Acuité
RATINGS & RESEARCH

MACRO PULSE

REPORT

August 2023

From the desk of the Chief Economist

Dear Readers,

Greetings from Acuité Ratings & Research!

This is the **thirty first** edition of **Acuité Macro Pulse (AMP)** and its second edition with a completely different power point based template. Hope you have liked the new look!

The mood of the nation continues to be upbeat with the successful landing of Chandrayaan-3 near the South pole of the lunar surface which takes India to the forefront of space research apart from USA, China and Russia. In the current month, we also saw the meteoric rise of an Indian chess prodigy, R. Praggnanandha who became the youngest player to reach the finals of the World Championship and challenge the reigning champion, Magnus Carlsen. To add to that, India will be hosting the G20 Summit in early Sept which will be chaired by the Indian Prime Minister.

While all such developments boost the optimism about the long-term prospects of India, the economy is witnessing some short-term challenges. The economy was on a healthy momentum in the first quarter of the fiscal and the GDP growth, the data for which is expected to be released shortly, is likely to be over 7.5%, albeit supported by the base factor. Our **AMEP index**, however, highlights a slowdown in some of the high frequency indicators in July which may translate into lower growth in the subsequent quarters. Further, the risk of higher food inflation and a further rise in crude oil prices, can complicate the economic environment although government can play an important role to address such risks. RBI is unlikely to tamper with the interest rates for now but will keep its 'hawkish' eye on the inflation numbers; it has already absorbed the excess liquidity in the system through an incremental CRR.

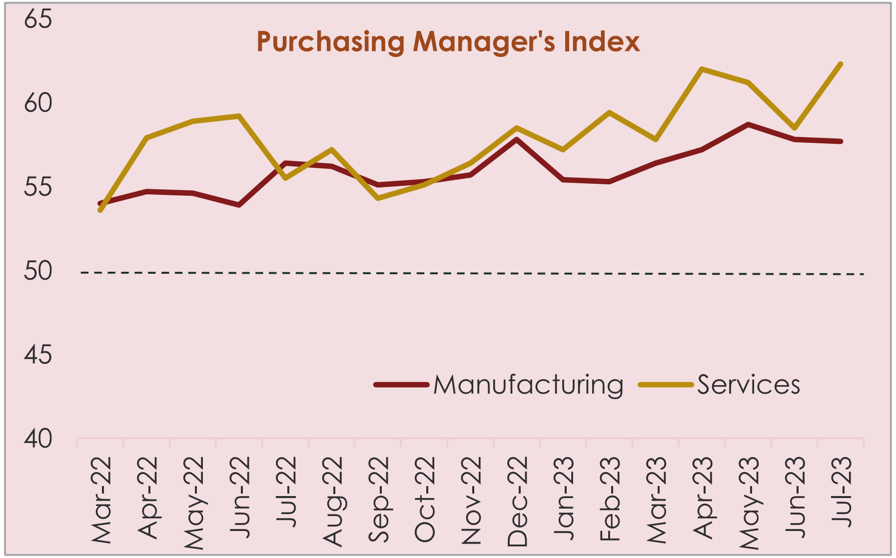
Essentially, the 'higher for longer" rate theme is clearly going to play out across most parts of the globe amidst demand resilience particularly in US and this will continue to keep the global capital markets volatile. From a domestic perspective, however, we expect the interest rates and the currency to be relatively stable. Cheers!

- Suman Chowdhury, Chief Economist and Head – Research

Growth: Services the key engine

Services growth continues to lead domestic economic recovery. Jul-23 services PMI rose to a high of 62.3 in Jul-23 from 58.5 in Jun-23, signalling the sharpest increase in output since Jun-10, attributable to strength in demand and new businesses.

Most other high frequency services-oriented indicators, especially in the transport/logistics side continue to show traction in growth terms well into Jul-23

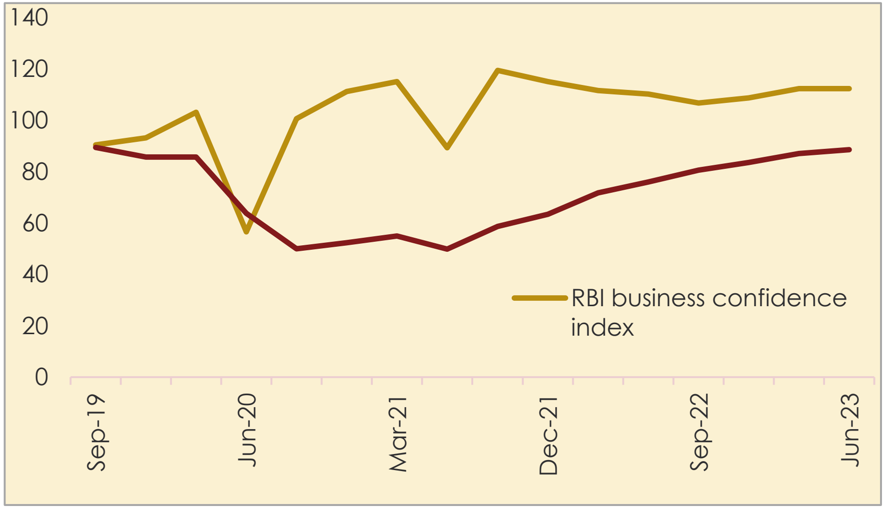


High frequency indicators : Services				
	Q3 FY23	Q4 FY23	Q1 FY23	Jul-23
Railway freight traffic	3.2	3.7	1.2	1.5
Port cargo traffic	5.3	8.6	1.7	4.3
Air Cargo traffic	-7.6	0.0	-0.4	NA
Domestic Air passenger traffic	19.2	58.6	18.0	19.2
International Air Passenger traffic	99.5	97.3	35.6	NA
GST E-way bills (units)	8.1	8.5	8.6	8.8
Services PMI	56.7	58.1	60.6	62.3

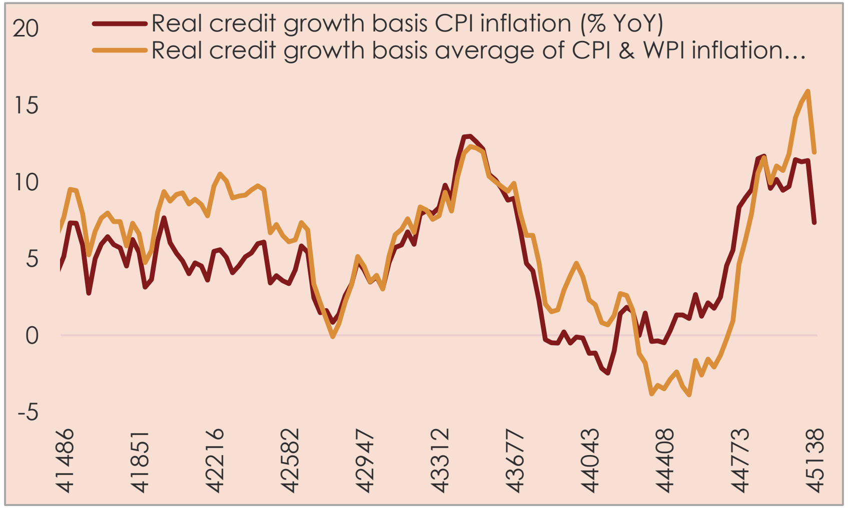
*E-Way bills are in Cr, Services PMI an index, rest are YoY%

Reasons to be optimistic on growth

Business and consumer sentiment continues to improve incrementally. Both, the indices (as compiled by the RBI) have now exceeded their pre Covid levels.

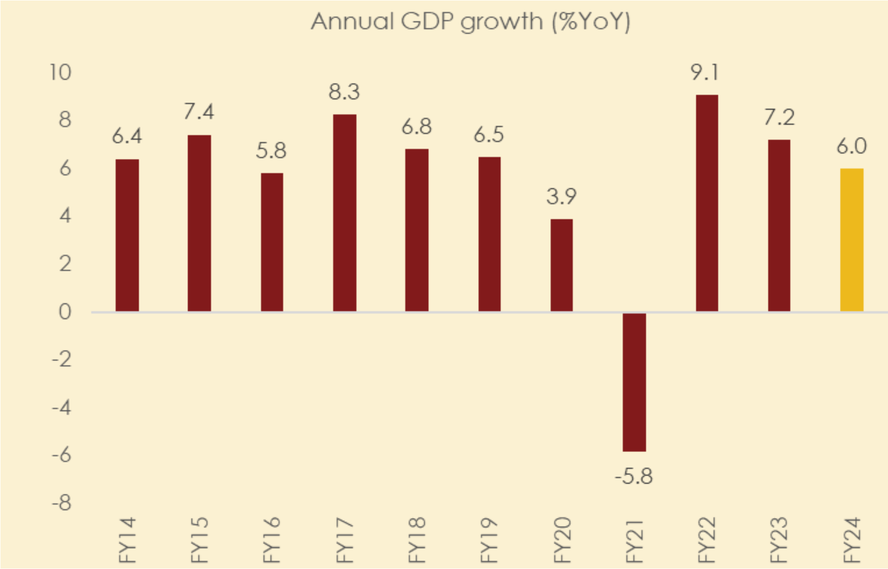


Adjusted for inflation, real bank credit growth is currently running at its highest levels in the last 10-years. Ebbing of twin balance sheet concerns has boosted credit appetite along with the post pandemic economic recovery. This should help support a private sector capex upcycle.



Factors weighing on FY24 GDP growth

On net basis, we continue to expect FY24 GDP growth to moderate to 6.0% from 7.2% in FY23.



There are four key factors that would weigh upon FY24 GDP performance:

- Adverse spillover from the anticipated (albeit somewhat delayed) global slowdown.
- Fading of pent-up demand (esp. in services)
- Lagged impact of domestic monetary tightening curbing leveraged urban demand (esp. for goods)
- Likelihood of some disruption to monsoon performance from the back-loaded El Nino impact and its impact on rural consumption

-1.6%

- Average annual change in Agriculture GVA during El Nino years*

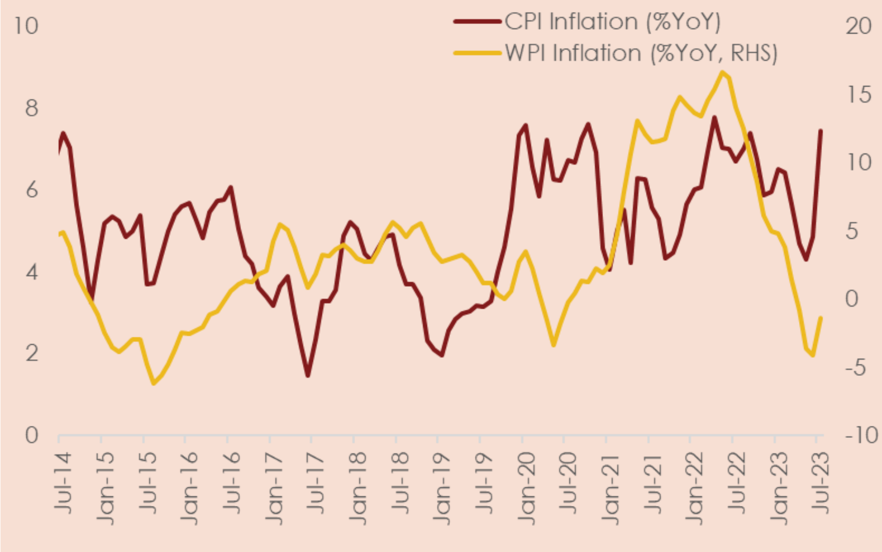
315 bps

- Effective rate hike done by the RBI between Apr-22 and Feb-22

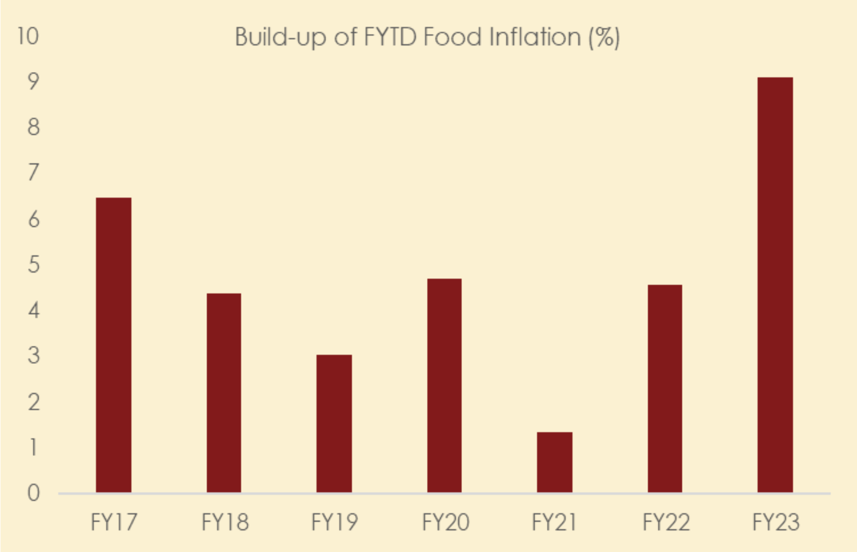
* Time period: 1995-2021

Red hot inflation prints in Jul-23

India's inflation indicators accelerated sharply in Jul-23. CPI inflation stood at a 15-month high of 7.44% YoY (vs. 4.87% in Jun-23), outpacing market consensus of ~6.4% by a wide margin. Despite being in negative territory, WPI inflation too increased to a 3-month high of -1.36% YoY vs -4.12% in Jun-23.



Build-up in retail food inflation in the current season has been significantly higher compared to average historical experience. Pre-monsoon showers, late start to Southwest monsoon and pest attacks in select regions have led to price pressures in Tomatoes, Onions, and some other vegetables over Jun-Jul-23 apart from cereals and pulses.



Food inflation beyond just tomatoes

In addition to tomato prices, price pressures were seen to be somewhat broad-based within Food. Sub-categories of cereals (both rice and wheat), Pulses, Spices have seen higher than seasonal build-up in prices in 2023, so far.

Buildup of TOP inflation during monsoon season (Aug over May)	2023 YTD (%)	Past 9Y Average (%)
Tomato (0.57%)	289.7	67.3
Onion (0.64%)	17.7	19.5
Potato (0.98%)	13.2	16.1

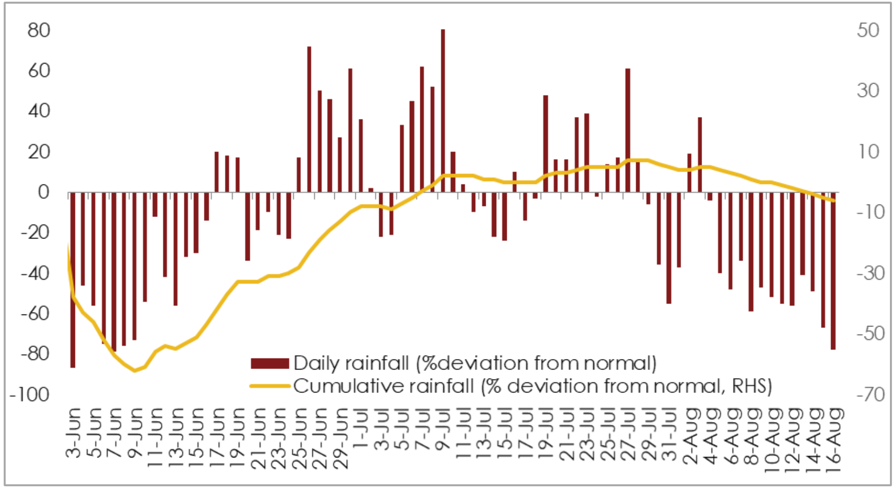
Note: (1) Price comparison between Ap-July, (2) Figures in parenthesis indicate weight in CPI basket.

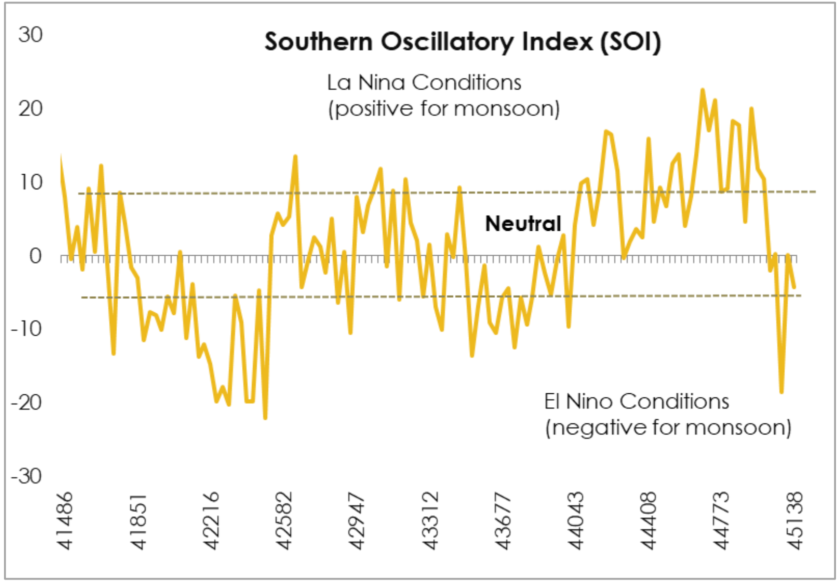
Food sub-categories (Price buildup)	LPA	2023 FYTD
Cereals	0.90	1.43
Meat & Fish	4.53	4.88
Eggs	1.60	3.98
Milk	1.31	1.79
Oils & fat	0.64	-9.41
Fruits	5.15	6.05
Vegetables	18.67	55.89
Pulses	1.26	8.51
Sugar & Confectionary	2.47	3.70
Spices	0.83	9.85
Non-alcoholic beverages	0.99	1.27
Prepared meals, snacks, sweets	1.08	1.24

Climate risks on watch

After recording strong performance in Jul-23, monsoon activity has once again waned in Aug-23 though in line with IMD's expectation. After ending Jul-23, at 5% surplus vis-à-vis LPA, cumulative rainfall is at 7% deficit (as of 24 th Aug-23)

El Nino conditions are not yet strong, with the SOI index moving into neutral range in Jul-23. Historically, India is seen to experience a normal monsoon in years when El Nino developed late (i.e., Aug or later)





Note: The SOI gives an indication of the development and intensity of El Niño or La Niña events in the Pacific Ocean.

CPI inflation: Remain a Monitorable

Upside risks to watch

Escalation of geopolitical tensions and the impact of OPEC+ decision to cut production on crude oil prices Brent crude oil price has rallied by nearly 12% since end Jun-23

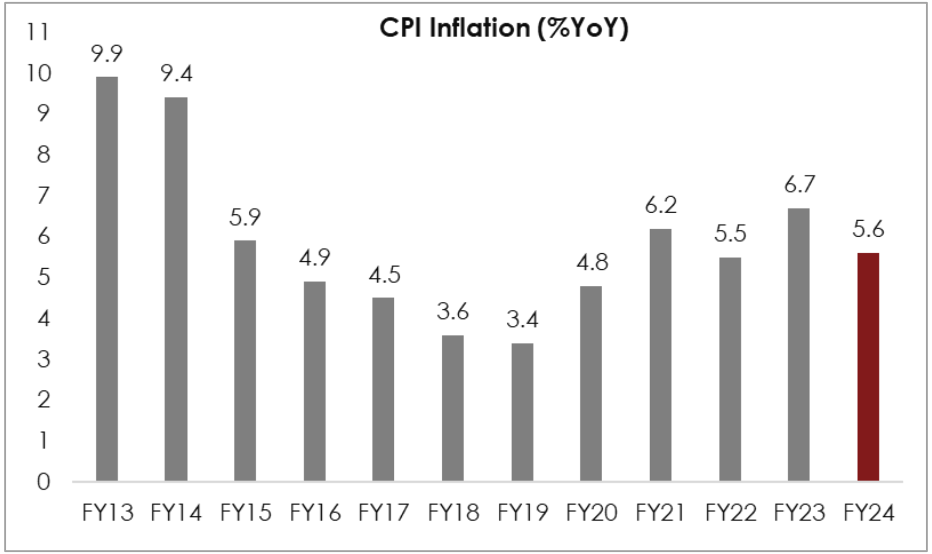
Global commodity prices have too begun to move up, especially food, post the cessation of Ukraine grain deal.

While tomato prices are expected to decline with the availability of new Kharif crop post Aug-23, the extent of normalization will be on watch

Durability of price pressures seen recently in cereals and pulses, amidst administrative measures already announced by Government (such as open market sales, stock holding limits etc.)

Impact of El Nino and subdued monsoon performance on Kharif crop yields

Given the anticipated upside to Q2FY24 CPI inflation estimate driven predominantly by Tomatoes, we have revised our FY24 average CPI inflation up by 30 bps to 5.6%.



Snapshot of Apr-Jun FY24 fiscal performance

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The FYTD (Apr-Jun) accretion to fiscal deficit stood at 25.3% of budget estimates (BE) for FY24, higher than 20.3% seen in the corresponding period in FY23. This was driven by relatively lower growth in tax revenue and divestments even as capital expenditure momentum remained robust.

Key Fiscal Variables (Cumulative position, Apr-Jun)				
	% of FY Actual/Target		%YoY	
	FY23	FY24	FY23	FY24
Revenue Receipts	23.8	22.4	5.2	3.6
Net Tax	24.1	18.6	22.6	-14.3
Non-Tax	21.7	51.4	-51.2	149.3
Non-Debt Capital Receipts	38.8	12.7	278.0	-61.8
Total Receipts	**24.3**	**22.1**	**8.9**	**0.5**
Revenue Expenditure	22.4	22.0	8.8	-0.1
of which, Interest Payments	24.6	22.6	24.0	6.6
of which, Major Subsidies	21.4	23.2	-32.1	28.0
Capital Expenditure	23.8	27.8	57.0	59.1
Total Expenditure	**22.6**	**23.3**	**15.4**	**10.8**
Fiscal Deficit	**20.3**	**25.3**	**-**	**-**

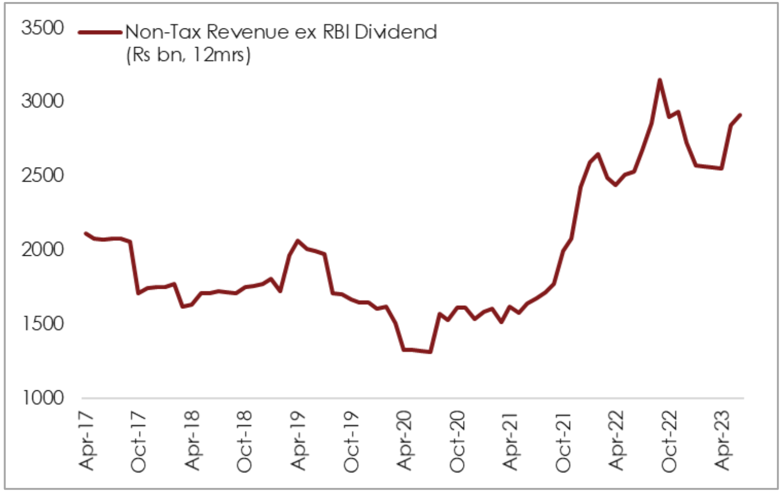
Revenues: A mixed bag

Gross tax collections posted a subdued performance in Q1 FY24. Corporate tax and excise collection is significantly trailing FY24 budget; with GDP growth expected to slow down in H2 FY24, likelihood of gross tax collections recouping lost momentum could be lower. Nevertheless, some offsetting impact can come from the resurge in commodity prices that would benefit customs and IGST component of imports.

Compensating for the moderation in tax collection is non-tax revenue. This has not just benefitted from the higher than budgeted surplus transfer from the RBI but continues to find support from strong dividend payout from PSUs and spectrum income. However, divestment activity has been on a slow start (Rs 42 bn in Q1 FY24 vs. Rs 246 bn in Q1 FY23) and needs considerable traction.

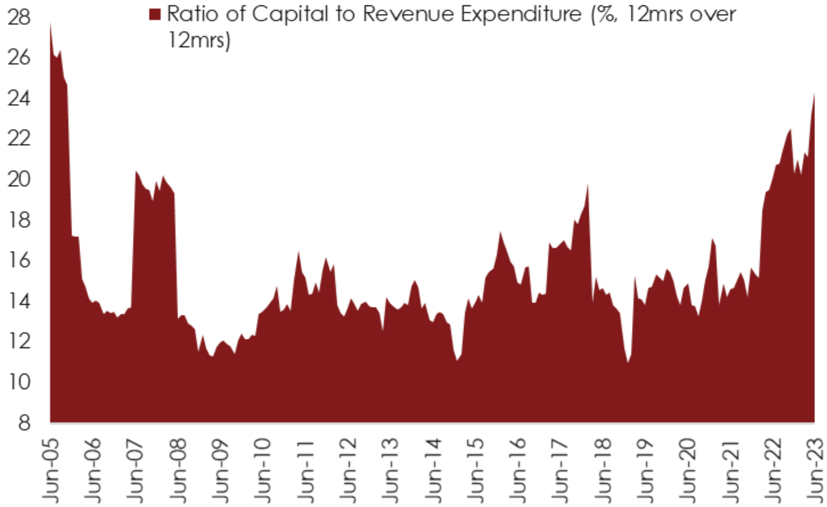
Growth in key tax categories	Q1 FY23 (% YoY)	Q1 FY24 (% YoY)	FY24 BE (% change*)
Gross Tax	22.4	3.3	10.1
Corporate Tax	30.0	-13.9	11.7
Income Tax	40.7	11.0	11.4
Customs	-11.8	34.9	9.2
Excise	-9.8	-15.4	6.3
GST	24.9	11.5	12.1

* Implied growth over FY23 actuals

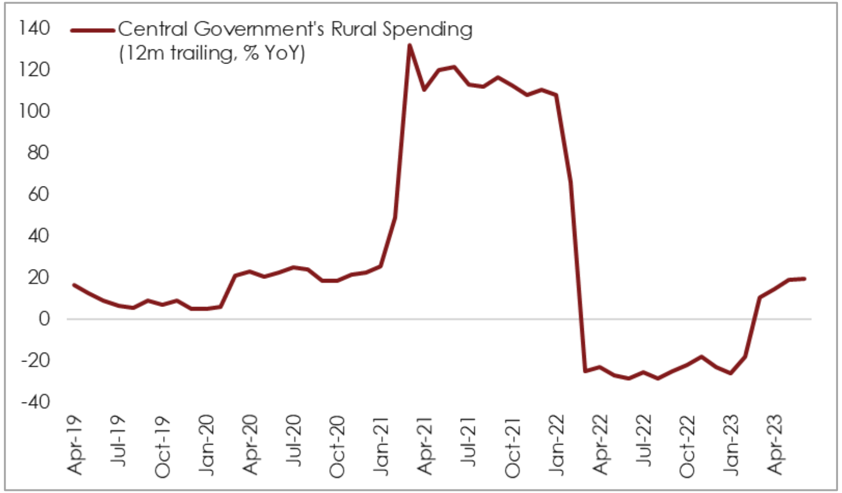


Focus on superior expenditure quality; fiscal risks appear neutral, but needs monitoring

Quality of central government spending continues to reflect prioritization of capex vis-à-vis revex. However, risk of an overshoot in revex (on account of higher fertilizer subsidies and likelihood of higher rural spending owing to soft rural demand conditions) could moderate the pace of improvement in quality of spending in H2 FY24.



In contrast to the BE of a 16.6% contraction, rural spending has picked up in Q1. Although these are early trends, downsizing of rural spend could be challenging amidst an erratic monsoon and the run-up to general elections in early 2024.



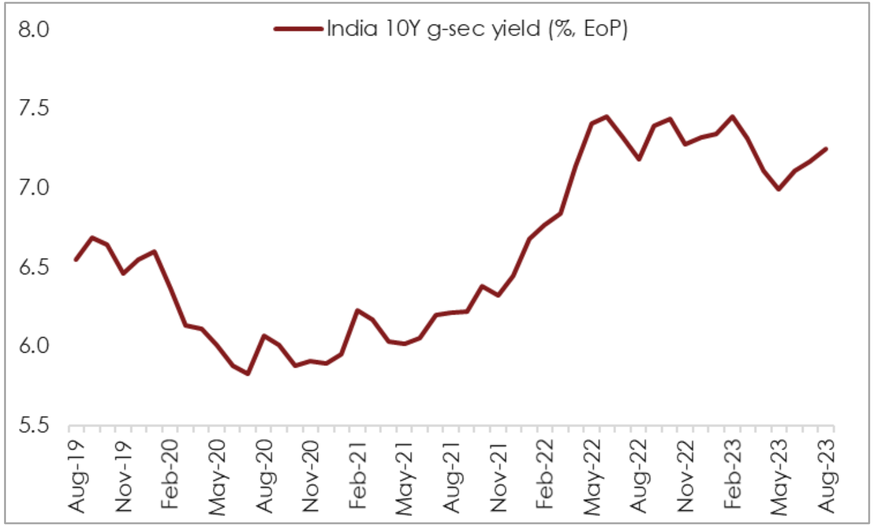
Note: Includes revenue spend by 9 ministries/departments with rural focus

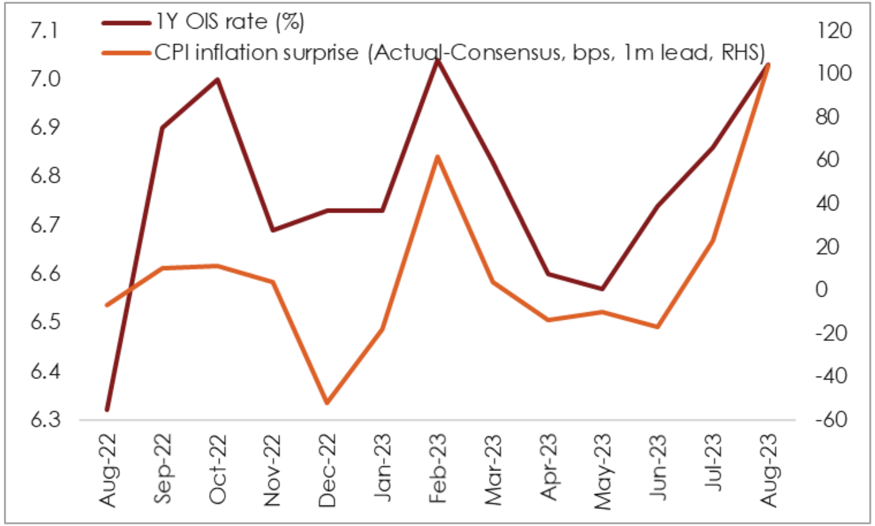
We continue to expect the central government to meet FY24 fiscal deficit target of 5.9% of GDP with risks appearing neutral at this stage (but needs monitoring).

G-sec yields showing moderate upward bias…

India's 10Y g-sec yield has been inching up slowly and is currently trading at 7.20% (at our near-term target) – that's almost 25 bps above its FY24 low of 6.96% seen in the month of May.

Rates market has acquired a bit of anxiety on account of recent inflation numbers beating market expectations by a wide margin.





…as inflation breaches tolerance threshold…

Breach of upper tolerance threshold on inflation is happening rather frequently in the post Covid period. Led by a substantial food price shock, FY24 could see at least three consecutive months of above 6% inflation print.

Actual CPI Inflation (%YoY) vs. Target Band							
	F18	F19	F20	F21	F22	FY23	FY24
Apr							
May							
Jun							
Jul							
Aug							
Sep							
Oct							
Nov							
Dec							
Jan							
Feb							
Mar							

Note: (i) Shaded cells denote downside and upside breach of inflation targeting band of 2-6%; (ii) Aug-Mar FY24 are Acuite estimates

Uncertainties with respect to food inflation

Skewed monsoon

Month-wise rainfall stands in Jun (-9%), Jul (+13%), and Aug so far (-30%)

On cumulative basis, North-West has received a surplus rainfall of 10% while East & NE has seen a deficit of 19%

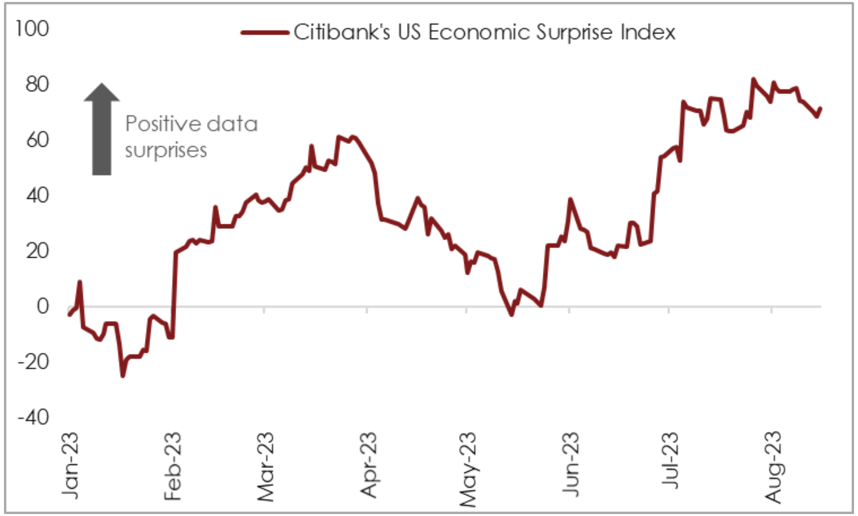
Besides volatility in vegetable prices, non-perishables like cereals, pulses, spices, and milk have been showing price pressures too

A back-loaded El Nino could potentially disrupt rabi sowing (although its irrigation intensity is better in comparison to kharif)

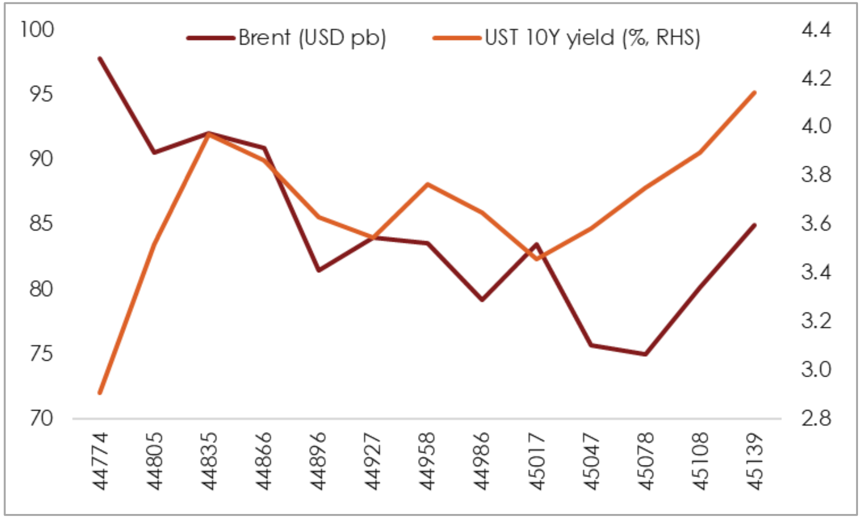
On a positive note, price pressures could be transitory as food tends to suffer from seasonal shocks, which can be expected to reverse between Sep-Dec. Administrative interventions in select food items will also help to curb price pressures on the margin.

…amidst an adverse global backdrop

US economy has been defying expectations of slowdown this year (Citibank's Economic Data Surprise Index is currently close to its highest levels in 2023).

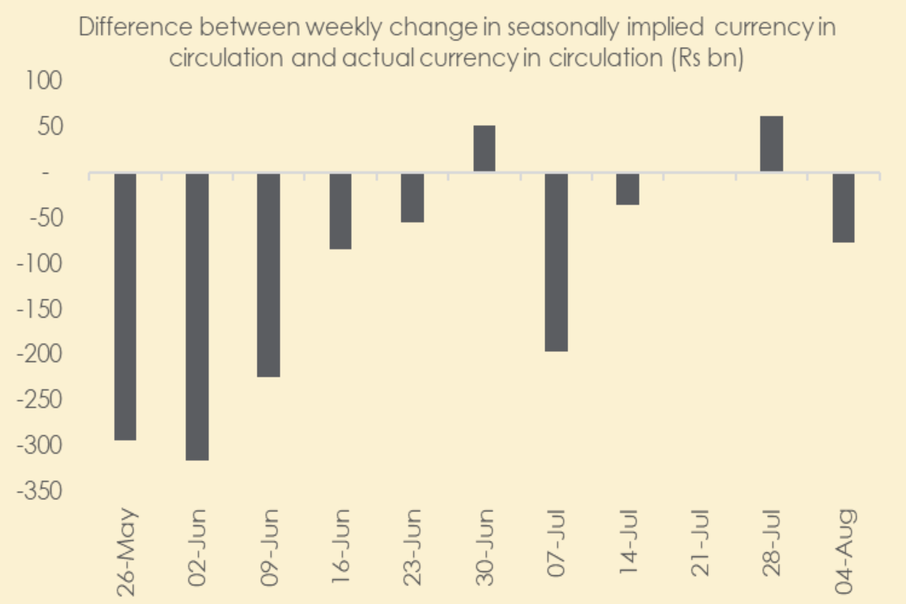


This is resulting in long term rates drifting up, with 10Y UST yield currently at its highest levels since 2007. Commodity prices, esp. crude oil, have also firmed up in response (with support from China's monetary easing and OPEC supply cuts).

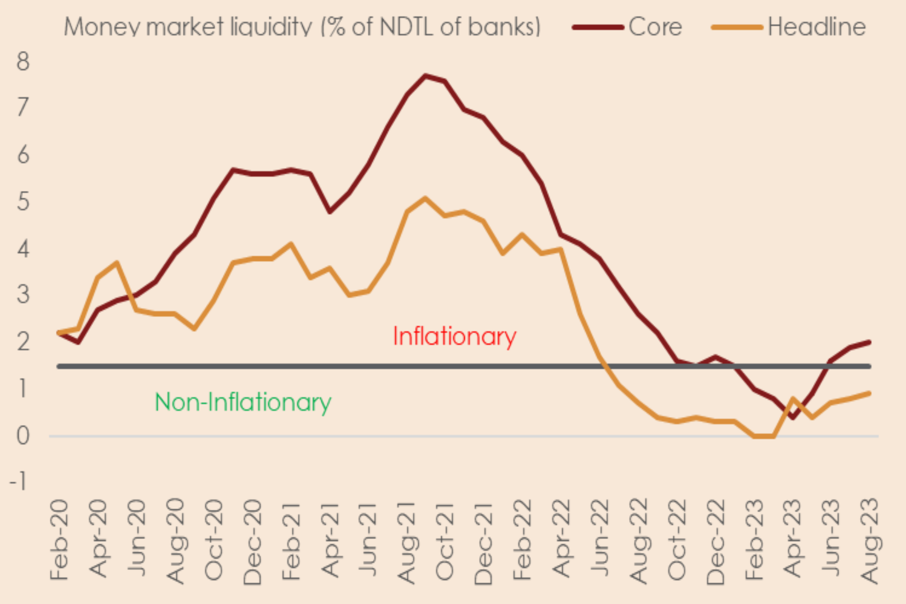


RBI to focus on curbing liquidity surplus

Due to withdrawal of Rs 2000 banknote from circulation, we estimate currency in circulation to have cumulatively declined by approx. Rs 1.6 tn on seasonally adjusted basis (between week ending Aug 4 th and week ending May 26th). The sequential weekly momentum of return of Rs 2000 banknote has tapered in recent weeks.

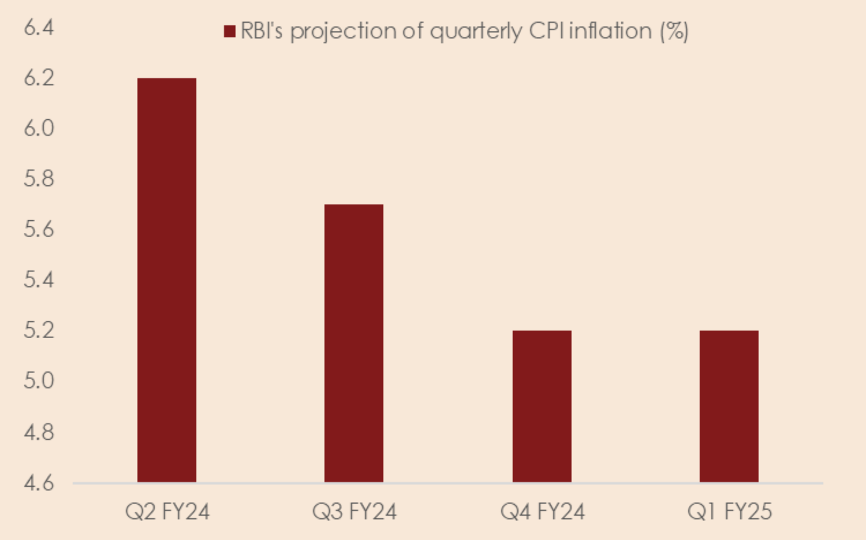


With core liquidity staying above the inflationary threshold (1.5% of NDTL) since Jun-23, the RBI announced a temporary hike in reserve requirement (I-CRR of 10% to be maintained on incremental NDTL between May 19th and Jul 28th). This will mop up Rs 0.95 tn for a 1-month period.

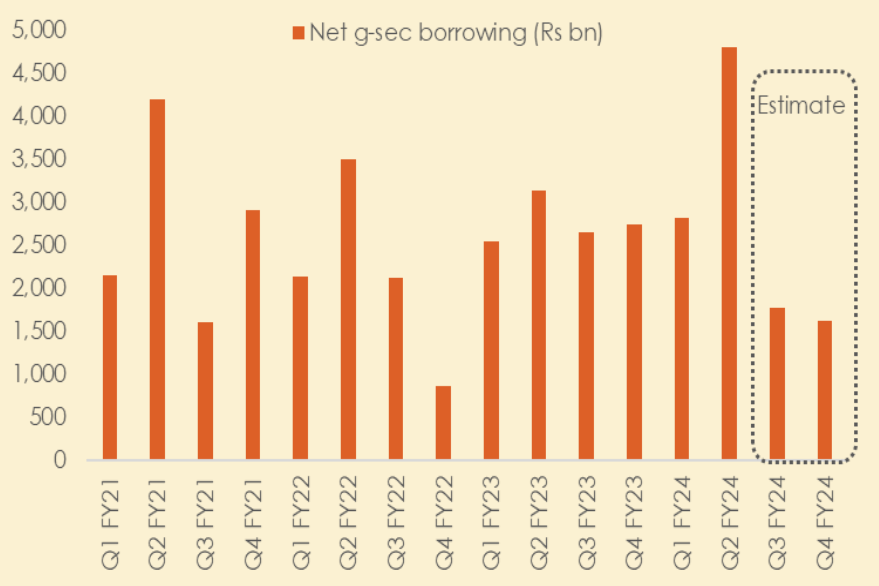


Rates outlook

RBI revised up its FY24 CPI inflation forecast to 5.4% (vs. 6.7% in FY23) from 5.1% earlier. On a quarterly basis, CPI inflation is projected to breach the 6% tolerance threshold in Q2, before moderating to 5.2% in Q4 FY24.



Although net g-sec borrowing is at its post Covid high in Q2 FY24, it is projected to decline considerably in H2 FY24.

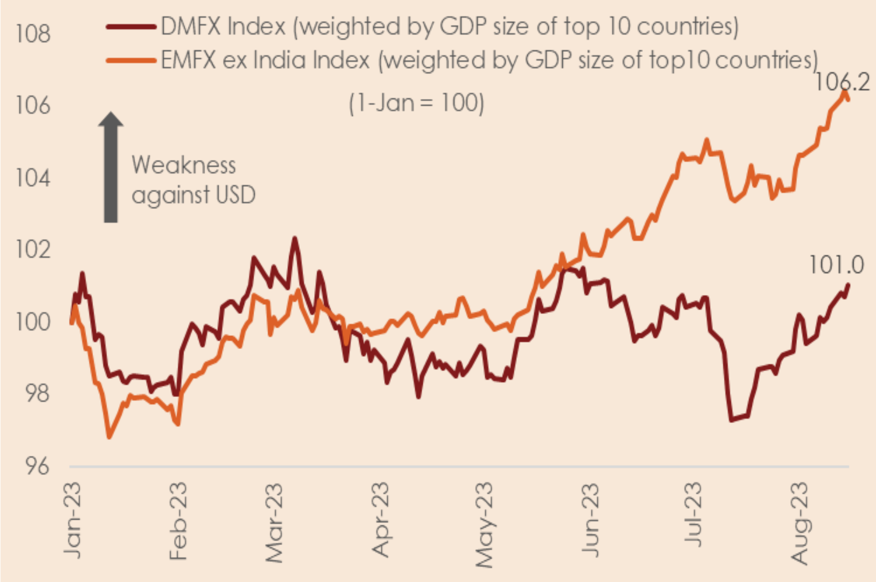


We continue to expect a prolonged pause from the MPC through FY24. Nevertheless, inflation anxiety and supply concerns could keep 10Y g-sec yield elevated in the near-term (7.20-7.30%). Going forward, **we continue to expect 10Y g-sec yield to moderate towards 7.00% by Mar-24, provided there are no fresh surprises.**

INR flirts with record low levels

USDINR is currently trading marginally above 83 levels, the weakest in rupee's history

Show of economic resilience in the US has led to a revival in dollar bullish sentiment. Over the last 2-months, this has been reflecting in case of EM currencies more prominently than DM currencies.



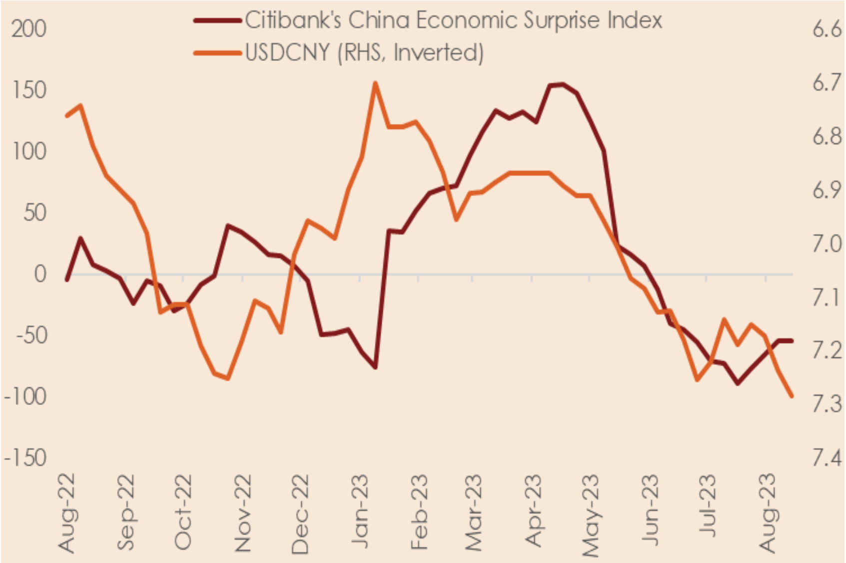
US slowdown expectations yet to fructify

Although inflation in US has been moderating along the projected trajectory, tight labor market conditions along with healthy growth in real economic indicators (Atlanta Fed's GDP nowcast model for Q3 is currently projecting a growth of 5.8% (saar* basis). This could prompt the FOMC to opt for another rate hike in Sep-23. The upcoming Jackson Hole Summit will be closely watched for cues.

FOMC Projections (median)	Jun-23
Terminal Fed Rate in 2023 (%)	5.6
Rate cuts in 2024 (bps)	100
Rate cuts in 2025 (bps)	125
Cumulative rate cuts over 2024-25 (bps)	225

Note: Current fed funds rate range is at 5.25-5.50%
*saar: seasonally adjusted annual rate

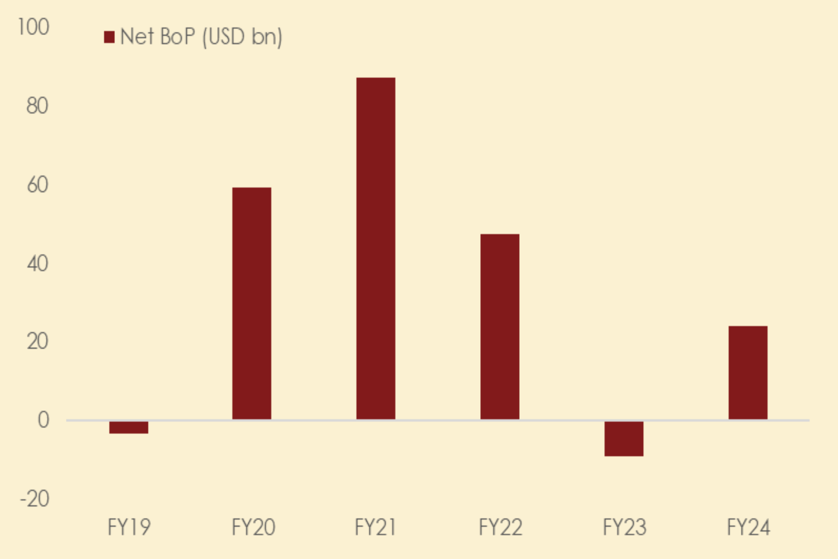
In contrast, CNY is facing depreciation pressures as expectations of a swift economic recovery post removal of Covid restrictions in end 2022 has now given way to concerns of a slowdown.

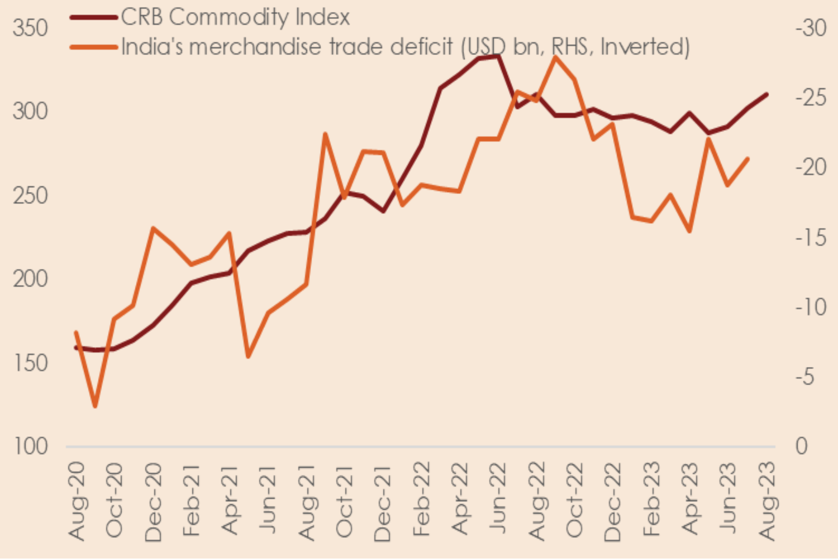


Expected BoP strength may wane due to higher commodity prices

We continue to expect current account deficit to moderate to USD 53 bn in FY24 from USD 67 bn in FY23. This is expected to result in a BoP surplus of USD 24 bn in FY24, in contrast to a deficit of USD 9.1 bn in FY23.

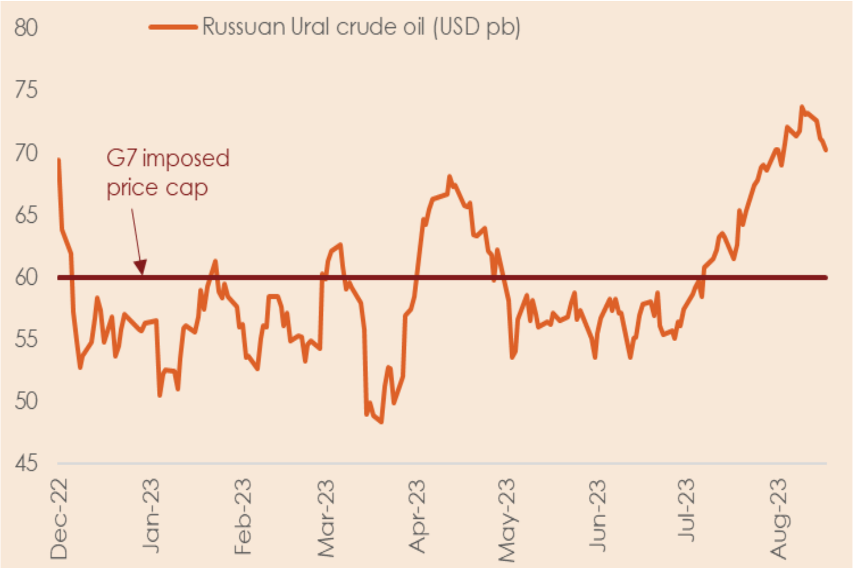
However, we need to keep a close watch on commodity prices – further hardening could potentially widen the monthly merchandise trade deficit towards USD 22-23 bn from an average of USD 19-20 bn seen so far this year..



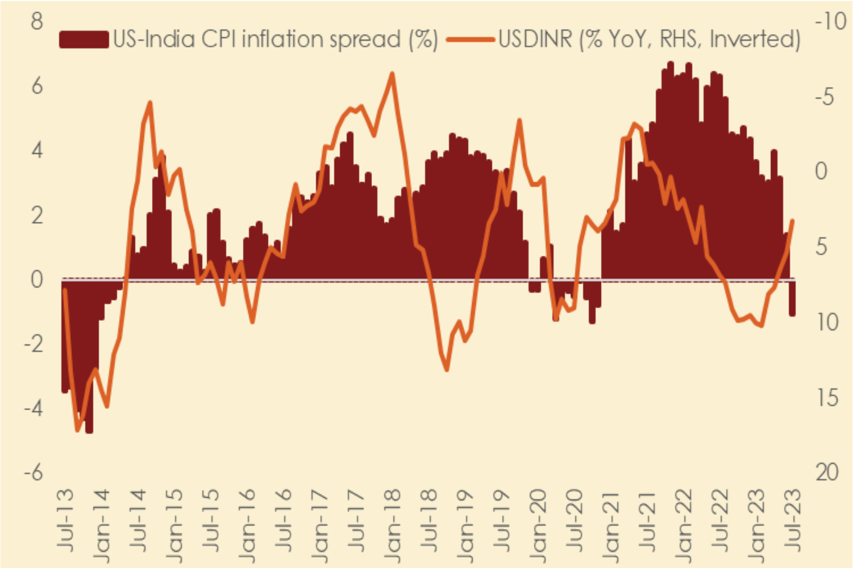


Rupee Outlook

Jump in price of Russian crude oil (above the G7 implied price cap) will erode the benefit for India's current account



With US-India inflation spread turning negative, INR could face some near-term pressure.

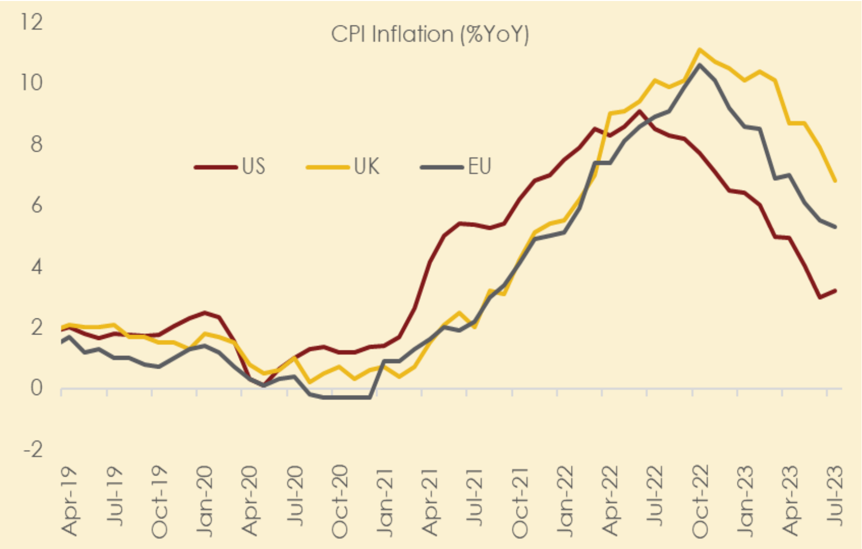


A BoP surplus and a backloaded dollar negative backdrop would support rupee in the medium term. However, near-term pressure points have emerged in the form of economic divide between US and China reflecting in a stronger USD and a weaker CNY, both individually capable of putting pressure on INR. As such, we expect INR to weaken towards 84 levels in the next 3-months. We now pare our constructive view on INR towards 82 (from 80 earlier) by Mar-24.

Commodity prices upturn could slowdown the inflation descent

Disinflation is well underway in the advanced global economies. Most measures of headline, core and sticky core inflation are now showing easing pressures.

That said, the recent upturn in commodity prices, particularly oil, can support the stickiness of above-target inflation beyond the very near term.



US growth outperformance continues...

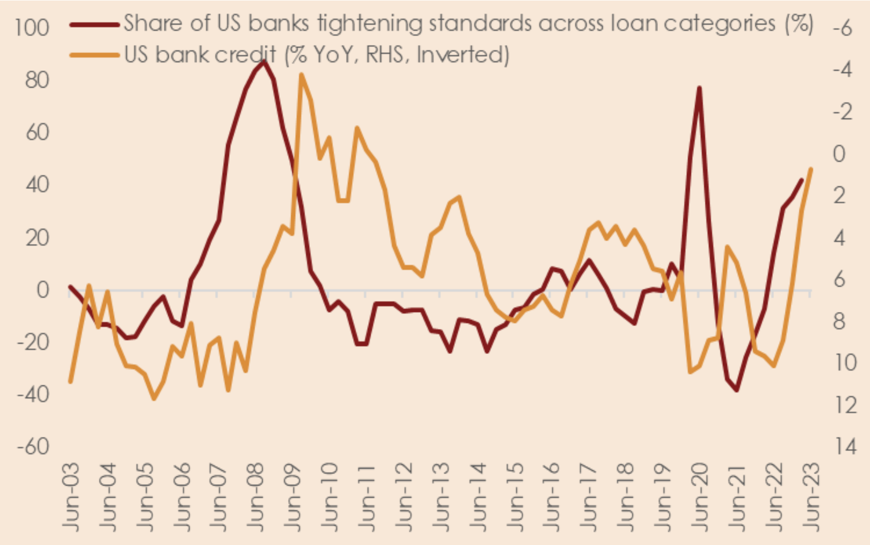
Global growth continues to show positive momentum, especially in the US where the possibility of a recession is now a fading risk.

Barring the US, economic activity in major advanced economies remains subdued. The Global PMI Composite Output Index dipped to post at 51.7 in Jul-23, down from 52.7 in June, to mark the slowest rate of expansion recorded since the global economy returned to growth in Feb-23.

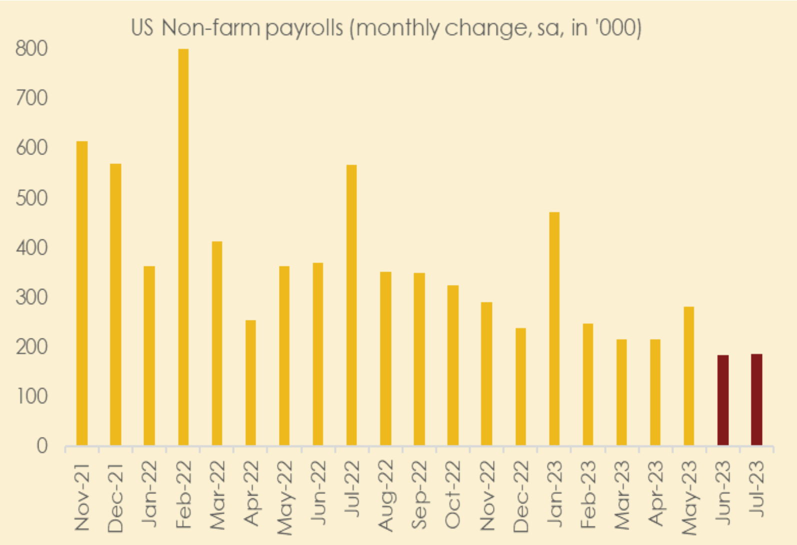
GDP growth (%YoY)						
Economies	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23
US	3.7	1.8	1.9	0.9	1.8	2.6
Eurozone	5.5	4.4	2.5	1.8	1.1	0.6
Japan	0.6	1.5	1.6	0.4	2.2	2.2
UK	10.6	3.8	2.0	0.6	0.2	0.4
Canada	3.2	4.7	3.8	2.1	2.2	
China	4.8	0.4	3.9	2.9	4.5	6.3
Korea	3.1	3.0	3.1	1.3	0.9	0.9
Brazil	2.4	3.7	3.6	1.9	4.0	
Mexico	1.9	2.2	4.4	3.6	3.7	3.7
Indonesia	5.0	5.5	5.7	5.0	5.0	5.2

…but seeds of growth moderation are gaining root

US commercial banks have started to tighten lending standards. The shadow banking crisis (that now appears to have got ring fenced), primarily centred in the US during Mar-Apr 2023, has further stoked caution, resulting in annualized bank credit growth slipping to its lowest levels in 12-years.



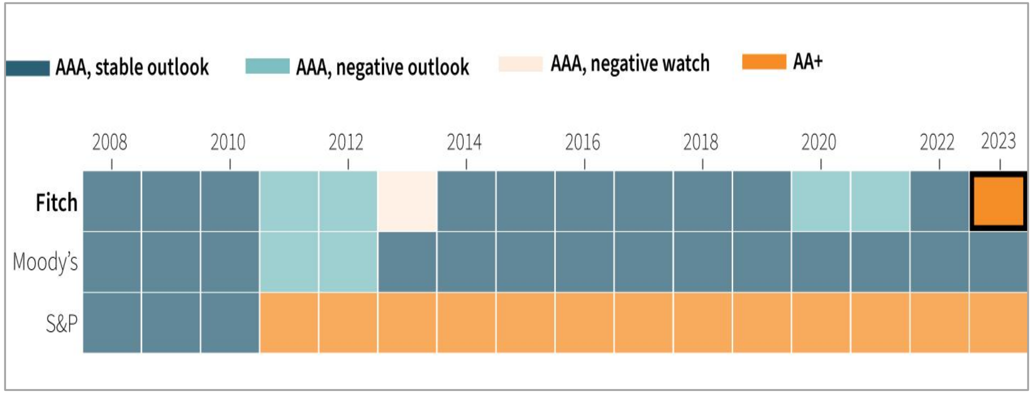
Jul-23 Non-farm payrolls mark the second straight month of below 200K additions. This is the weakest two-month performance in two and a half years and marks the sixth consecutive month of downward revisions to the previous month's estimate.



US Credit Ratings downgrade

Fitch Ratings downgraded the credit rating of the US from AAA to AA+ owing to a worsening fiscal situation, increasing US government debt burden, and decreasing governance standards.

Timeline of US credit rating



This is only the second time in US history that a credit rating agency has downgraded the country's sovereign credit rating, the other instance being in 2011 by Standard & Poor's.

Post the downgrade announcement on 1st Aug-23, US 10Y yield has hardened by nearly 35 bps, from below 4.0% to trading at close to 4.30% levels(as of 17th Aug-23)

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 9,600 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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