Macro Pulse Report

July 2023

From the desk of the Chief Economist

Dear Readers,

Greetings from Acuité Ratings & Research!

Acuité Macro Pulse (AMP), our monthly commentary on the global and the domestic economy, was first published in January 2021 and was intended to cater to a diverse set of stakeholders in the financial eco-system– namely investors, bankers, issuers or borrowers, market intermediaries and even academicians.

Over the last two and a half years, we have endeavoured to provide a comprehensive perspective on both the domestic and the global economy through this publication. In this **thirtieth** edition of **July 2023**, we have decided to revise the template of the report. The current edition and going forward, all the subsequent editions of the report will be in a PowerPoint format. This is based on the feedback that we received regarding the size of the report. In the current format, we have attempted to focus more on charts and graphs rather than text.

The overall mood of the Indian economy remains positive with the high frequency data particularly on the industrial front, coming better than expectations and the headline inflation below 5% in Q1. The PMI indices in India possibly remain the highest among the major nations with continuing resilience of domestic demand. Among the headwinds, the global slowdown is making its presence felt through exports and there is a material risk of higher food prices driven resurgence in inflation. On the other hand, there are signs of a pickup in private sector capital expenditure which has the potential to add 30-40 bps to India's GDP growth in FY24.

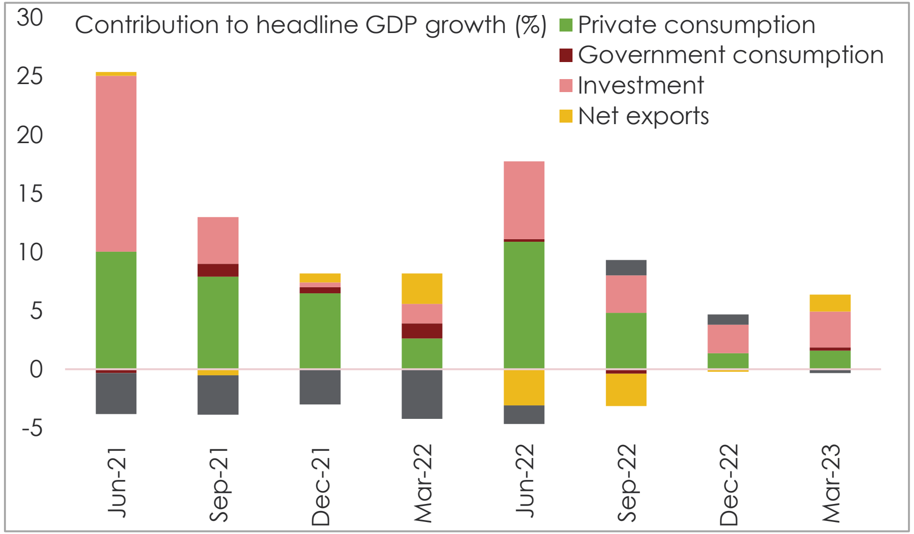
Do let us know if you have a feedback on our new format. Cheers,

Suman Chowdhury
Chief Economist & Head – Acuité Research

Economic activity: Win some, lose some

One key turnaround factor in India's GDP has been the role of net exports: its average contribution to headline GDP growth swung around from -2.9% in H1 FY23 to 0.6% in H2 FY23. With current account deficit expected to narrow in FY24, the overall support from net exports would continue.

High frequency indicators for Q1 FY24 present a mixed picture so far. We note that kharif sowing so far has not suffered from the initial delay in monsoon this year, given the largely adequate rainfall in July-23.



Key high frequency eco indicators	Q4 FY23	Q1 FY24
PMI-Manufacturing	55.7	57.9
PMI-Services	58.1	60.6
E-way Bill Generation (% YoY)	18.1	15.8
Rail freight (% YoY)	3.7	1.2
Motor Vehicle Registration (% YoY)	15.1	5.5
Petroleum Consumption (% YoY)	5.3	4.9
Infrastructure Index (% YoY)	6.9	4.3*
IIP (% YoY)	4.4	4.8*
Central government capex (% YoY)	14.4	108.4*

* Average over Apr-May

Q1 FY24 GDP growth likely to be strong

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Most multilateral agencies have upgraded their forecast for global economic growth in 2023. The intensity of the expected slowdown in developed economies have been lower than expectations. This is supported by the confidence among key central banks to continue with monetary tightening, albeit at a measured pace compared to 2022. This record degree of monetary tightening is nevertheless expected to have a lagged impact, manifesting in a loss of global growth momentum in H2 2023 vs. 2022.

Forecast for World GDP growth in 2023 by multilateral agencies	Previous	Latest
IMF	2.9	2.8
World Bank	1.7	2.1
OECD	2.6	2.7
UN	1.9	2.3
ADB*	4.6	4.8

* Forecast pertains to Developing Asia

India's Q1 FY24 GDP would benefit from (i) the delay in the expected onset of global economic slowdown, and (ii) a favorable statistical base effect.
The table below highlights statical scenarios (not our forecast) for Q1 FY24 GDP growth. We believe scenario (2) and (3) present the best and the worst-case outcomes. The RBI projects Q1 FY24 GDP growth at 8.0% YoY.

Statistical projection of Q1 FY24 GDP growth under different scenarios	YoY (%)
(1) If QoQ change = 0.0%, implying Q1 FY24 GDP base remains unchanged vs. Q4 FY23	16.5
(2) If QoQ change = -4.7% (series average excluding Covid impact), implying an average seasonal behaviour for Q1 FY24 GDP	11.0
(3) If QoQ change = -9.0%, implying same impact as seen in Q1 FY23	6.0

Note: GDP growth in Q1 and Q4 of FY23 was recorded at 13.1% and 6.1% on YoY basis, respectively. We expect Q1FY24 GDP growth in the range of 6.5%-7.5% YoY.

Reasons to be optimistic on growth

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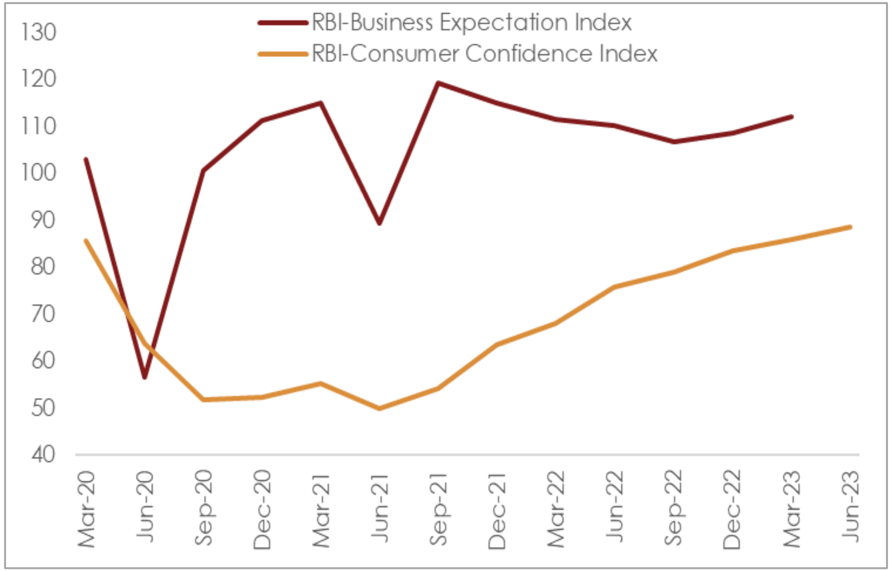
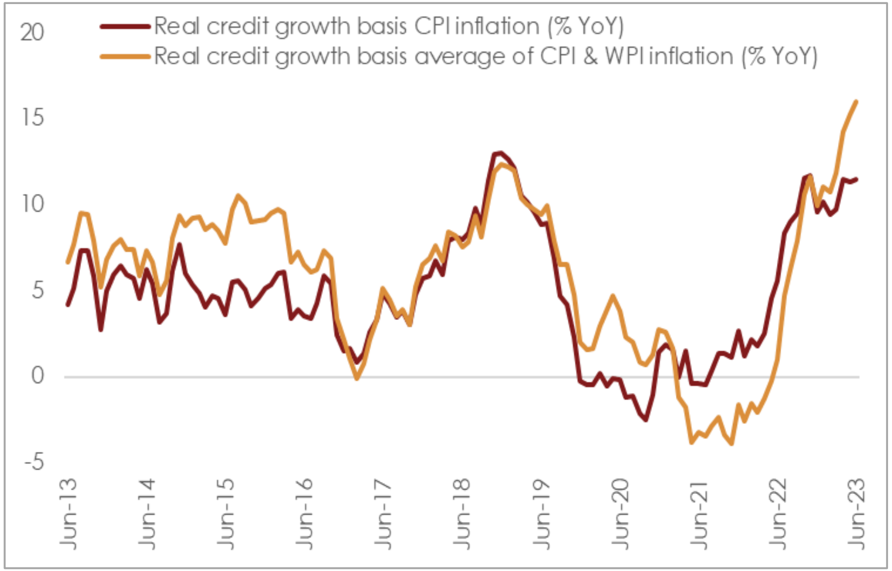
Business and consumer sentiments have seen a consistent uptrend in Q1. Notably, the consumer confidence index (as compiled by the RBI) has now exceeded its pre Covid levels.

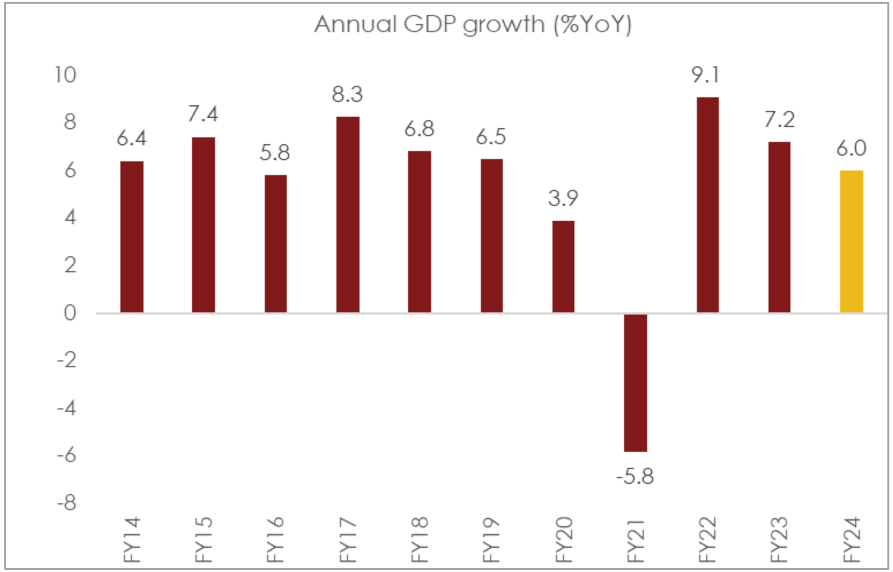


Adjusted for inflation, real bank credit growth is currently running at its highest levels in the last 10-years. Ebbing of twin balance sheet concerns has boosted credit appetite along with the post pandemic economic recovery.



Factors weighing on FY24 GDP growth

Overall, we continue to expect FY24 GDP growth to moderate to 6.0% (with a potential upside of 30-40 bps) 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
- Gradual erosion of pent-up demand (esp. in services)
- Lagged impact of domestic monetary tightening curbing leveraged urban demand
- Likelihood of some disruption to monsoon performance from the emergence of El Nino

-1.6%

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

315 bps

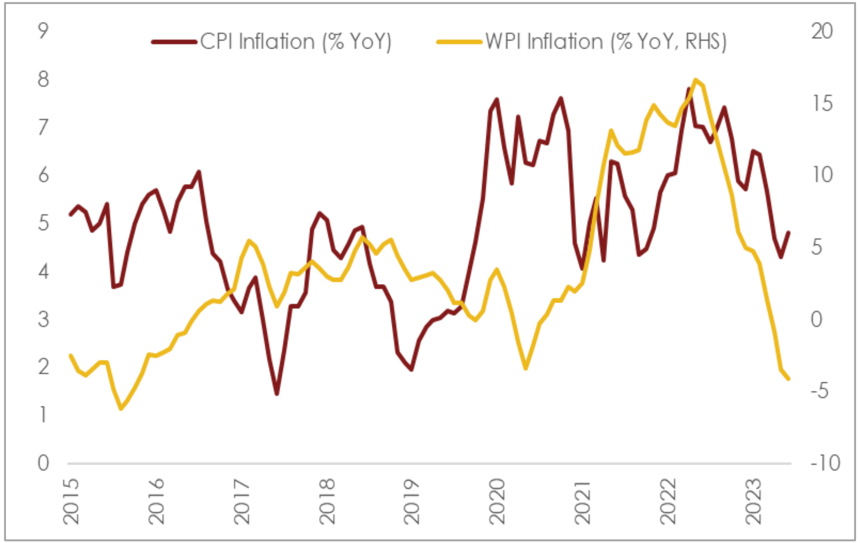
- Effective rate hike done by the RBI between Apr-22 and Feb-23#

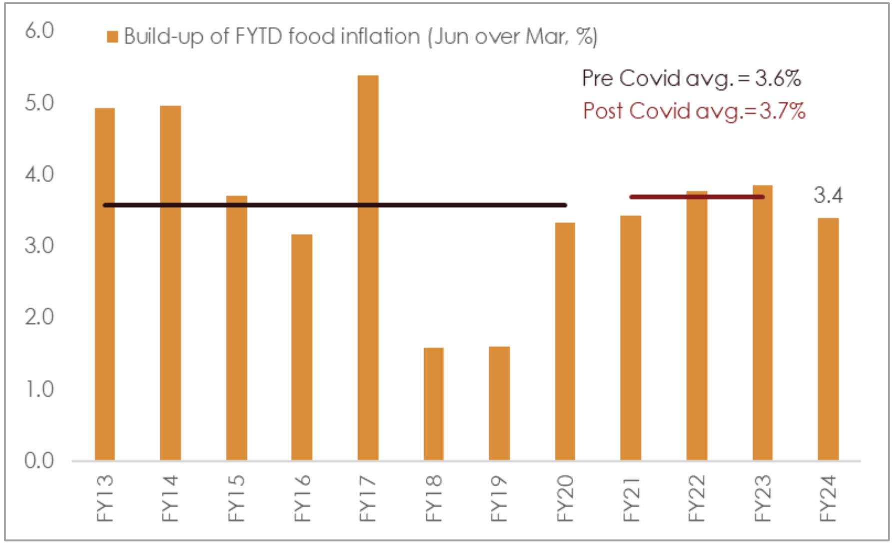
* Time period: 1995-2021 # This is the total difference between the earlier fixed reverse repo rate and the current repo rate.

Inflation:
Remains comfortable despite near term risks

CPI inflation accelerated to 4.81% YoY in Jun-23 from 4.31% in May-23. Notwithstanding the jump, this is the 4 th successive instance of CPI inflation printing within RBI's policy target band of 2-6%. Meanwhile, Core CPI inflation decelerated to a 20-month low of 5.4% YoY in Jun-23, while the deflation in WPI intensified to -4.12% YoY in Jun-23 from -3.48% in May-23.

Build-up in retail food inflation in the current season has been marginally lower compared to average historical experience. Pre-monsoon showers in select regions and continued decline in price of cereals and edible oils played a key role. However, vegetables, spices and protein items sprang a strong sequential jump.

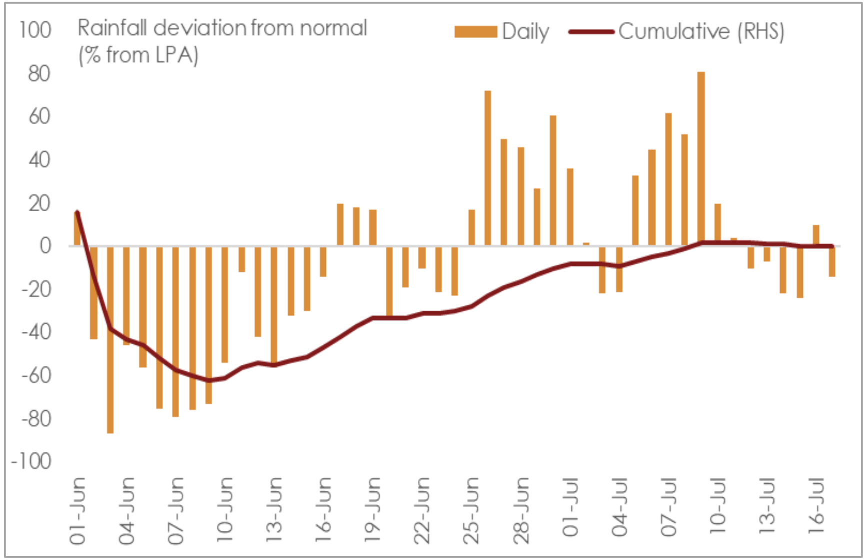


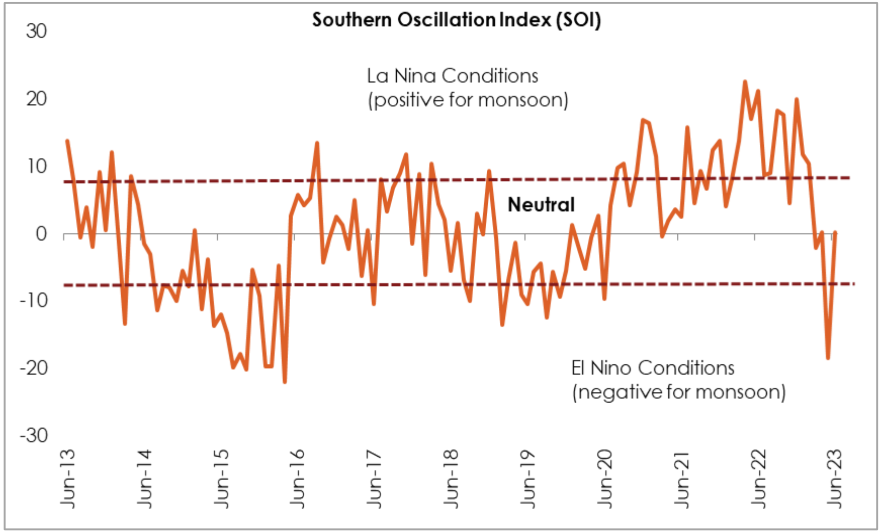


Climate risks on watch

Post a delayed onset and a weak start, rainfall has picked up momentum in July. Month of June clocked a deficit (vs. the long period average) of 10%. The cumulative rainfall deficit has got wiped out thereafter (by third week of July). IMD expects rainfall to be 'normal' in Jul-Aug.

El Nino risks remain on 'alert', recent prints of SOI suggest a move from neutral conditions. We will monitor this closely and review the situation by end July. Meanwhile, as per high frequency signals, price pressures have begun to mount for items like tomatoes, ginger, chilly and pulses.





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

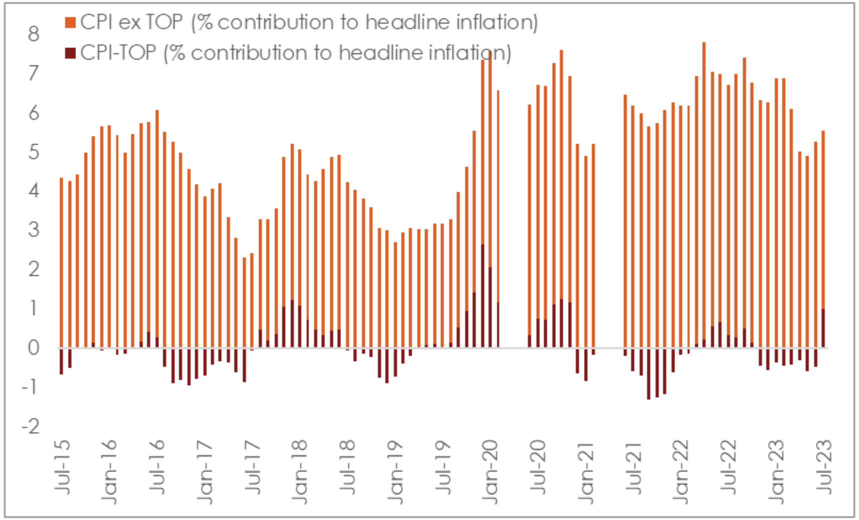
Bracing for near term volatility in food inflation

Erratic weather conditions coupled with delayed start to the monsoon season has led to a spike in tomato prices. The TOP (tomato, onion, and potato) vegetable items usually have a short cropping cycle and is susceptible to rainfall disruption. While tomato prices have shown a significant jump compared to usual summer/ monsoon seasonality, onion and potato prices have undershot their seasonal price jump so far – this will help in partially offsetting the overall impact on headline inflation.

Buildup of TOP inflation during monsoon season (Jul over May)	2023 (%)	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 for Jul-23 captures data until 17 th July , (2) Figures in parenthesis indicate weight in CPI basket.

While TOP has a cumulative weight of 2.2% in CPI basket, it is a source of significant price volatility. If TOP prices remain unchanged at current levels, then CPI inflation could potentially touch 5.5% levels in Jul-23 (providing upside risk to RBI's forecast of 5.2% for Q2 FY24) from 4.8% in Jun-23. Since TOP prices generally tend to correct over Aug-Sep, the overall adverse impact could be transient.



We expect CPI inflation to moderate in FY24

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Drivers of FY24 inflation

Amidst expectation of normal monsoon and lower global food prices, domestic food inflation could see price pressures ease in FY24

Slowdown in global growth in 2023 to keep upside in commodities prices in check, including crude oil.

Core-goods to see some disinflation as pent-up demand fades and leveraged consumption becomes costlier

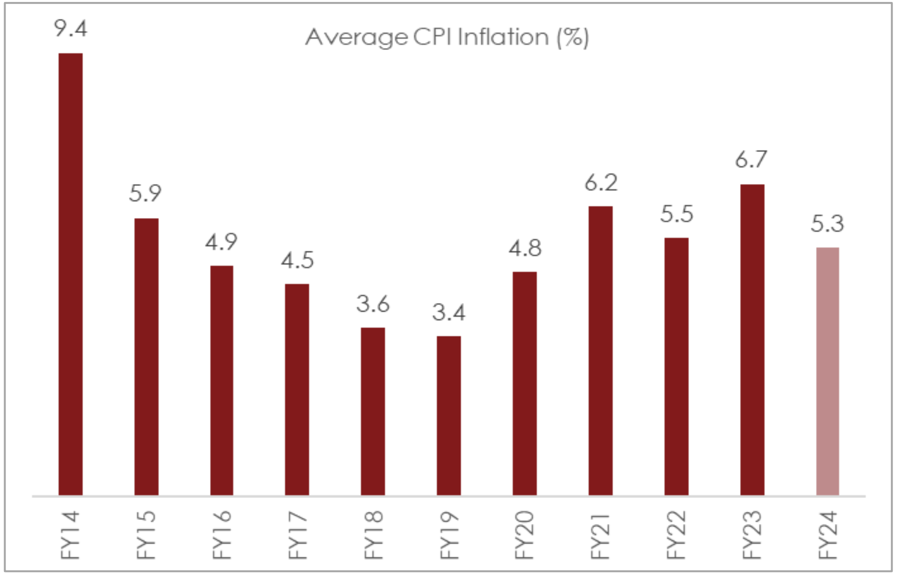
Upside risks to watch

Escalation of geopolitical tensions and the impact of OPEC+ decision to cut production, taking crude higher.

Extent of impact of the El Nino on the monsoon, which could add to food price pressures.

Core inflation showing stronger than anticipated downward rigidity due to continued traction in services sector.

Overall, we continue to maintain our FY24 CPI inflation forecast of 5.3%, down from 6.7% in FY23. Our forecast incorporates the impact of MSP hike (approx. 10-15 bps) but so far excludes the tail risk of a full blown El Nino disruption to monsoon, which as of now remains unpredictable.



Snapshot of Apr-May FY24 fiscal performance

The FYTD (Apr-May) accretion to fiscal deficit stood at 11.8% of budget estimates (BE) for FY24 – same as that seen in the corresponding period in FY23. However, the internal difference in FY24 stems from: (i) moderation in tax revenue collection, (ii) higher momentum in non-tax revenue, (iii) subdued start to divestment, (iv) and a relatively better composition of spending.

Key Fiscal Variables (Cumulative position, Apr-May)				
	% of FY Actual/Target		%YoY	
	FY23	FY24	FY23	FY24
Revenue Receipts	15.0	15.7	2.0	15.7
Net Tax	14.7	11.9	31.7	-9.6
Non-Tax	17.2	44.6	-57.7	173.4
Non-Debt Capital Receipts	34.7	3.6	420.0	-88.0
Total Receipts	**15.5**	**15.3**	**7.6**	**8.9**
Revenue Expenditure	13.9	13.1	15.3	-4.3
of which, Interest Payments	11.4	10.2	19.0	5.0
of which, Major Subsidies	11.3	14.8	-42.9	54.5
Capital Expenditure	14.5	16.8	70.1	56.7
Total Expenditure	**14.0**	**13.9**	**22.6**	**6.9**
Fiscal Deficit	**11.8**	**11.8**	**-**	**-**

Revenues: Signs of a slowdown in taxes

Gross tax collection contracted by a 1.6% YoY over Apr-May FY24, significantly undershooting the pre pandemic medium-term trend and posting its worst performance in the post Covid recovery phase. Its performance got weighed down by collections from corporate tax and excise duties. While first 2-months offer a sparse sample for inference, it nevertheless warrants close monitoring.

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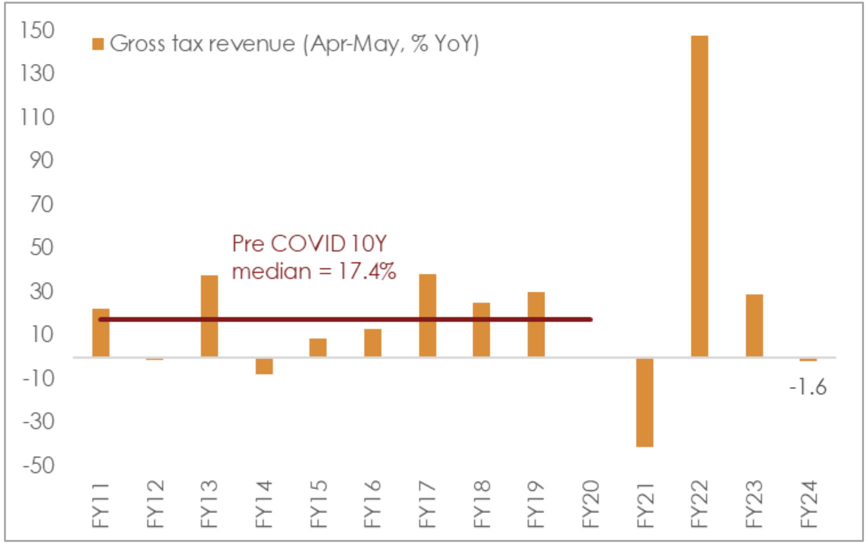
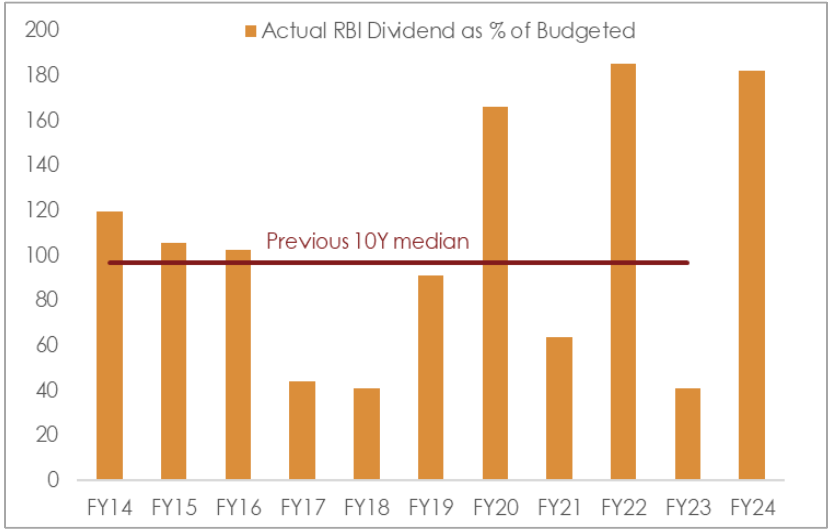
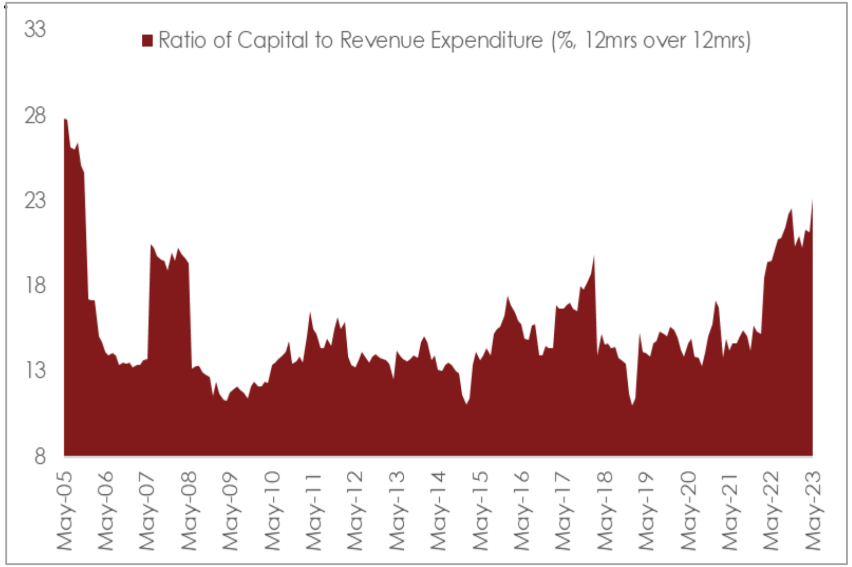


Compensating for the moderation in tax collection is non-tax revenue, which found significant support from RBI's dividend transfer this year (Rs 874 bn vs. budgeted target of Rs 480 bn that includes dividend from other financial institutions). However, divestment activity has been on a slow start (Rs 42 bn in Q1 FY24 vs. Rs 246 bn in Q1 FY23) and may not see much traction in a pre-election year.



Expenditure quality improves; risks neutral for now

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 a scale up of rural spending owing to El Nino risks) could moderate the pace of improvement in quality of spending in H2 FY24.



On average basis, El Nino disrupts agriculture production relatively more than food inflation (where risks get mitigated via administrative interventions). A disruptive El Nino this year could put pressure on the government to increase rural spending (which is budgeted to contract by 16.6% in FY24).

	Average CPI Food Inflation (%)	Average Agricultural GVA Growth (%)
El Nino with IOD Negative	6.6	-0.2
El Nino with IOD Neutral	6.6	-2.4
El Nino with IOD Positive	5.2	-1.0

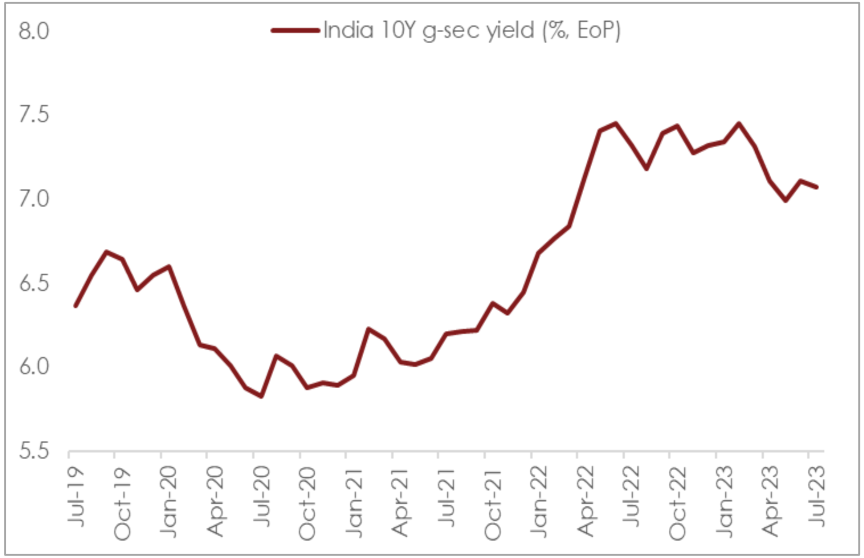
Note: Indian Ocean Dipole (IOD) is defined as the difference between the sea surface temperature of the western and the eastern Indian Ocean. If the temperature in the west is greater than that of the east, it leads to more rainfall in India (Positive IOD) and vice-versa. IOD can either aggravate or weaken the impact of El Niño on Indian monsoons.

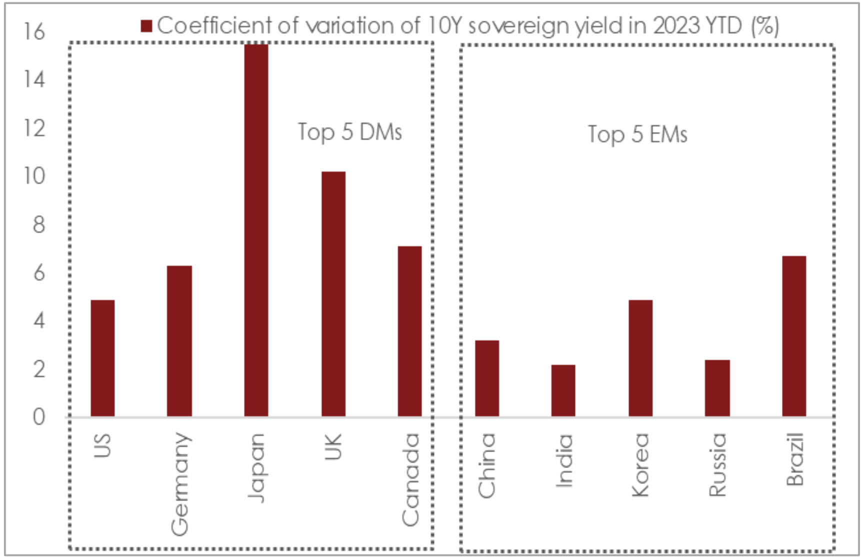
We continue to expect the central government to meet FY24 headline fiscal deficit target of 5.9% of GDP with risks appearing neutral at this stage.

G-sec yields in consolidation mode

India's 10Y g-sec yield has been trading in a narrow range in FY24 so far. However, the yield has risen from its recent low of 6.96% in May-23 to a near term high of 7.16% (moderating thereafter slightly) on account of pressure from global yields, domestic food price uncertainty on account of El Nino, and record high g-sec supply.

However, the relative volatility remains extremely low compared to key developed and emerging market economies. This in our opinion manifests overall macroeconomic and policy stability.

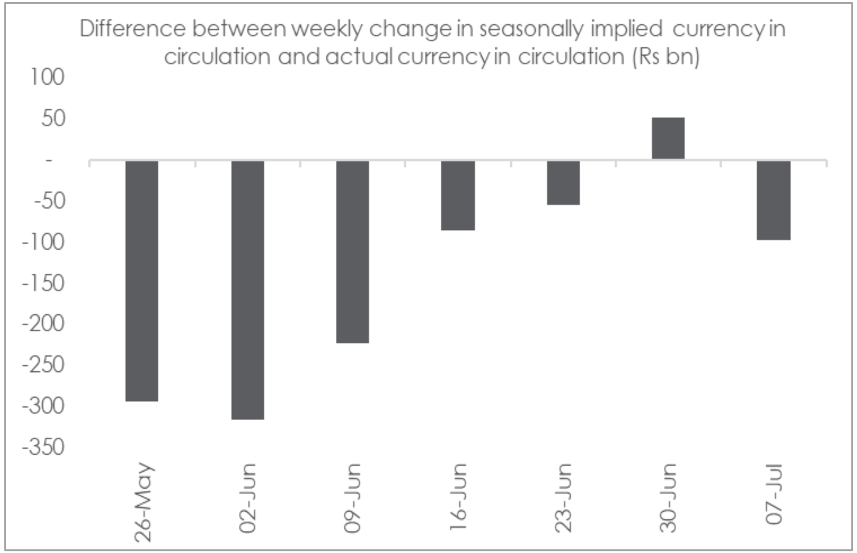


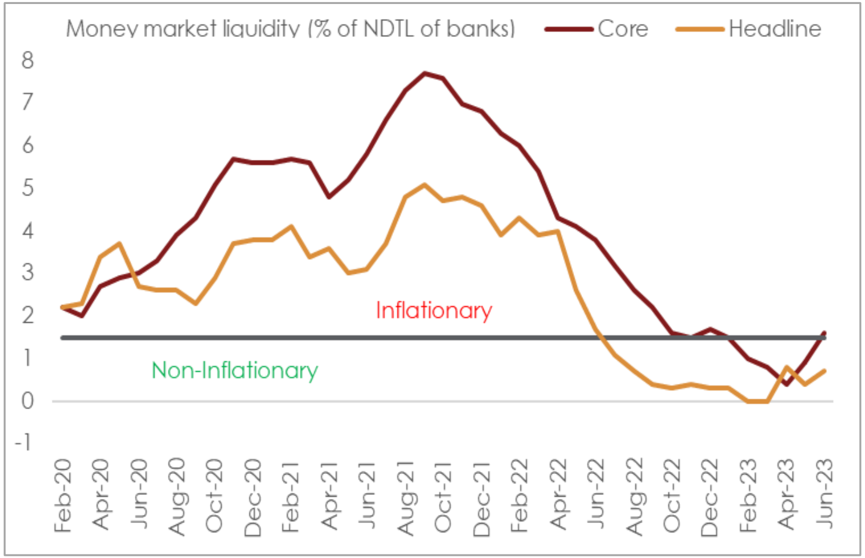


Adroit liquidity management by RBI to continue

Due to withdrawal of Rs 2000 banknote from circulation, we estimate currency in circulation to have cumulatively declined by approx. Rs 1.4 tn on seasonally adjusted basis (between week ending Jul 7 th and week ending May 26). The sequential weekly momentum of return of Rs 2000 banknote has tapered in recent weeks.

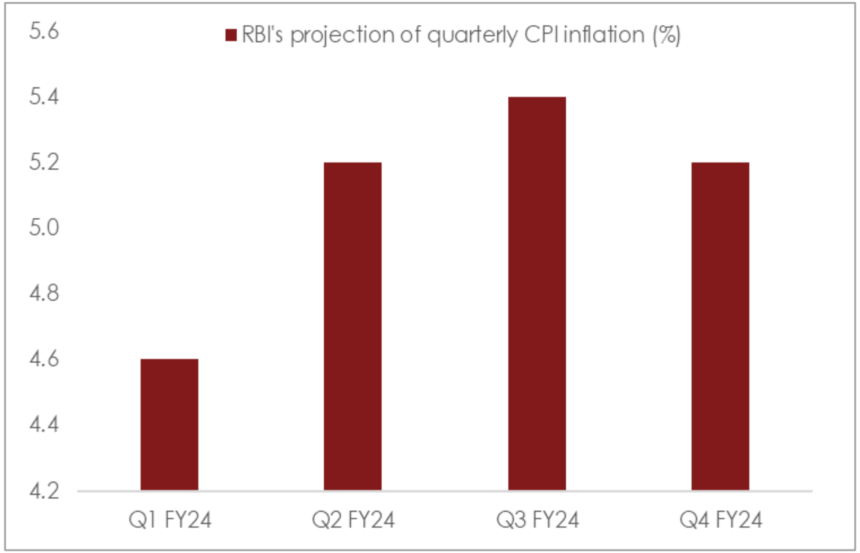
So, far, the RBI has been sterilizing the liquidity impact of withdrawal of Rs 2000 banknote by relying upon variable rate reverse repo auctions (VRRR). If liquidity surfeit persists or strengthens, then usage of sell/buy FX swaps could become an additional policy tool for sterilizing liquidity to ensure it remains in anti-inflation mode.



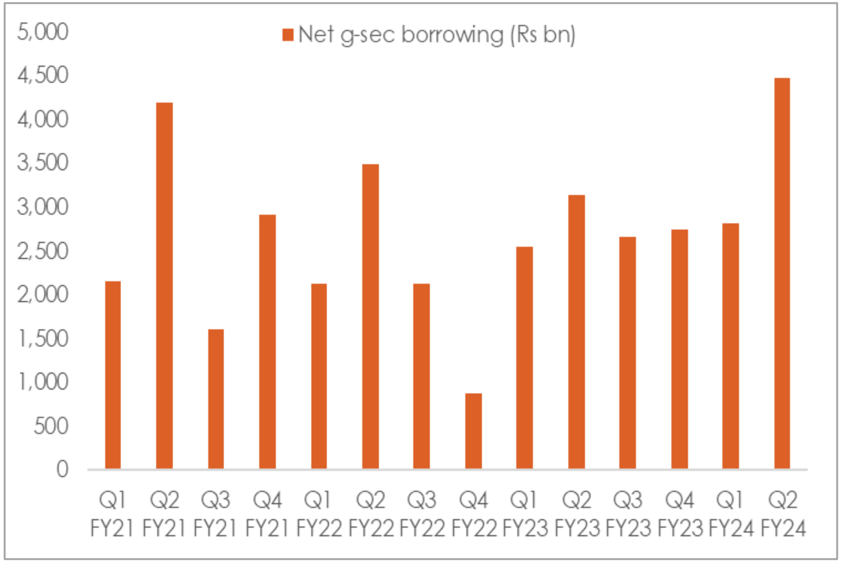


Largely Stable outlook on Rates

RBI projects CPI inflation to moderate to 5.1% in FY24 from 6.7% in FY23. Bulk of this moderation is front-loaded. On quarterly basis, CPI inflation is projected to increase in both Q2 and Q3 of FY24, before moderating somewhat in Q4.



As per the g-sec borrowing calendar, Q2 FY24 will see the largest quantum of net borrowing (at Rs 4.5 tn) in the post pandemic period.

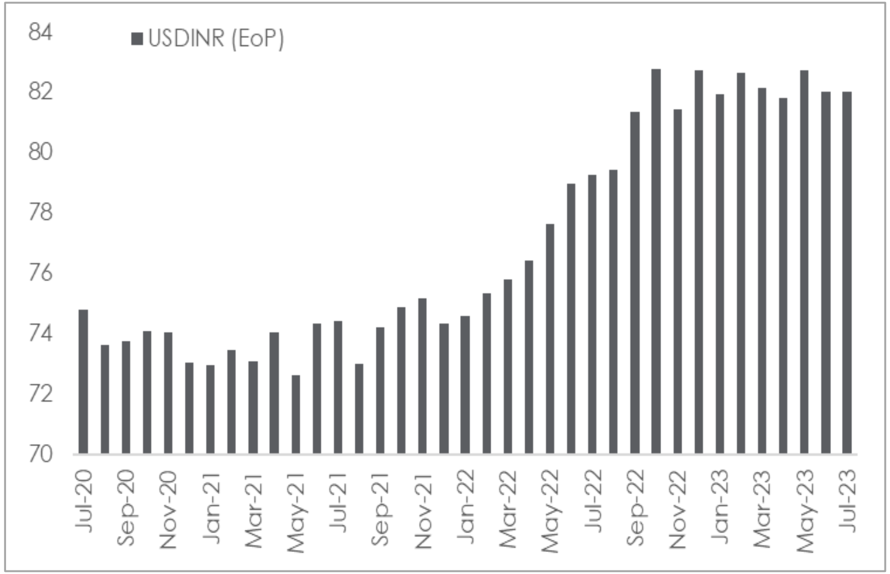


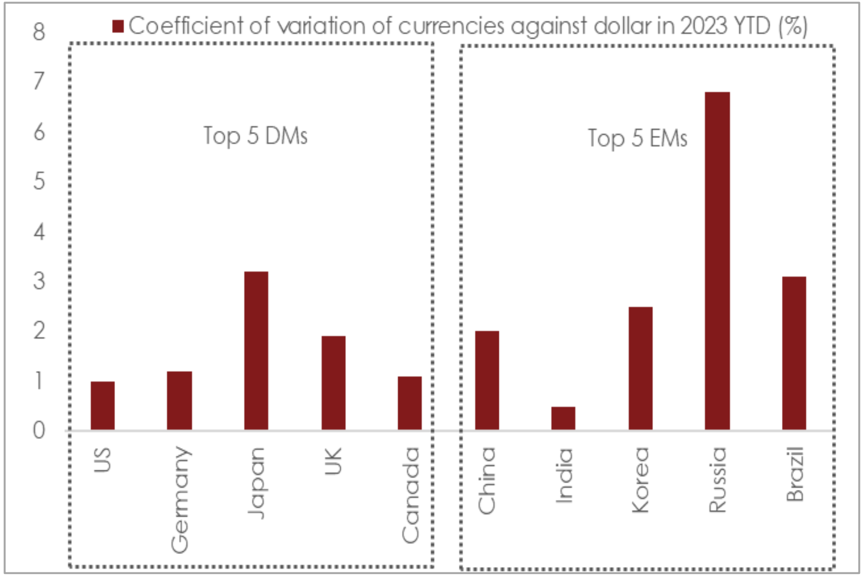
We continue to expect a prolonged pause from the MPC. While the sight of end of rate hikes is comforting for bonds, supply concerns and monsoon related risks could provide some further upside (potentially towards 7.25%) in the near-term. Nevertheless, we **continue to expect 10Y g-sec yield to moderate towards 7.00% (with some downside risk) by Mar-24**.

Consolidation of INR in a narrow range

For the past 8-months, the Indian rupee has been trading in a narrow range of 81-83 against the US dollar. The currency has remained stable in FY24 so far (appreciating by a modest 0.2%) and is currently trading close to 82.04 levels.

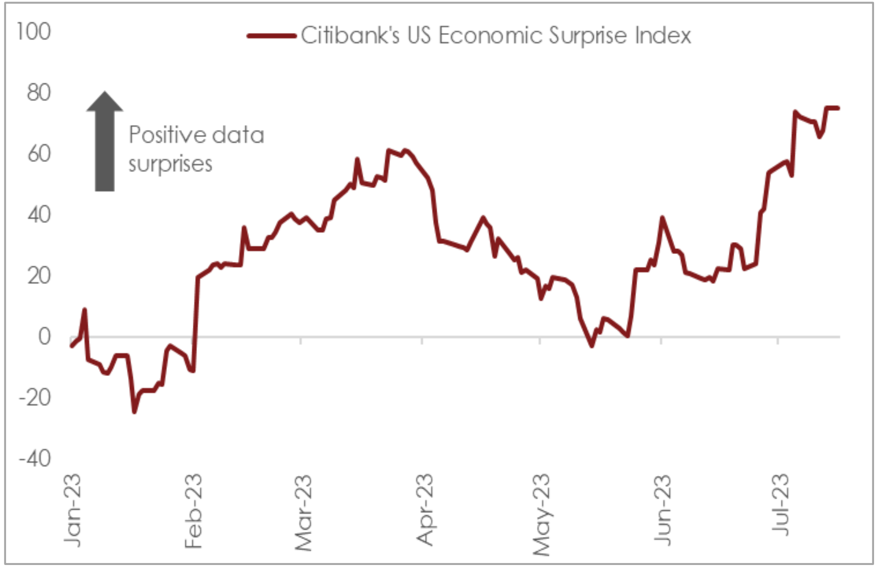
The relative volatility remains extremely low compared to key developed and emerging market economies. Similar to stability in domestic yields, this in our opinion manifests overall macroeconomic and policy stability.





US slowdown expectations yet to bite

On aggregate basis, US economic data continues to surprise on the upside.

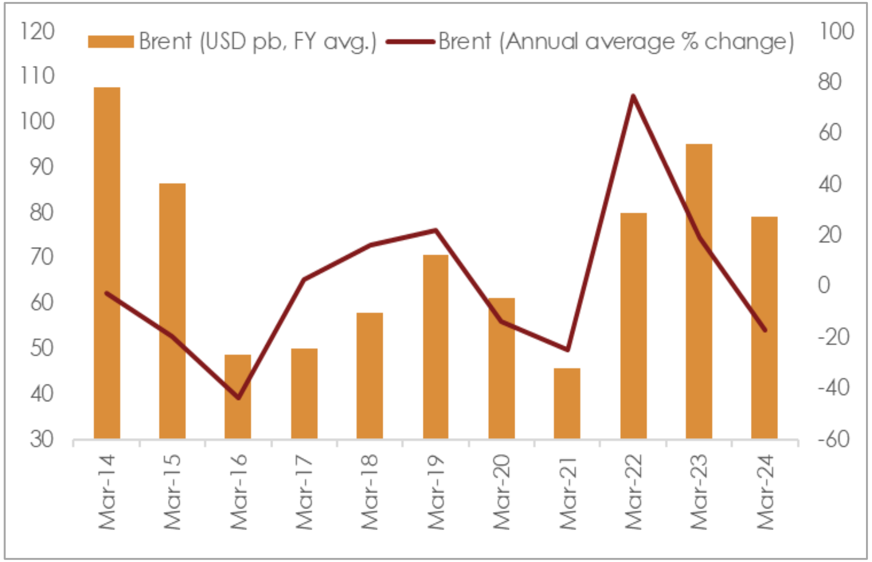


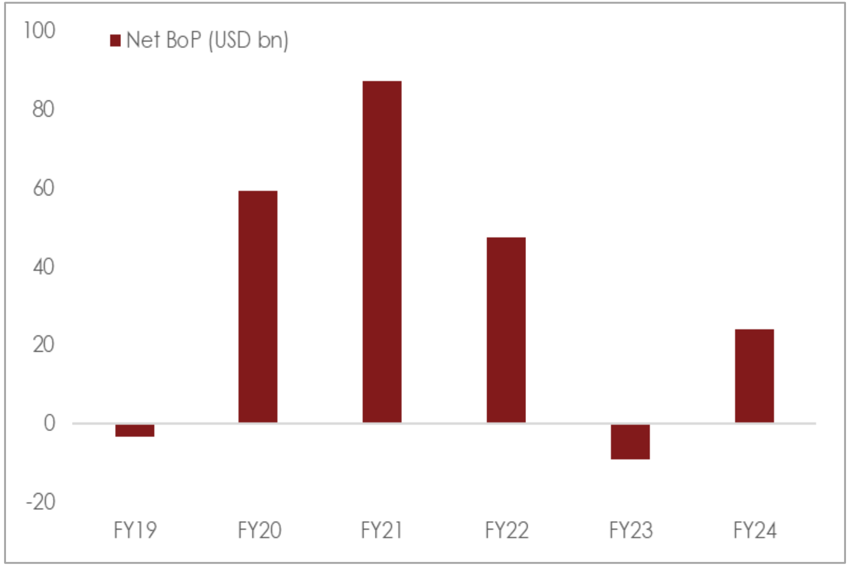
US economy continues to be marked by tight labour market and sticky core inflation. This has resulted in expectation of additional 50 bps rate hike from the Fed, thereby providing some tailwind to the USD. However, with Fed likely to lead the rate cutting cycle in 2024, USD could face a cyclical pressure.

BoP to provide support in FY24

Most global commodity prices have softened in Q1 FY24. Price of Brent crude averaged at USD 78 pb in Q1 FY24 vs. its average of USD 95 pb in FY23. Taking oil price futures as a guide, the projected average annual price for FY24 is currently tracking USD 79 pb, down 17% vis-à-vis FY23 levels.

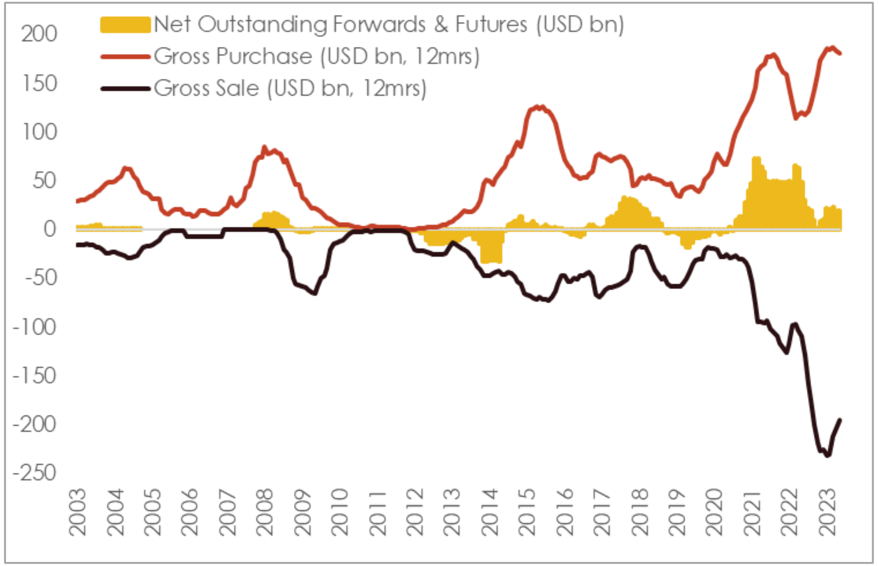
Lower commodity prices along with expected moderation in domestic demand, resilience in invisibles, and revival in appetite for Indian financial assets by FPIs is expected to result in a BoP surplus of USD 24 bn in FY24, in contrast to a deficit of USD 9.1 bn in FY23.



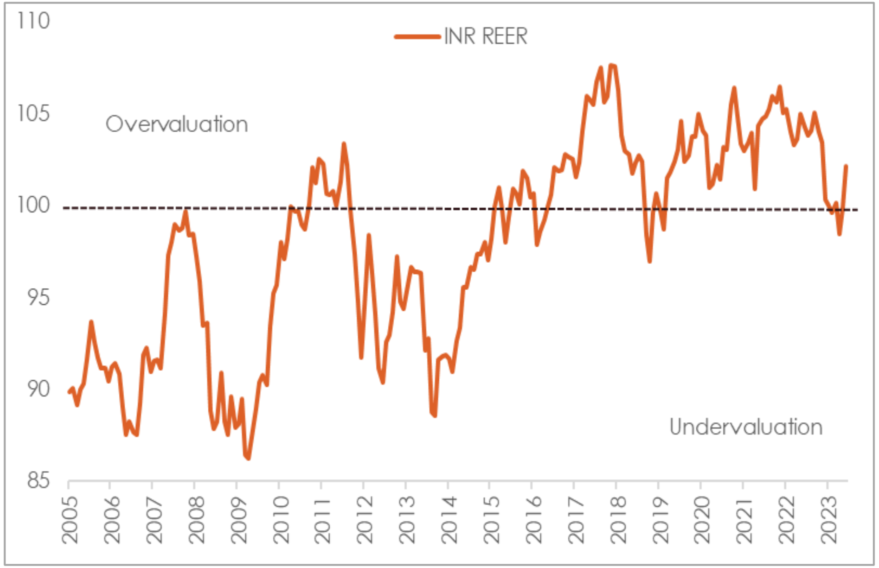


Outlook on the INR

RBI is likely to continue to with two-sides intervention to reduce INR volatility.



Rupee's outperformance in recent months vs. its trading partners has given rise to moderate overvaluation on REER basis. This could make RBI somewhat tolerant of a mild weakness in INR in the near-term.



With expected improvement in BoP and a backloaded dollar negative backdrop, we continue to expect rupee to strengthen moderately, with USDINR forecast of 80.0 by Mar-24. However, a mild weakness in the near-term cannot be ruled out.

Has global growth troughed?

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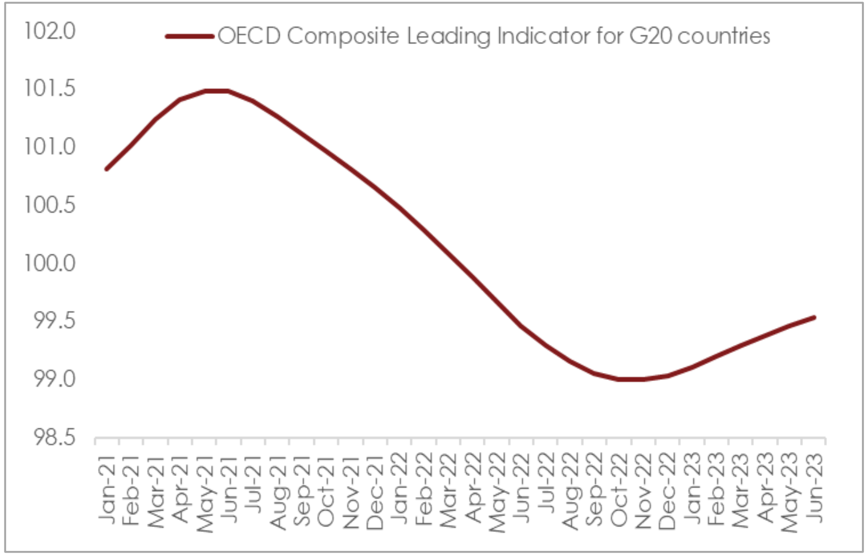
In the post pandemic recovery phase, global growth was at its weakest during Q4 2022. While weakness lingered somewhat in Q1 2023, there is evidence of some increase in growth momentum across key economies.

OECD's composite leading indicator for G20 countries shows further improvement in economic activity in Q2 2023.

Economies	GDP (% YoY)				
	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23
US	3.7	1.8	1.9	0.9	1.8
Eurozone	5.5	4.4	2.5	1.8	1.5
Japan	0.6	1.5	1.6	0.4	1.8
UK	10.6	3.8	2.0	0.6	0.2
Canada	3.2	4.7	3.8	2.1	2.2
China	4.8	0.4	3.9	2.9	4.5
Korea	3.1	3.0	3.1	1.4	1.0
Brazil	2.4	3.7	3.6	1.9	4.0
Mexico	1.9	2.2	4.3	3.7	3.7
Indonesia	5.9	7.6	5.4	1.1	1.2



Global signals are mixed

Sovereign yield curve in US is deeply in negative (with 10-2Y spread currently at -94 bps). Moreover, it's been negative for 13-months in a row – the longest period in over 2-decades. This suggests a subdued economic outlook for US in the medium term.

Nevertheless, inflation concerns in the near-term continue to dominate policy focus. The FOMC has projected two more rate hikes in 2023. While this is putting pressure on short-term rates in the US, we note that FOMC projection of cumulative rate cuts over 2024-2025 has gone up from 200 bps in Mar-23 to 225 bps in Jun-23. This is likely to be comforting after the terminal fed rate is attained (we expect the Fed to deliver its final round of 25 bps rate hike by Sep-23).

FOMC Projections (median)	Mar-23	Jun-23
Terminal Fed Rate in 2023 (%)	5.1	5.6
Rate cuts in 2024 (bps)	75	100
Rate cuts in 2025 (bps)	125	125
Cumulative rate cuts over 2024-2025 (bps)	200	225

Note: Current fed funds rate range is at 5.00-5.25%

Fiscal-monetary policy mix not in sync in key DMs

In a bid to fight inflation, key central banks in DMs have not just taken their monetary policy rate to pre pandemic levels in an aggressive manner over the last one and a half years but have also indicated room for further tightening in H2 2023.

In contrast, fiscal policy remains accommodative compared to pre Covid levels. It should be noted that sequentially, fiscal policy is expected to turn accommodative in 2023 for key economies like US and Eurozone. This is one of the reasons behind the delay in the anticipated slowdown in global growth, which is also resulting in inflation remaining elevated and stubborn.

Central Bank	Post Covid rate hike (bps)	Rate hike priced in for H2 2023 (bps)
Federal Reserve	500	31
ECB	400	52
BoJ	0	2
BoE	490	110

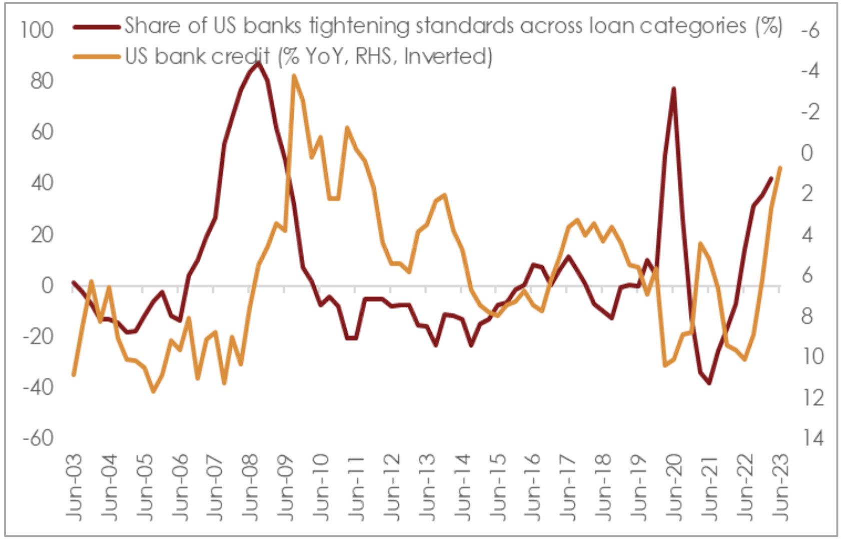
Note: Pricing of rate action by central banks for H2 2023 is as implied by respective interest rate futures.

General government structural balance (% of potential GDP)	2019	2020	2021	2022	2023
US	-6.0	-10.7	-10.7	-5.9	-6.6
Eurozone	-0.5	-4.0	-3.8	-2.8	-3.1
Japan	-3.3	-8.1	-6.2	-7.8	-6.4
UK	-1.6	0.8	-3.6	-4.5	-4.3

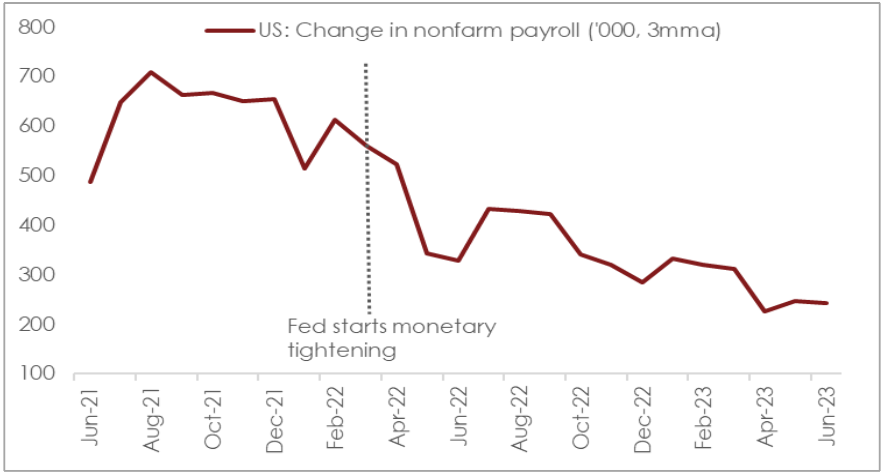
Note: Compilation and projection of data done by IMF

Nevertheless, growth moderation setting in…

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. Gradual credit tightening…



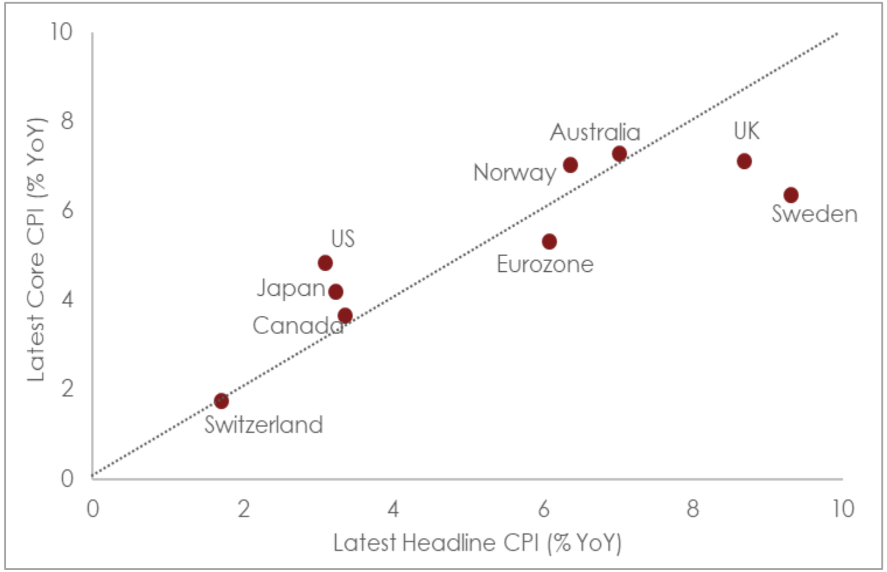
…will further moderate the pace of job creation in the US, thereby relieving the labour market from the current tight conditions. We note that change in nonfarm payroll in US printed at 209k in Jun-23, the lowest in the post pandemic recovery phase.



Change in NFP (monthly avg, '000)	2019	2020	2021	2022	2023
	163	-774	606	399	278

…which should help moderate inflationary pressures

Despite record pace of monetary tightening, headline inflation remains elevated (notwithstanding the decline from their 2022 peak) with stickiness in core. However, lagged impact of monetary tightening…



…along with decline in most commodity prices would help lower inflationary pressures in the near-to-medium term. Having said so, geopolitical risks on commodity prices will have an overhang with the latest rise in crude oil prices a monitorable.

World Bank's generic commodity basket	Average change in 2022 (%)	Average change in 2023* (%)
Total	41.8	-27.2
Energy	60.0	-34.1
Food	17.9	-8.5
Fertilizers	54.8	-37.3
Base Metals	4.0	-10.2
Precious Metals	-2.4	7.5

* Projected assuming price level for Jun-23 remains unchanged till Dec-23

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