillion (0.7% of NDTL) as of Mar 24, 2023 down from Rs 2.86 trillion (1.7% of NDTL) on Dec 30, 2023. As per central bank's estimates, liquidity surplus of less than 1.5% of NDTL is considered to be non-inflationary.
  - With a cumulative of Rs 661 bn of Covid era special liquidity programs due for maturity in FY24 (~92% of which is scheduled for Apr-23), repricing of incremental liquidity need would now take place at the prevailing repo rate of 6.50% vs. 4.40% earlier – this will have an implicit rate hike impact.
  - Further, since we expect core liquidity surplus to dry up gradually during the course of FY24, this will serve as tool to boost monetary policy transmission.

<u>Chart 3: Repricing of COVID era special liquidity programs will happen at higher rates</u>



G-sec view

Post the surprise pause in Apr-23 policy review, the bar for incremental rate hikes has got reset at a higher level and is now likely to be conditional on Fed rate trajectory compared to market expectations and/or crystallization of upside inflation risks.

In a base case scenario, repo rate at 6.50% can be taken as the terminal rate in the current cycle – thereby taking away the uncertainty with respect to the peak of monetary policy cycle.

Going forward, the only thing that would keep weighing on sentiment is the record high g-sec borrowing program in FY24. While this would partially offset the comfort from monetary policy, the broader anticipated macroeconomic backdrop of moderation in growth and inflation would help pull yields lower during the course of FY24. We maintain our 10Y g-sec view of 7.00% before Mar-24.

Rupee

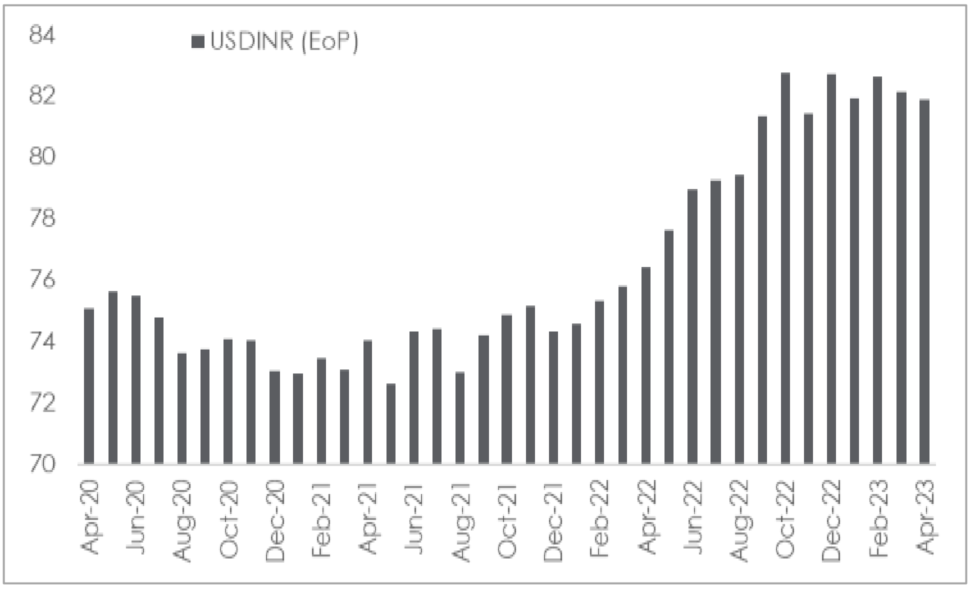
Moderate strength in the offing

KEY TAKEAWAYS

- After closing the month of Feb-23 at a level of 82.67, the Indian rupee appreciated by 0.6% against the US dollar during Mar-23. Appreciation trend continues to persist in the month of Apr-23, with USDINR currently trading around 81.9 levels.
- The mini credit crisis in the US has led market participants to expect an early turnaround in the Fed rate cycle and a pivot to crystallize within the next few months.
- With 75 bps of rate cuts priced in by market participants in CY23, the US Fed could potentially lead in monetary policy easing among DM central banks.
- Cyclically, US dollar could face headwinds from a turn in monetary policy trajectory.
- Meanwhile, INR is expected to benefit from gradually improving growth-inflation balance as well as its twin deficit position i.e. fiscal and current account deficit levels.
- With BoP projected to get back to surplus after estimated to have stayed in deficit territory in FY23, we expect rupee to moderately strengthen in FY24, with forecast of USDINR touching 80.0 levels before end of FY24. This is however, subject to the non-emergence of any fresh geo-political or financial sector turbulence.

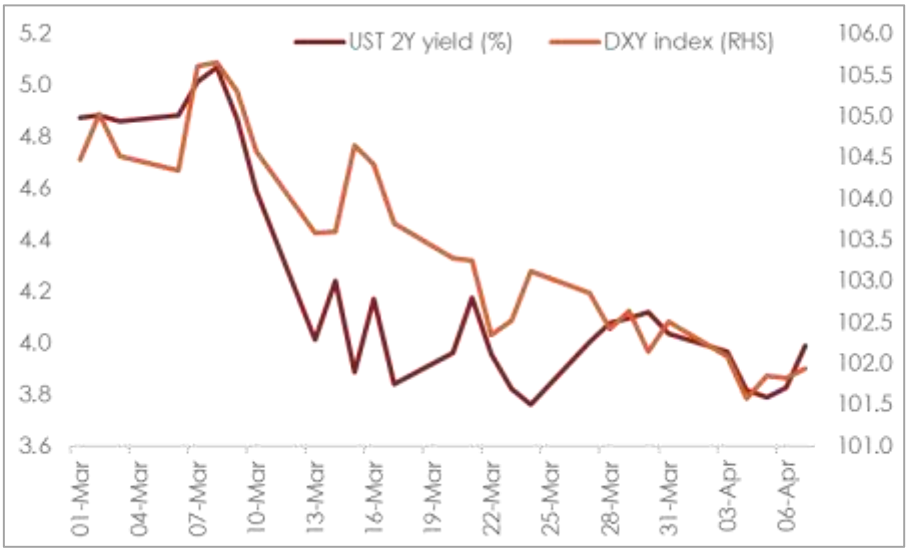
After closing the month of Feb-23 at a level of 82.67, the Indian rupee appreciated by 0.6% against the US dollar during Mar-23, closing the month at 82.17. The strength continues to persist in the month of Apr-23, with USDINR currently trading around 81.9 levels.

Chart 1: On monthly basis, NR is currently trading at its strongest in last 5-months



The episode of global risk aversion triggered by the banking sector turmoil in the US in the month of Mar-23 seems to be weighing upon the USD. Although the mini credit crisis now seems to have got resolved post prompt liquidity injection by key central banks like the Fed and the ECB, the mini credit crisis will turn small and medium sized banks cautious from balance sheet expansion perspective. This would eventually accentuate the anticipated economic slowdown.

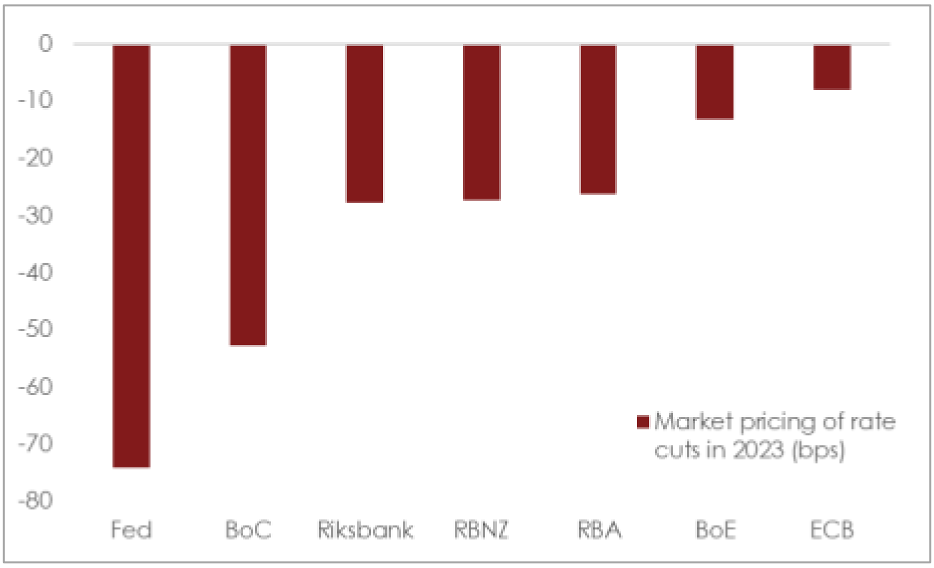
Chart 2: Sharp fall in US yields has weighed upon the US dollar



From FX market perspective, the implication of this would be in central banks turning dovish in the near future, thereby reversing the interest rate cycle with start of monetary easing.

In fact, in sharp contrast to the recent Fed dot plot projection of one more rate hike in May-23 followed by a status quo through the remaining months of 2023, market participants are pricing in as much as 75 bps rate cut from the Fed before the end of 2023. From consensus expectations perspective, this would make the US Fed lead monetary policy easing among DM central banks.

Chart 3: Market expects US Fed to lead in monetary easing cycle as well



Although other central banks might start following the Fed with some lag in the rate cutting cycle, this would nevertheless weigh upon the USD as it would enter a cyclically bearish phase. This in turn would offer support to most emerging market currencies, including the INR.

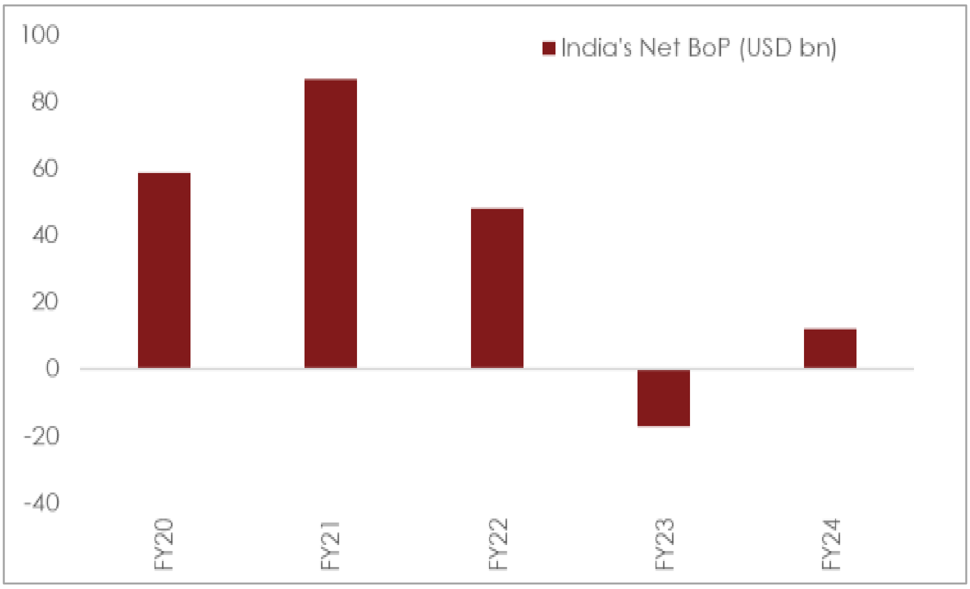
While global FX backdrop for INR is getting comfortable, the domestic setting too is providing comfort.

- Despite an expected moderation in GDP growth towards 6.0% levels in FY24 from 7.0% in FY23, the slowdown elsewhere is likely to be deeper, thereby helping India to remain one of the fastest growing major economies in the world. IMF's projection of long-term growth path indicates likelihood of India's GDP growth remaining between 6.2-6.8% between 2024 and 2027.
- We expect CPI inflation to get back to its target band in FY24 by averaging close to 5.3% from 6.7% in FY23. Further, the recent Monetary Policy Report of the RBI estimates FY25 CPI inflation at 4.5%. This is comforting as it signals alignment of current elevated inflation with the 4% target in a gradual manner over a period of two years.
- India's central government's fiscal deficit has been on a gradual correction path after hitting its pandemic high of 9.2% of GDP in FY21. The revised

estimates for FY23 indicate fiscal deficit to be at 6.4%, which is budgeted for further consolidation towards 5.9% levels in FY24.

- Last, but not the least, is the sharp improvement in India's current account deficit profile. Towards the middle of FY23, market participants expected FY23 current account deficit to print between 3.0-3.5% of GDP on account of elevated commodity prices and reopening led domestic demand. However, we now expect current account deficit to come at 2.0% of GDP, down from our previous estimate of 3.1%. Going forward, the current account deficit is expected to narrow down further to 1.4% in FY24.
    - Despite persisting geopolitical pressures, easing of COVID era supply chain bottlenecks and anticipation of global economic slowdown has helped to keep a check on commodity prices. Price of India Crude Basket is currently trading at an average level of USD 85 pb in Apr-23, down from its recent peak of USD 116 pb in Jun-22.
    - Russia's share in India's import basket has steadily climbed from 2.1% in Jan-22 to 10.0% in Jan-23. Since most of this is on account of crude oil, which is procured at a discount of USD 25-30 pb compared to Brent, this is increasingly becoming an important source of saving for the current account deficit.
    - There is a structural improvement in services exports amidst post pandemic thrust on digitization and cost optimization globally. In addition, with threat of COVID ebbing at a global level, India is once again witnessing tourism related foreign inflows.

Chart 4: India's BoP set to get back into surplus after being in deficit territory in FY23



On net basis, the expected improvement in BoP to a surplus of USD 14 bn in FY24 along with a dollar negative backdrop, we expect rupee to strengthen moderately, with USDINR forecast of 80.0 by Mar-24.

Global Overview

Slowdown in growth momentum

KEY TAKEAWAYS

- It is perhaps apropos to define last month as intensely challenging on the economic front with complexities arising from persisting geopolitical tensions along with tightening of credit markets in US and Europe on account of the turmoil in the banking sector.
- Globally, markets rushed into panic mode following the collapse of Silicon Valley Bank and news of distress in Credit Suisse apart from visible stress in some US regional banks.
- Capturing the weakness in growth momentum, global manufacturing PMI index moderated from 49.9 in Feb-23 to 49.6 in Mar-23, on account of slowdown in the pace of production and employment.
- While global markets were buoyed by the decline in headline CPI inflation in US from 6.4% YoY in Jan-23 to 6.0% in Feb-23 and further to 5.0 in Mar-23, the strong sequential momentum on core inflation dented the fervour somewhat.
- To be objective, central banks are widely expected to soften their monetary policy stance with some forward-looking indicators pointing towards an impending slowdown, or even perhaps a recession.

Global overview

It is perhaps apropos to define the month of Mar-23 as intensely challenging on the economic front with complexities arising from persisting geopolitical tensions along with tightening of credit markets in US and Europe on account of turmoil in the banking sector. Although the banking turmoil seems to have been averted with provision of quick targeted liquidity by the U.S. Fed and ECB (including few other central banks), the developments (tighter regulations, flight of deposit to larger banks etc.) could weigh on credit offtake in advanced economies, thereby exacerbating the anticipated global economic slowdown.

Capturing the weakness in growth momentum, global manufacturing PMI moderated from 49.9 in Feb-23 to 49.6 in Mar-23 on account of slowdown in the pace of production and employment, from 49.9 in Feb-23. The upturn in production volumes was led by Asia, with Thailand, India and the Philippines registering the fastest rates of expansion. The region also benefited from the ongoing re-opening in China. In contrast, downturn was registered in Japan, South Korea, UK and Brazil. Manufacturing activity in North America and Europe remained on a weaker turf, on average, compared to Asia.

Aggressive monetary policy tightening exposed the first cracks in the financial system. Policymakers stepped in swiftly to stem concerns of a broader bank run, with the U.S. Fed, Treasury and Federal Deposit Insurance Corporation (FDIC) announcing guarantees on uninsured deposits at failed banks. Despite these emergency measures, risk of a recession has risen. Recent events are already leading to tighter credit conditions, which could slow aggregate demand and become disinflationary. With signs of deposits moving from regional banks to large nationwide ones and a rise in banks' general risk aversion, risk of a large negative shock to consumer and business confidence and a further sharp tightening in lending standards have risen meaningfully.

As a result, central banks are set to soften their monetary policy stance. Although interest rates are not necessarily the primary tool to address financial stability risks, a pause in the Fed's tightening cycle beyond May-23 is likely appropriate in the interest of financial stability as the FOMC assesses the fallout from SVB's collapse and evaluates the full effect of the cumulative tightening to date. Indeed, markets are now expecting at a final rate hike of 25 bps in the FOMC meeting in May-23.

US economy

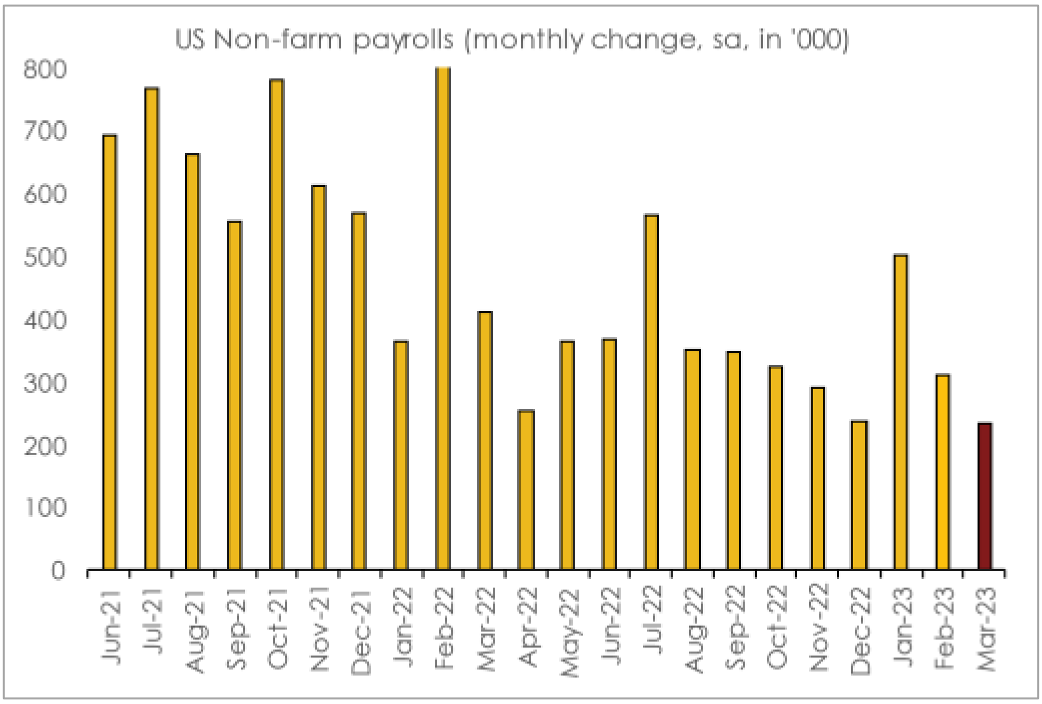
Despite potential risks to financial stability following the collapse of SVB, the US macroeconomic situation continues to remain healthy. Three key data points released in Mar-23 are having a strong bearing on economic assessment of the economy -

- **Elevated Inflation:** US headline CPI inflation continued to descend lower to 6.0%YoY in Feb-23 from 6.4% in Jan-23, in line with market consensus, but rose sequentially by 0.4% MoM in Feb-23, up from 0.5% in the previous month. Excluding volatile food and energy, Core CPI marked the slowest annualised expansion since Dec-21 by 5.5% YoY in Feb-23 from 5.6% in Jan-22. However, on sequential basis, core inflation increased by 0.4% MoM in Feb-23.

- **Resilience in labour market:** Mar-23 saw 236k addition to non-farm payrolls, close to market expectations (Refinitiv: 239k), while the unemployment rate fell marginally to 3.5% from 3.6% in Feb-23.
- **Robust consumption**: Core retail sales (headline excluding automobiles, gasoline, building materials, and food service) rose by 0.5% MoM in Feb-23. Overall, retail sales however dropped by 0.4% MoM in Feb-23, marginally worse than consensus estimates of a 0.3% contraction. On a positive note, the upward revision in Jan-23 data to 3.2% from 3.0% as previously reported.

On the monetary policy front, the still elevated inflation pushed the FOMC to raise the fed funds rate by 25 bps in Mar-23, same as the Feb-23 FOMC meeting, to a range of 4.75-5.00%. In terms of its monetary policy outlook, FOMC signalled that it is not done hiking yet. The statement maintained that "some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time". The Fed also committed to continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities as described in its previously announced plans. On the dot plot, the median terminal rate forecast was unchanged at 5.1%, with most of the members' predictions coalescing just above 5%, suggesting at least one more 25-bps hike at this juncture.

Chart 2: US non-farm payrolls at +236k in Mar-23, in line with consensus expectations



UK

Inflation in UK snapped 3-consecutive months of decline, with the headline print coming in higher than expected at 10.4% YoY in Feb-23 compared to 10.1% YoY in Jan-23. The largest upward contribution to the headline came from restaurants and hotels, food and non-alcoholic beverages, and clothing and footwear categories. Core CPI jumped to 6.2%YoY in Feb-23, up from 5.8% in Jan-23.

Given that headline inflation still remains much above BoE's target of 2.0%, the central bank raised its policy rate by 25 bps to 4.25% in its Mar-23 policy review and signalled that further tightening was in the offing. The BoE noted "large and volatile moves" in global financial markets but said its Financial Policy Committee judged that Britain's banking system was resilient.

To tackle the cost-of-living crisis, Finance minister Jeremy Hunt introduced a raft of measures including extending household energy subsidies by three months along with freezing the duty on pub alcohol and fuel prices. In a bid to speed up growth, Hunt also introduced a mix of measures including childcare and pension reforms to tempt people back to work, as well as corporate tax breaks to boost weak business investment. Despite these measures (as they would work with a lag), Britain remains at risk for a record fall in living standards over the two years to the end of Mar-24 with real household disposable income per person expected to fall by a cumulative 5.7% YoY over 2022/23 and 2023/24. Living standards are still expected to be 0.4% below pre-pandemic levels in 2027/28 with tighter fiscal and monetary policies likely to weigh on household budgets.

According to estimates released by the Office for National Statistics (ONS), GDP is estimated to have performed better than market expectations as it grew by 0.3% MoM in Jan-23, after falling by 0.5% MoM in Dec-22. The services sector grew by 0.5% sequentially, after falling by 0.8% in Dec-22, with the largest contribution to growth coming in from education, transport and storage, human health activities, and arts, entertainment and recreation activities. However, the economy remains fragile with GDP growth remaining flat in the three months to Jan-23 when compared with the three months to October 2022.

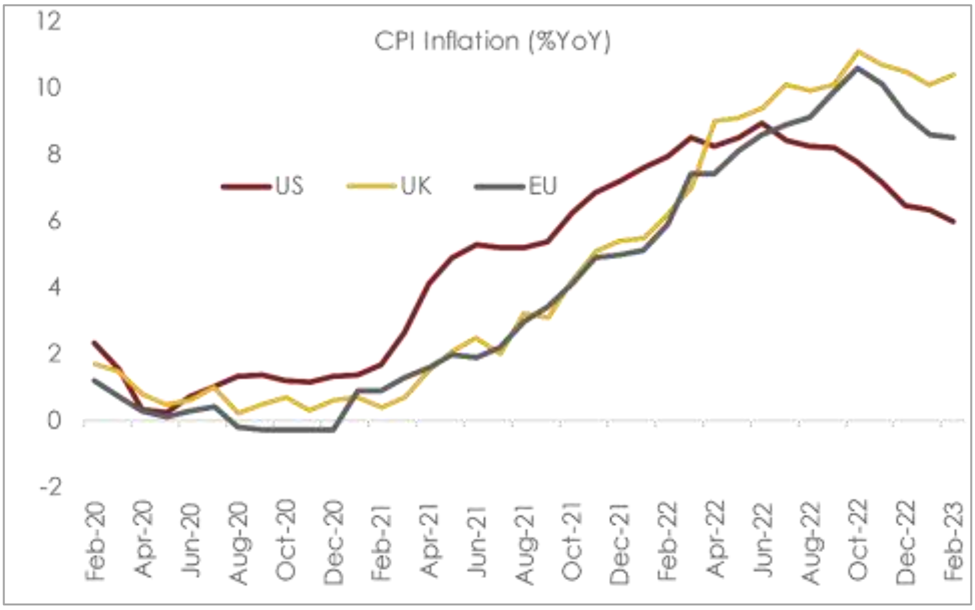
Eurozone

In Eurozone, inflation eased marginally for the fourth consecutive month in Feb-23, to 8.5% YoY from 8.6% in Jan-23 as a big fall in energy costs was offset by a price surge in nearly all other segments. Food, alcohol and tobacco remained the biggest driver, rising by 15.0% YoY in Feb-23 from 14.1% in Jan-23 while energy inflation moderated to 13.7% YoY from 18.9% in the previous month. Stripping off both these volatile components, core inflation accelerated to 5.6% YoY in Feb-23, well above market consensus and adding pressure on the European Central Bank to maintain a tight monetary policy.

In its Mar-23 meeting, ECB hiked rates, in line with its forward guidance, by another 50 bps to bring the deposit rate to 3.0%, the highest level since late 2008, and refinancing rate to 3.5%. The opening statement of the accompanying press release clearly showed the ECB's determination to ensure the timely return of inflation to the 2% medium-term target, stressing that "Inflation is projected to remain too high for too long". Indeed, the central bank expects headline inflation to overshoot its 2% target through 2025. The latest decision was accompanied with limited guidance regarding the future policy path, against the backdrop of financial stability concerns. Both the statement and the press conference held by ECB President Christine Lagarde and

ECB Vice-President Luis de Guindos, nonetheless, highlighted the resilience of the banking sector. With manufacturing PMI for the region remaining in contraction at 48.5 in Feb-23 vs. 48.8 in Jan-23 and the sharp tightening seen over the last three quarters, there is likely to be a material impact on 2023 growth, with IMF projecting region's annualised growth slowing to 0.7% from 3.5% in 2022.

Chart 3: G3 inflation peaked but pace of sequential moderation slower than forecast



CHINA

China's manufacturing activity fared better than expected, with manufacturing PMI rising to 52.6 in Feb-23 from 50.1 in Jan-23, beating market expectations and expanding at the fastest pace since Apr-12. The overall expansion was driven by furniture manufacturing, metal products and electrical machinery equipment, with production indices in these industries remaining above the 50-point mark. The rapid expansion came amid an accelerated resumption of factory output after the Chinese New Year holidays, while the impact of the epidemic continues to wane. The non-manufacturing PMI rose to 56.3 in Feb-23 from 54.4 in Jan-23, the fastest pace of expansion since Mar-21. Construction activity led the acceleration for non-manufacturing PMI, standing at 60.2 from 56.4 in Jan-23, supported by the persistent emphasis on infrastructure spending and increased financing to help developers complete stalled projects. The composite PMI, which includes both manufacturing and non-manufacturing activity, rose to 56.4 in Feb-23 from 52.9 in Jan-23.

However, trade activity data from China extended its decline, as exports for the Jan-Feb 23 period fell, pointing to continued weakness in foreign demand and backing government's concerns that a global slowdown will hamper the country's recovery from pandemic-era slowdown. Exports fell 6.8% YoY during Jan-Feb 2023 building on the 9.9% decline recorded in Dec-22. Imports fell at a faster pace of 10.2% YoY during the first two months of 2023, while they shrank 7.5%YoY in Dec-22. The data reflects worsening global demand for goods, as also seen among other major Asian exporters, such as South Korea and Vietnam. However, we expect imports to recover gradually as consumer confidence improves following the removal of COVID-19 restrictions.

Retail inflation in China moderated to 1.0% YoY in Feb-23, the lowest in a year, with easing price pressures seen across both food and non-food components. On a sequential basis, consumer prices fell by 0.5% MoM in Feb-23, reversing from the 0.8% MoM gains in Jan-23 as demand softened following the Lunar New Year holiday. Leading the pullback were food prices which declined by 2.0% MoM in Feb-23 while non-food prices fell marginally by 0.2% MoM.

In the annual session of the National People's Congress, the Chinese government set a modest growth target of around 5% for 2023, the lowest annual growth target on record. Government stressed the need for economic stability and improved domestic consumption, setting a goal to create around 12 mn urban jobs in 2023, up from last year's target of at least 11 mn. Preferential policy support to sectors such as defense, new-energy cars and childcare was indicated, along with an overarching focus on developing technology. The main support tools for growth were indicated to be a stable monetary policy and an expansionary fiscal stimulus, with the budget deficit target widening to 3.0% of GDP from a goal of 2.8% last year.

In its Mar-23 policy, People’s Bank of China kept its key lending rates unchanged for for the seventh consecutive month, but it cut the reserve requirement ratio (RRR) by 25 bps to bring the effective RRR to 7.6% to shore up liquidity. Governor Yi Gang said that the real interest rates are at appropriate levels with liquidity at a reasonable and balanced level.

About Acuité Ratings & Research Limited:

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