Macro Pulse Report

October 2023

From the desk of the Chief Economist

Dear Readers,

Greetings from Acuité Ratings & Research! The **thirty third** edition of **Acuité Macro Pulse (AMP)** is being released as we get into the peak of the festive season.

Following the ascending trail of the previous month, **Acuité Macroeconomic Performance index (AMEP index)** has shown further buoyancy in September. The average index print in the second quarter of the fiscal is 2.36% higher than in the corresponding period of the previous year. The consistent momentum in economic activities in the second quarter of the current fiscal was supported by steady urban demand, onset of festive season, increased public expenditure in infrastructure and higher power demand in periods of deficient monsoon rainfall. Therefore, we expect the GDP growth in the second quarter of the fiscal to remain strong between 6.4%-6.8%.

The second half of the current fiscal, however, may be a different ball game altogether. With no base factor advantage, the economy will have to be driven by the strength of consumption demand and the acceleration in investments, both public and private. The key concern on growth at this stage emanates from the downside risks to agricultural output induced by an irregular monsoon and the uncertain impact of the prevailing El Nino. This may hit agricultural incomes and may keep food inflation sticky particularly in cereals and pulses, thereby constraining rural demand. Further, new geo-political risks in West Asia may hold the global crude oil prices at elevated levels; while it may not put pressure on the headline inflation directly, it can enhance the fiscal and the current account deficits. In a pre-election period, it may be a difficult balancing act for the government to provide cushion against higher food and fuel inflation while also walking on the path of fiscal consolidation. These risks have made us hold on to the 6.0% growth forecast for FY24.

Given the broader uncertainty on growth-inflation dynamics, we see the phenomenon of "higher for longer" theme to play out globally at least till the first quarter of next fiscal which will also imply higher volatility on bond yields and the rupee. Nevertheless, we expect capital flows to normalize and the rupee as well as the bond yields to settle at lower levels by the end of the current fiscal. For now, let's welcome the sparkling lights of Deepavali and keep on cheering for Team India in the ongoing Cricket World Cup.

- Suman Chowdhury, Chief Economist and Head – Research

Services and lower input costs in manufacturing support growth

Services growth has led domestic economic recovery well into Q2 FY24, with most high-frequency services-oriented indicators, especially on the transport-logistics side displaying traction

Notwithstanding recent increases, comfort on commodity-input prices enjoyed over Q4FY23 and Q1 FY24 has continued into Q2 FY24; likely to support manufacturing GVA growth

High frequency indicators: Services				
	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24
Railway freight traffic (%YoY)	3.2	3.7	1.2	3.9
Port cargo traffic (%YoY)	5.3	8.6	1.7	2.4
Air Cargo traffic (%YoY)	-7.6	-0.1	-1.1	12.4
Domestic Air passenger traffic (%YoY)	19.2	58.6	19.2	22.3
Intl Air Passenger traffic (%YoY)	99.5	97.3	35.6	15.3
GST E-way bills (cr)	8.1	8.5	8.6	6.8
Services PMI (index)	56.7	58.1	60.6	45.9

Annualised change in commodity prices				
Quarter	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24
CRB Index	22.2	3.7	-11.1	2.6

Expenditure side of GDP: Capex push

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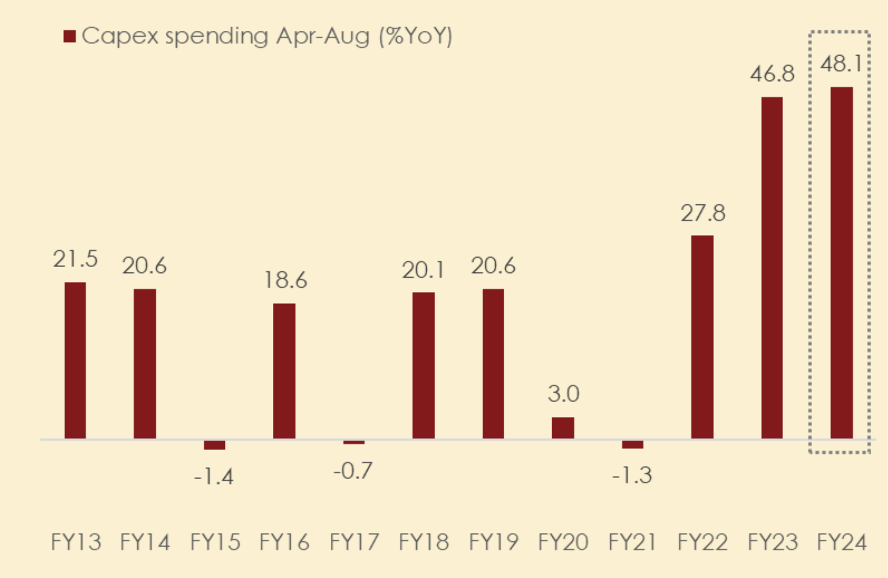
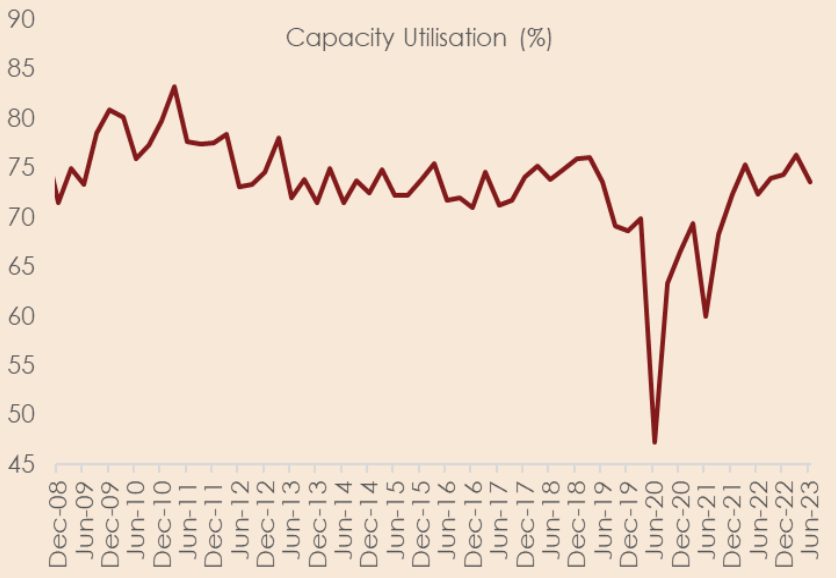
Government capex on a FYTD basis has expanded at a strong pace of 48.1%YoY on a sizeable base of last year

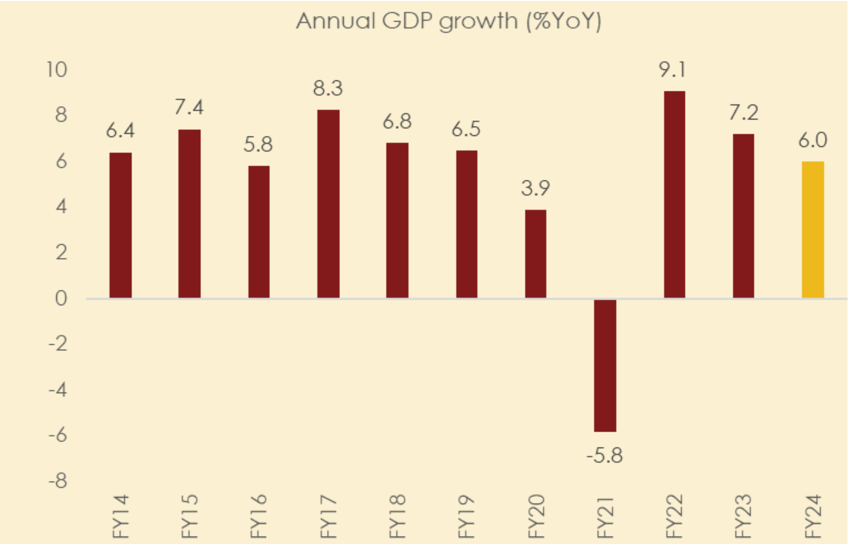


Strength in domestic consumption reflecting in continued improvement in capacity utilisation level, currently at 73.6% as of Jun-23 as per RBI's OBICUS survey. This is allowing a nascent recovery in private capex to take shape in select sectors (such as auto and infra)



But GDP growth to moderate in H2 FY24

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.
- Dilution of pent-up demand (esp. in services)
- Lagged impact of domestic monetary tightening curbing leveraged urban demand (esp. for goods)
- Likelihood of some downside to crop yields amidst monsoon deficiency in 2023
- Elevated crude oil prices, if persist above USD 90 pb over H2 FY24, could shave off 10-15 bps from GDP growth

-1.6%

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

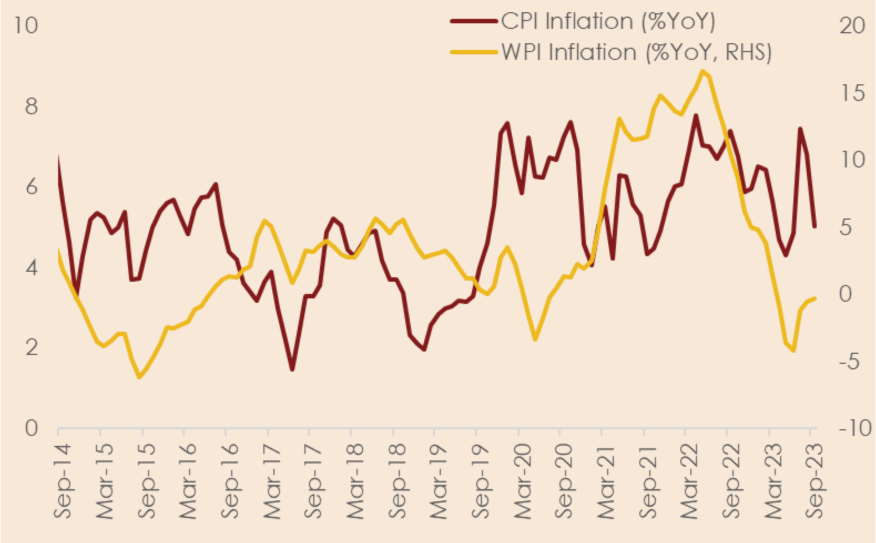
315 bps

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

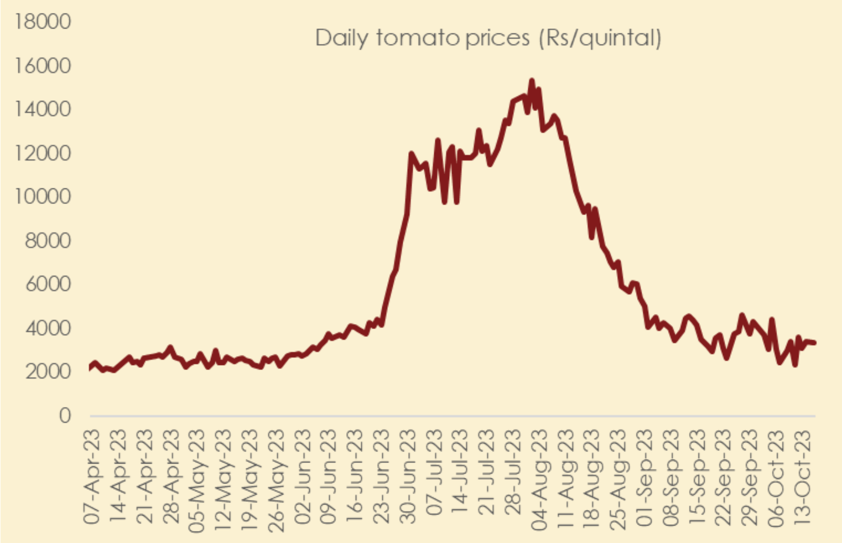
* Time period: 1995-2021

Sep-23 CPI moderates more than expected

India's CPI inflation in Sep-23 retreated further and sharply to 5.02%YoY from 6.83% in Aug-23, led by sequential decline in food and fuel prices



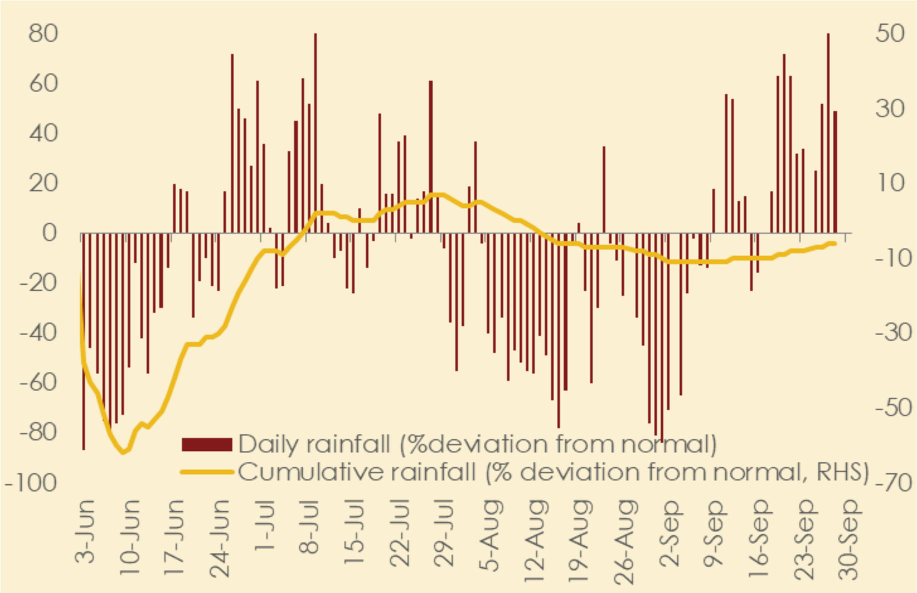
Bulk of impact of price correction on food was driven by Tomatoes – price of which completely normalised in Sep-23. In addition, the Rs 200 reduction on LPG cylinder offered a further downside to headline print.

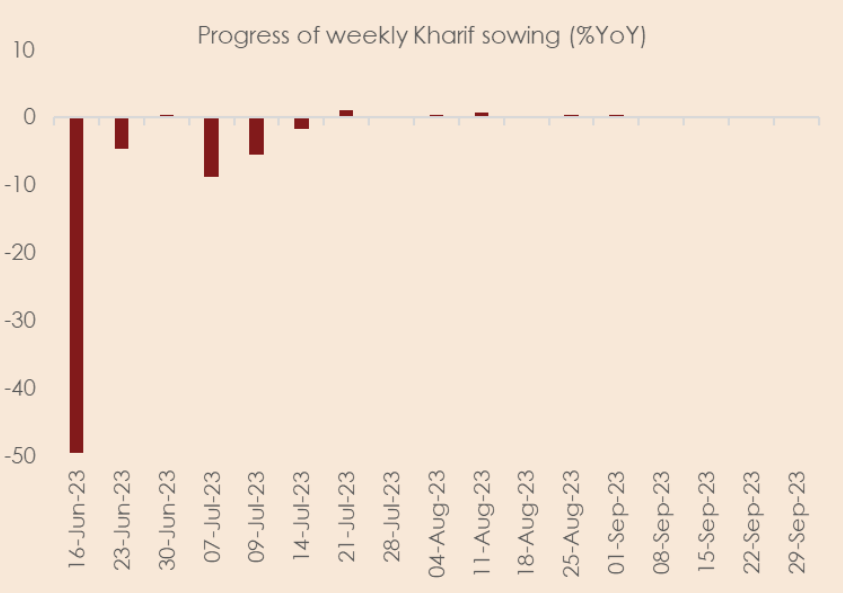


Southwest monsoon ends in a deficiency in 2023

After a deep deficit in Aug-23, rainfall activity picked up pace in Sep-23 to close the season with a cumulative deficiency of 6% vs. LPA

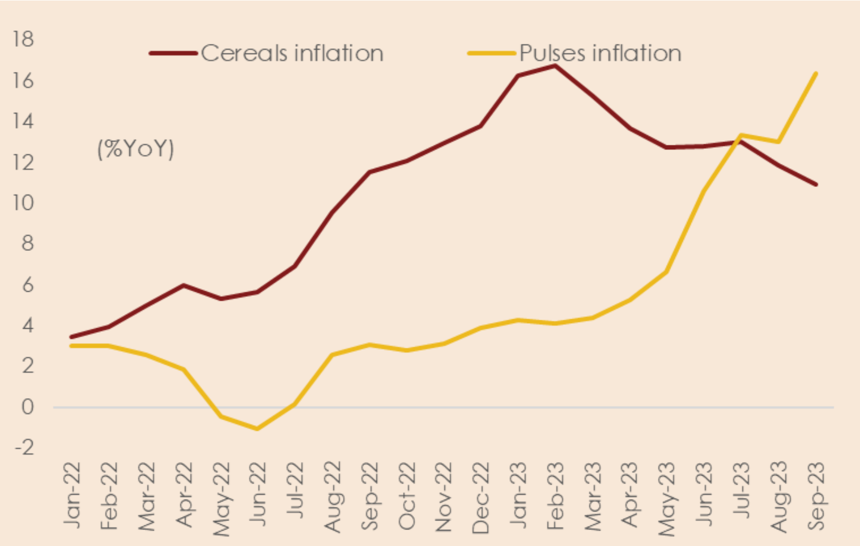
Kharif sowing though remained at par with last year's level despite temporal and spatial unevenness in rainfall distribution, crop yields will be on watch for any likely downside.



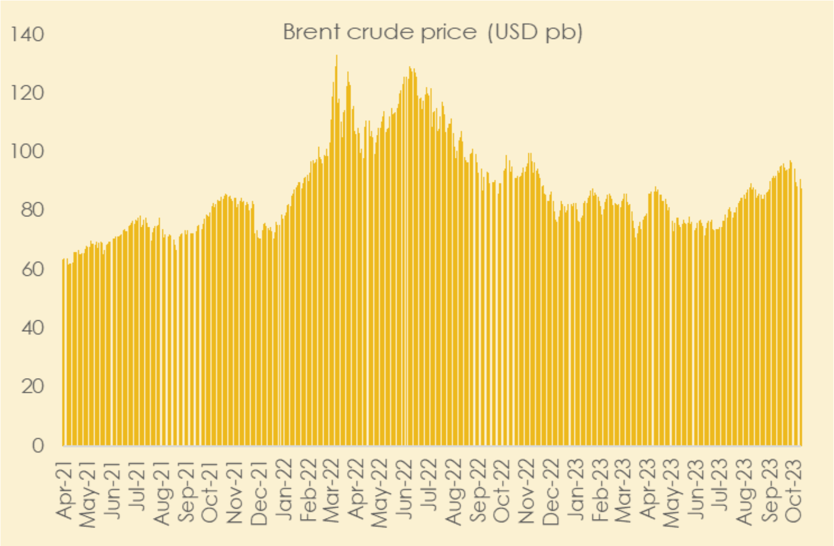


Food and crude prices remain on watch

Continued price pressures on cereals and pulses despite administrative measures continue to impinge on food inflation within CPI.



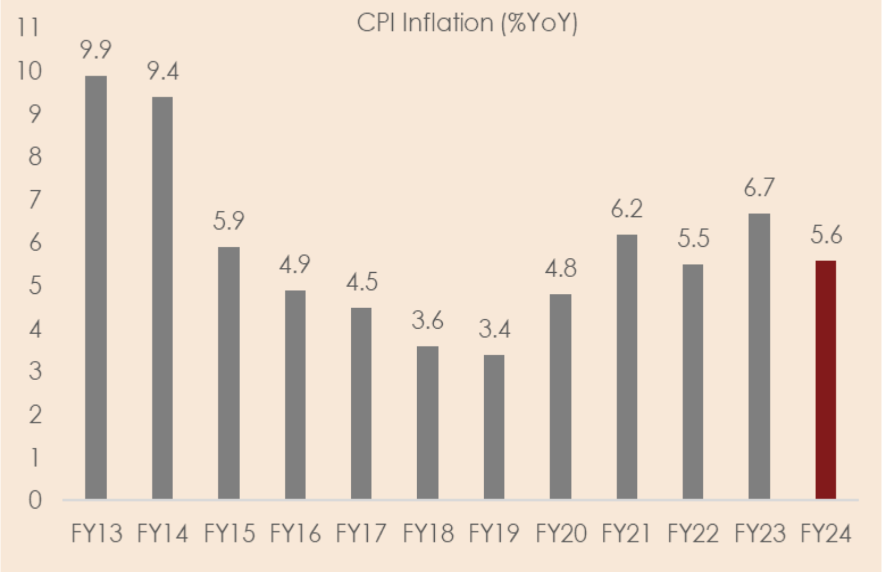
The recent spike in crude oil prices, if sustained could push India Crude Basket above RBI's estimate of USD 85 pb for FY24. However, we expect minimal impact on retail inflation this time as a large part of price increase could be absorbed by the Government (cut in duties) and OMCs ahead of key elections



CPI inflation: Risks stacked on the upside

We hold our FY24 average CPI inflation estimate of 5.6% amidst such risks.

Upside risks to watch
Impact of Israel-Hamas war, OPEC+ decision to cut production on crude oil prices
Impact of El Nino on global food production in the coming months
Durability of price pressures seen in cereals, pulses and spices, despite administrative measures
Impact of deficient monsoon on Kharif crop yields



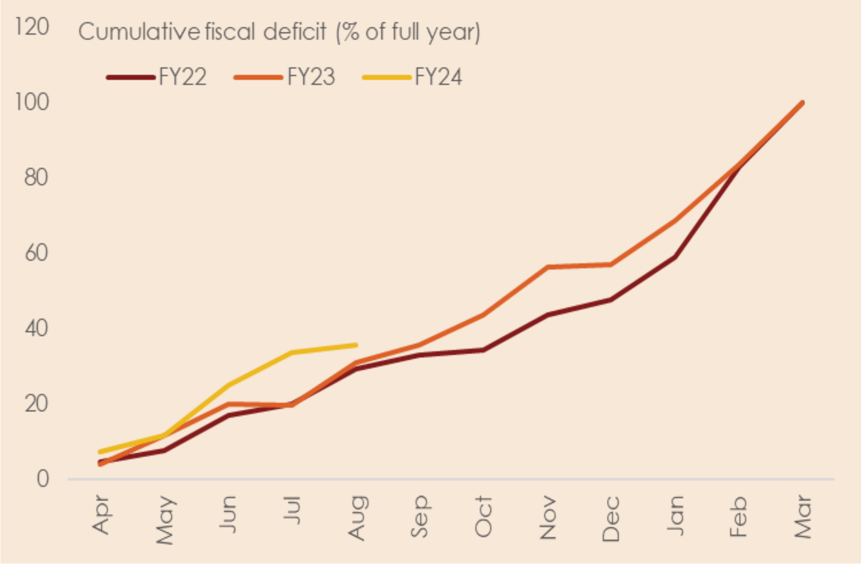
Apr-Aug FY24 fiscal performance

The FYTD (Apr-Aug) accretion to fiscal deficit stood at 18.7% of budget estimates (BE) for FY24, higher than 15.7% seen in the corresponding period in FY23. While both receipts and expenses have registered a faster pace of accrual/disbursal in FYTD24 vs. FYTD23, relatively faster pace of expenditure this year has driven the fiscal deficit moderately higher on FYTD basis.

Key Fiscal Variables (Cumulative position, Apr-Aug)				
	% of FY Actual/Target		%YoY	
	FY23	FY24	FY23	FY24
Revenue Receipts	34.3	38.5	2.9	24.1
Net Tax	33.4	34.5	8.6	14.8
Non-Tax	40.8	69.5	-21.4	79.4
Non-Debt Capital Receipts	43.7	18.3	107.7	-51.1
Total Receipts	**34.5**	**37.9**	**4.9**	**21.3**
Revenue Expenditure	33.0	37.1	3.0	14.1
of which, Interest Payments	36.5	34.0	21.6	8.5
of which, Major Subsidies	26.2	48.2	-7.4	32.5
Capital Expenditure	34.3	37.4	46.8	48.1
Total Expenditure	**33.2**	**37.1**	**8.9**	**20.3**
Fiscal Deficit	**15.7**	**18.7**	**-**	**-**

Faster pace of fiscal deficit buildup in H1

Pace of fiscal deficit accretion saw some moderation in Aug-23 on account of a sharp reported increase in direct tax collections. Corporate tax and income tax collections recorded their best monthly performance in Aug (as share of full year collections).



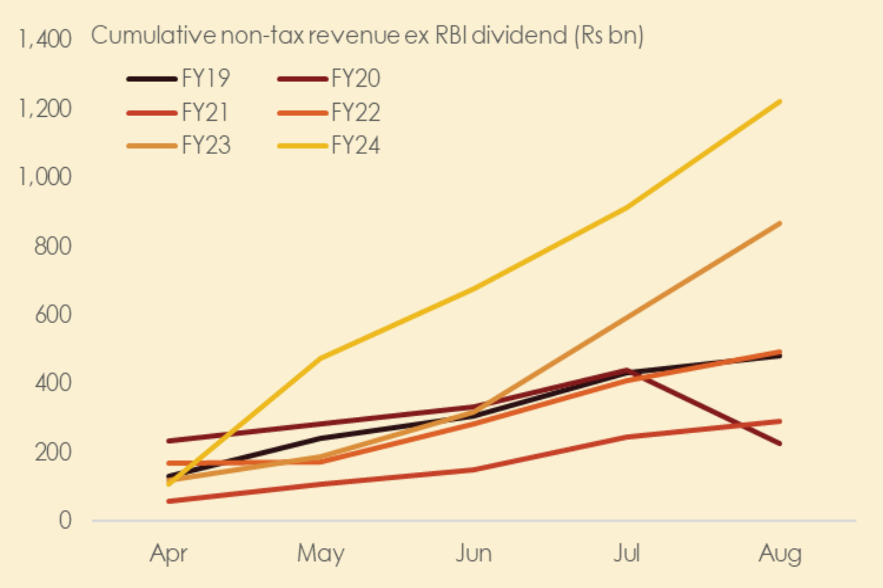
Revenues: Comfort emerging

Although gross tax collection growth remains marginally lower than in FY23, it has picked up pace on account of reconciliation of Rs 760 bn of tax revenue (while this accrued in Jul-23, it got accounted for in Aug-23). As of Aug, except excise, all other categories of taxes have maintained healthy momentum (GST is running marginally lower than the required run rate but could potentially find support in the upcoming festive season).

Growth in key tax categories	Apr-Aug FY23 (% YoY)	Apr-Aug FY24 (% YoY)	FY24 BE (% change*)
Gross Tax	**18.7**	**16.5**	**10.1**
Corporate Tax	23.6	**15.1**	11.7
Income Tax	33.2	**35.7**	11.4
Customs	-14.3	**27.8**	9.2
Excise	-17.0	**-12.4**	6.3
GST	33.0	**10.6**	12.1

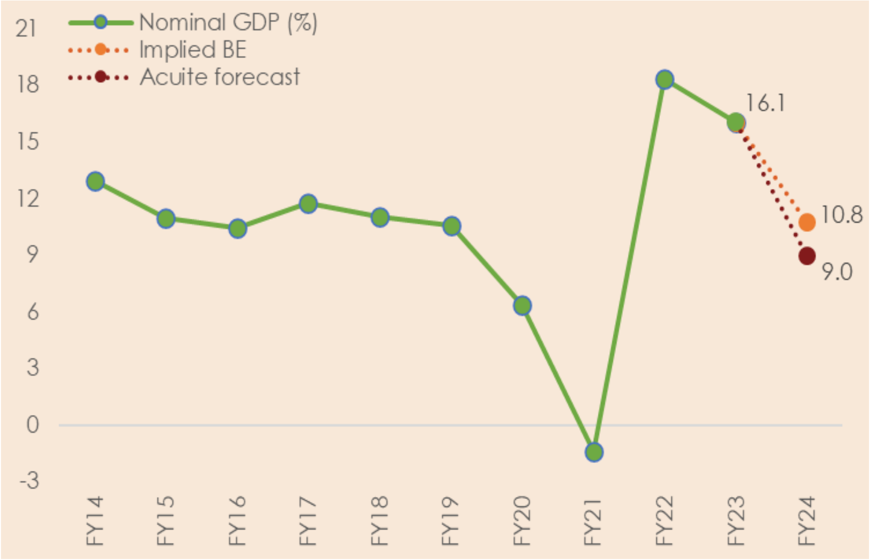
* Implied growth over FY23 actuals

Meanwhile, non-tax revenue 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 is slow (Rs 56 bn until Aug-23 vs. Rs 246 bn until Aug-22) and needs considerable traction.

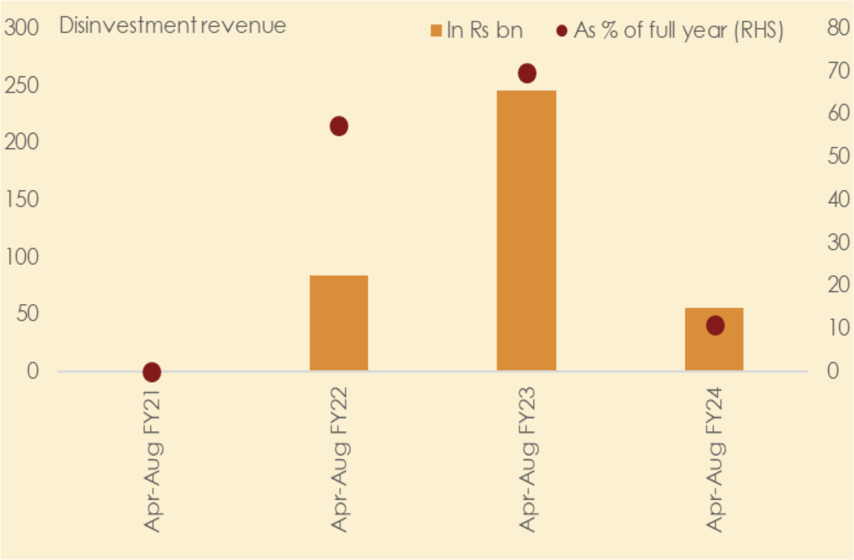


But lower nominal growth and slow divestment could weigh on revenues

Deflation in WPI is seen to be weighing upon Nominal GDP growth



Divestment activity has been lackadaisical; busy election season poses risk of slippage, govt exploring OFS route.

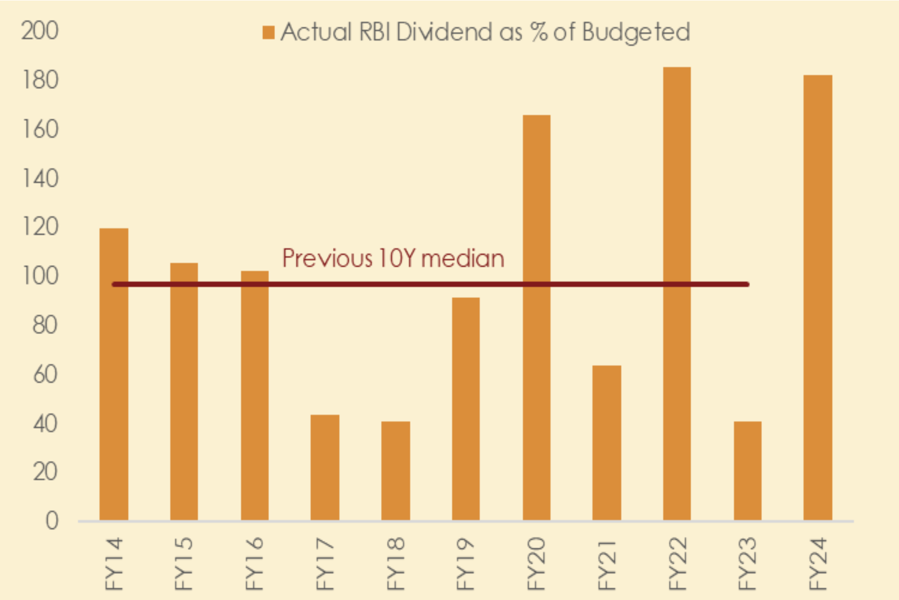


However, non-tax revenues provide cushion

Non-tax revenue collection is a positive surprise

FYTD performance of non-tax revenue collection	
Total NTR: Apr-Aug FY23 (Rs bn)	1168
Total NTR: Apr-Aug FY24 (Rs bn)	2096
Total NTR: Apr-Aug (% of FY23)	40.8
Total NTR: Apr-Aug (% of FY24)	69.5
Growth in Total NTR: Apr-Aug FY23 over Apr-Aug FY22 (% YoY)	-21.4
Growth in Total NTR: Apr-Aug FY24 over Apr-Aug FY23 (% YoY)	79.4

RBI dividend did the heavy lifting



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

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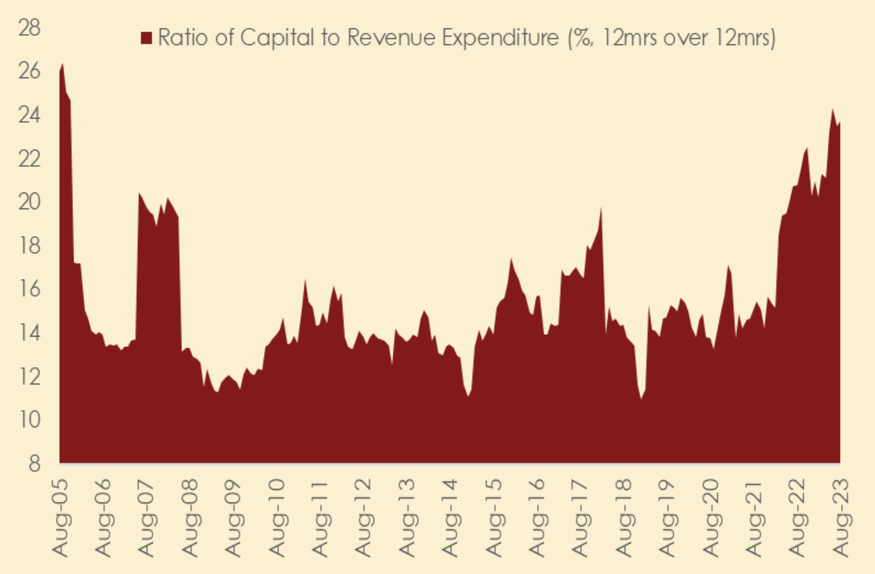
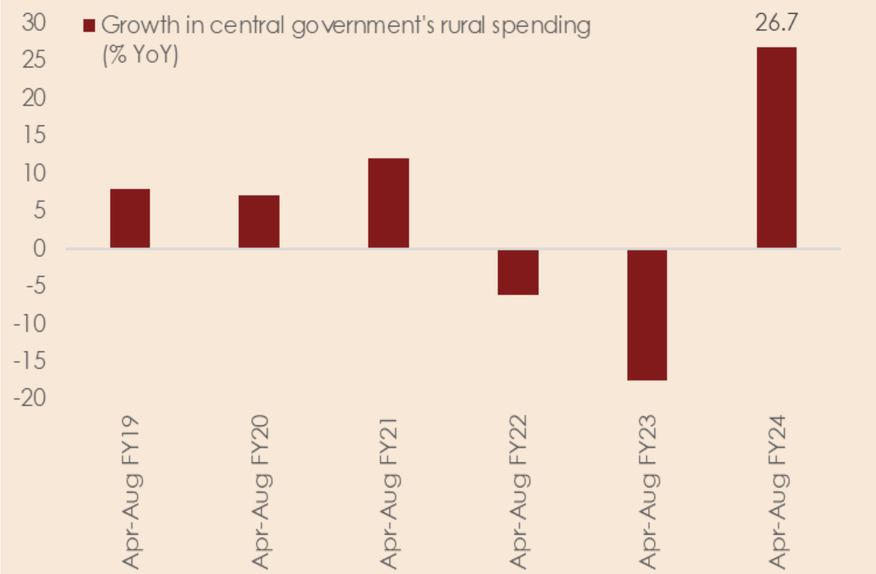
Capex continues to receive priority over revex; upcoming elections might be driving the front-loaded disbursals



In contrast to BE of 16.6% contraction, rural spending has picked up momentum; downsizing could be a challenge amidst an erratic monsoon and upcoming elections

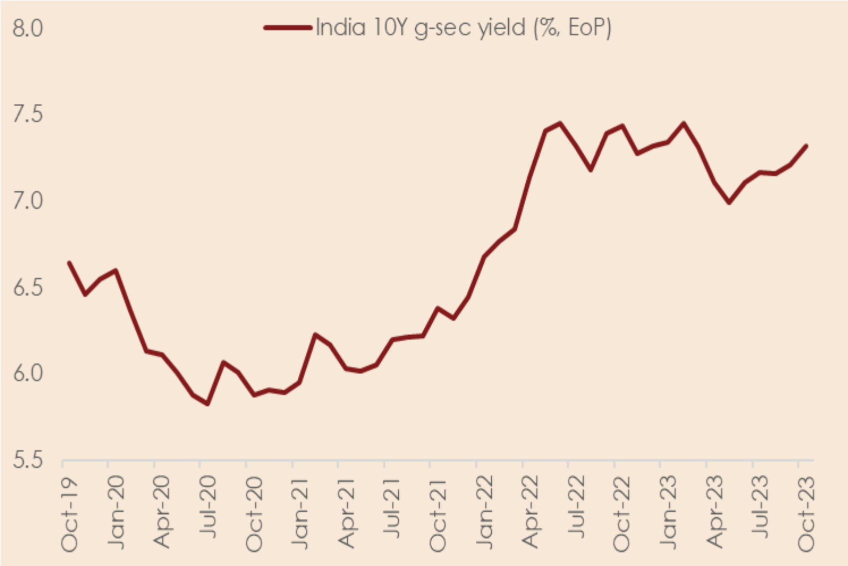


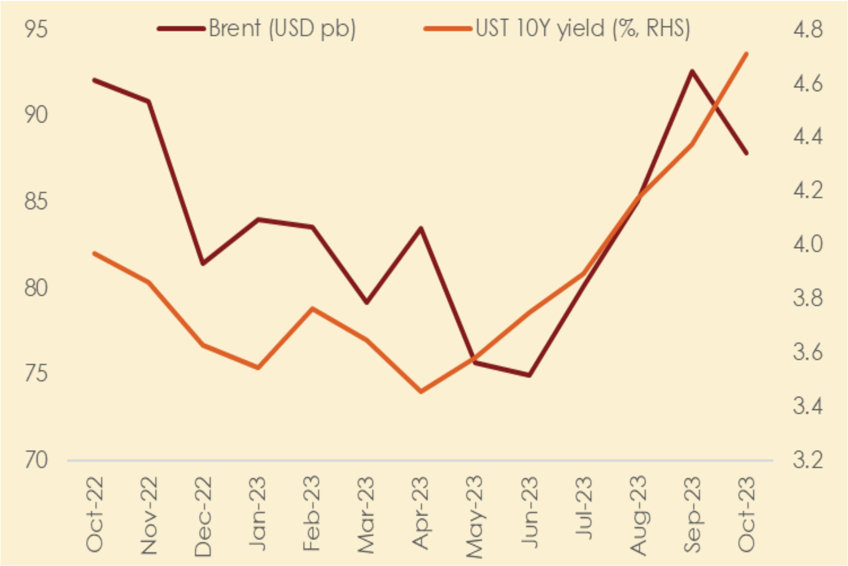
We continue to expect FY24 fiscal deficit target of 5.9% of GDP to be met (with expenditure compression in Q4 and some cushion from non-tax revenues) with risks appearing neutral at this stage but needs monitoring.

G-sec yields hardened in last 1-2 months

From its recent monthly low of 6.99% in May-23, India's 10Y g-sec yield has risen MoM, and is currently trading around 7.3%+ levels.

Over the last 3-months, adverse global markers in the form of rising UST yields and crude oil prices have weighed on sentiment (besides the temporary shock on CPI inflation from tomato prices, which has now got reversed).





Likelihood of 'higher for longer' rates in US has started to pinch

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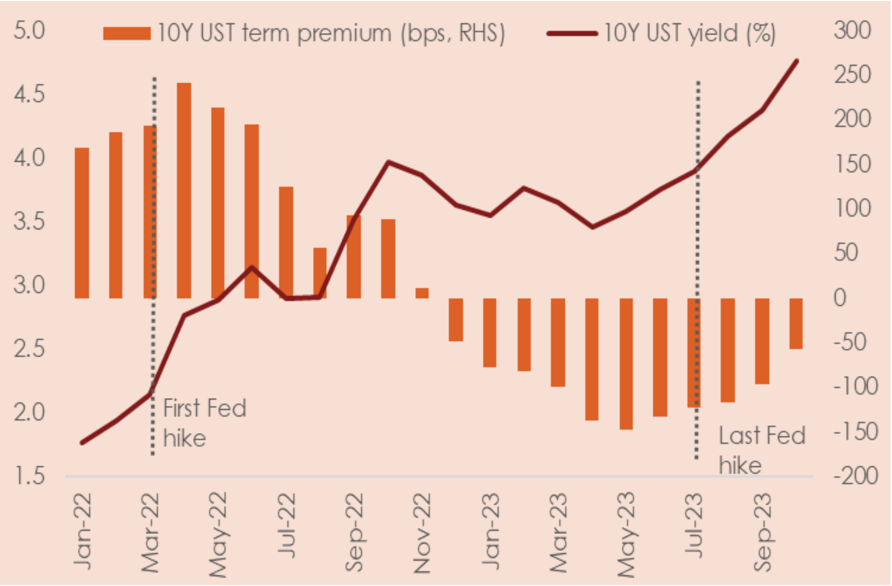
10Y UST yield has climbed to 4.85%, its highest since 2007. The spillover impact of rising US term premium is being felt in India too, albeit to a mild degree.

FOMC Projections (median)	Jun-23	Sep-23
Terminal Fed Rate in 2023 (%)	5.6	5.6
Rate cuts in 2024 (bps)	100	50

Note: Current fed funds rate range is at 5.25-5.50%

What's weighing on long term US rates?
Elevated supply from US Treasury
Threat of US sovereign downgrade
Japan's shift in YCC amidst ongoing Fed's QT

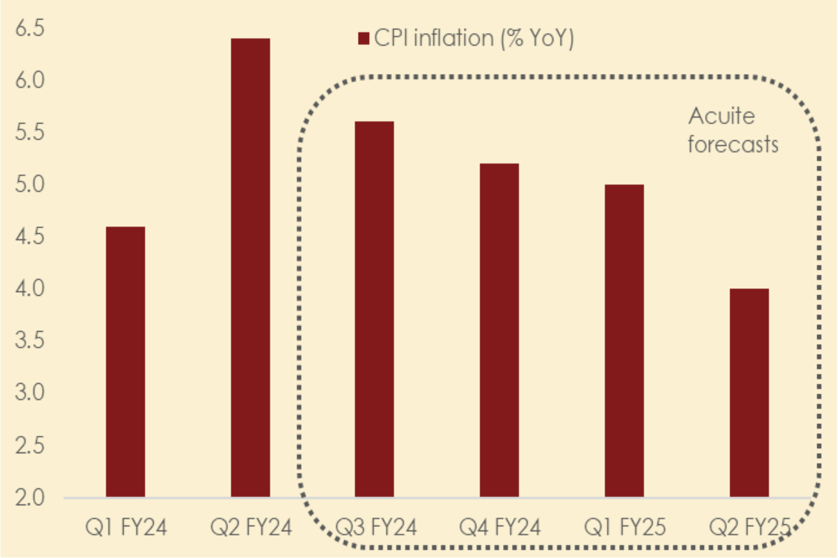


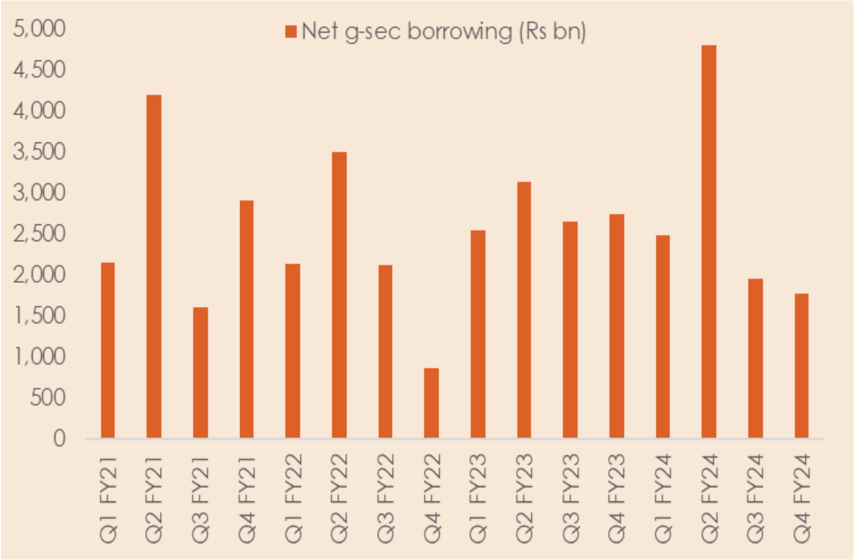
Note: Term premium is defined as the spread between 10Y UST yield and the fed funds rate

Domestic factors in favor in H2 FY24…

After peaking at 6.4% in Q2 FY24, CPI inflation is projected to moderate to 5.2% in Q4 FY24, and further towards ~4% in Q2 FY25.

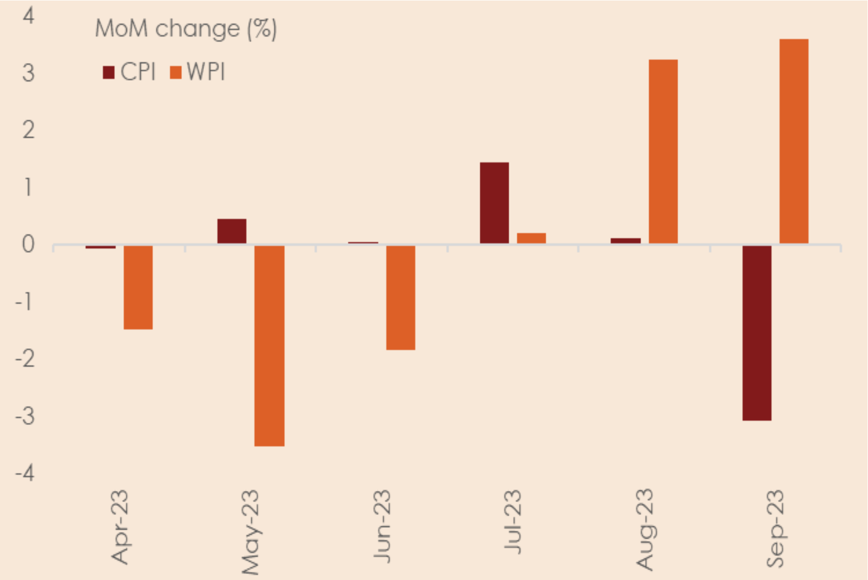
Although net g-sec borrowing is at its post Covid high in Q2 FY24, it is scheduled to decline considerably in H2 FY24.



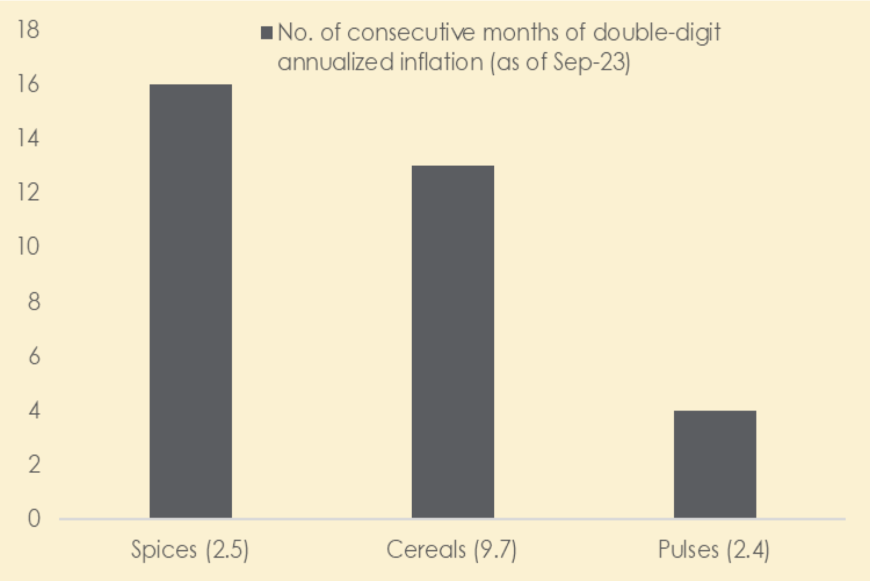


...however, MPC needs to maintain caution

Increase in Brent price from an average of USD 75 pb in May-Jun 2023 to USD 91 pb in Sep-Oct 2023 has started to show up in higher momentum in case of WPI-Fuel inflation. This increase in input costs may get passed on to CPI inflation with some lag.



Below normal and erratic monsoon has kept key food items (within staples) at elevated levels. This can provide downward rigidity to food inflation in coming months despite favorable seasonality.

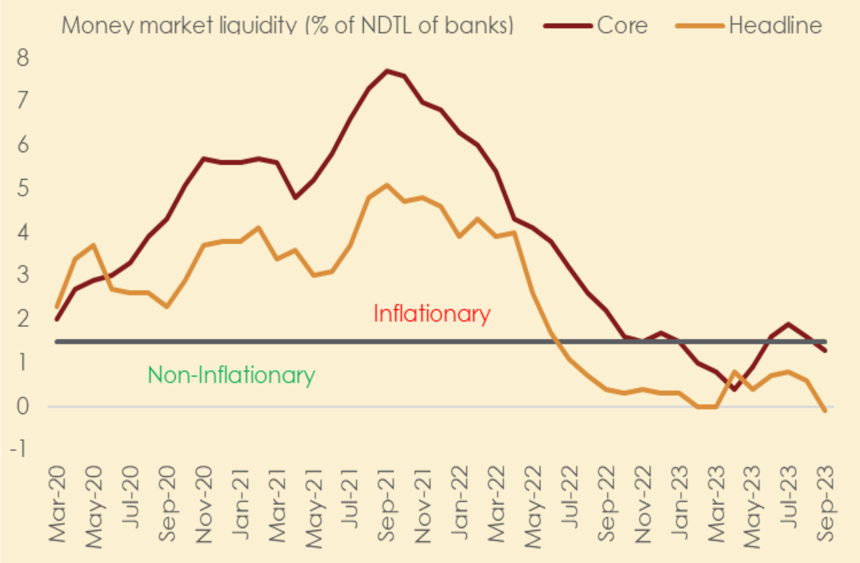


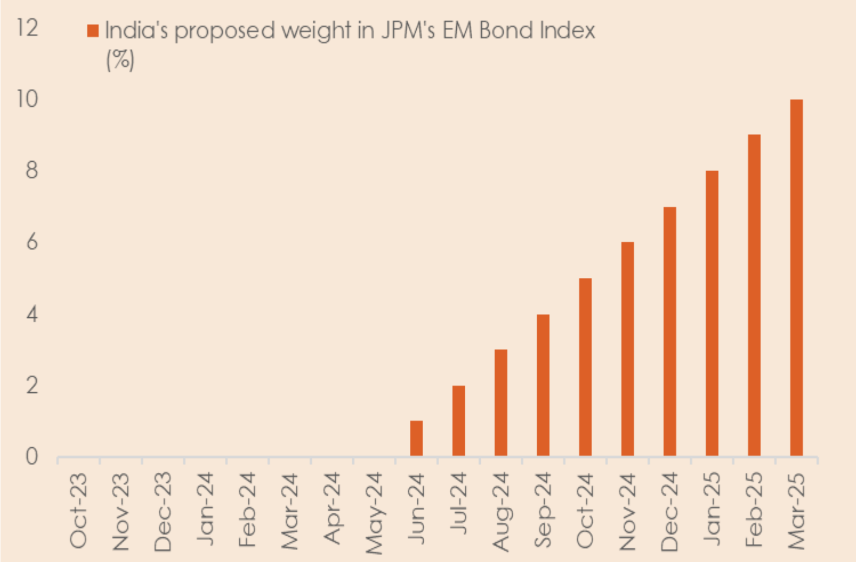
Note: Figures in parenthesis indicates the weight in CPI

Rates outlook

We expect RBI to moderate core liquidity surplus from Rs 2.9 tn as of end Q2 FY24 towards Rs 1.7 tn by end Q4 FY24 to boost policy transmission.

With India's inclusion in JP Morgan's EM Bond Index, there is a possibility of USD 20-21 bn passive inflows by Mar-25.



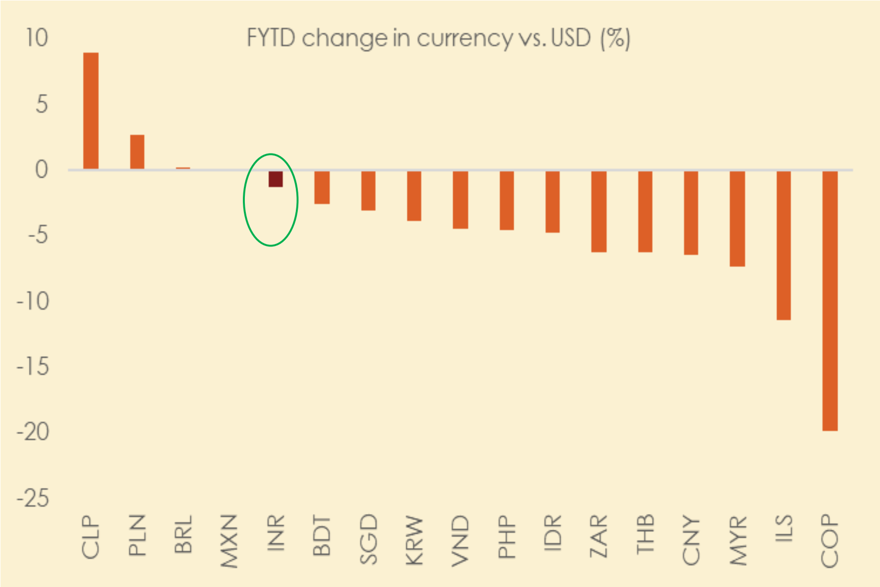


Global anxiety could keep 10Y g-sec yield over 7.3% in the near term. However, with domestic inflation projected to moderate and index inclusion becoming a reality **we expect 10Y g-sec yield to moderate towards 7.00% by Mar-24**.

INR touched a record low in Oct-23

USDINR is currently trading close to 83.2-83.3 levels, the weakest in history.

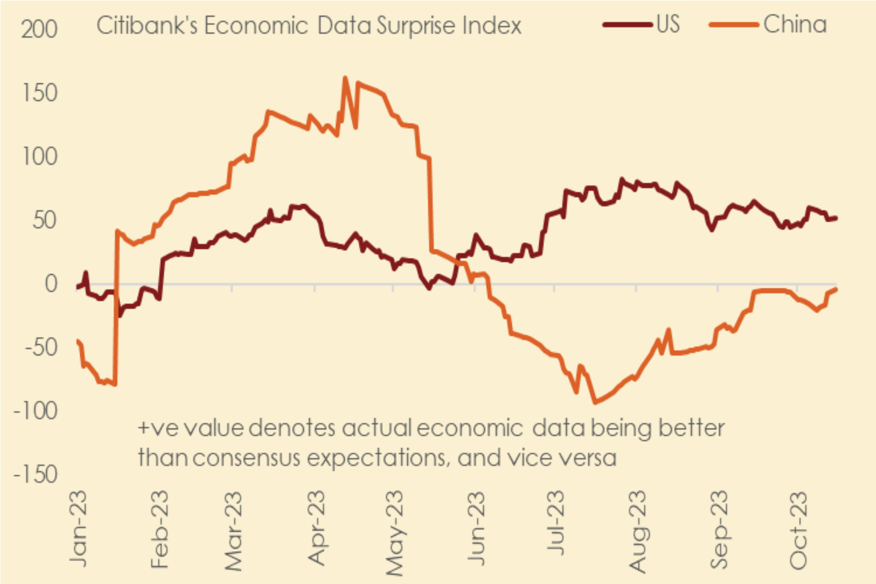
However, record low weakness in INR has not resulted in excessive volatility; in fact, INR has been one among the least volatile major EM currency



Global backdrop continues to remain adverse

Consistent positive data surprises in the US along with consistent negative data surprises in China is resulting in a stronger USD and a weaker CNY – this is weighing upon EM currencies.

Adverse geopolitical developments in recent months have led to a sharp jump in energy prices.

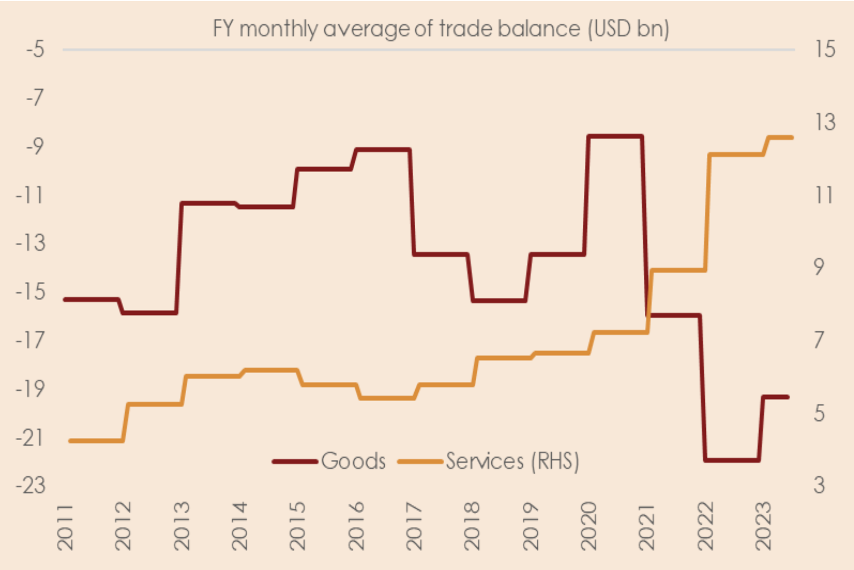


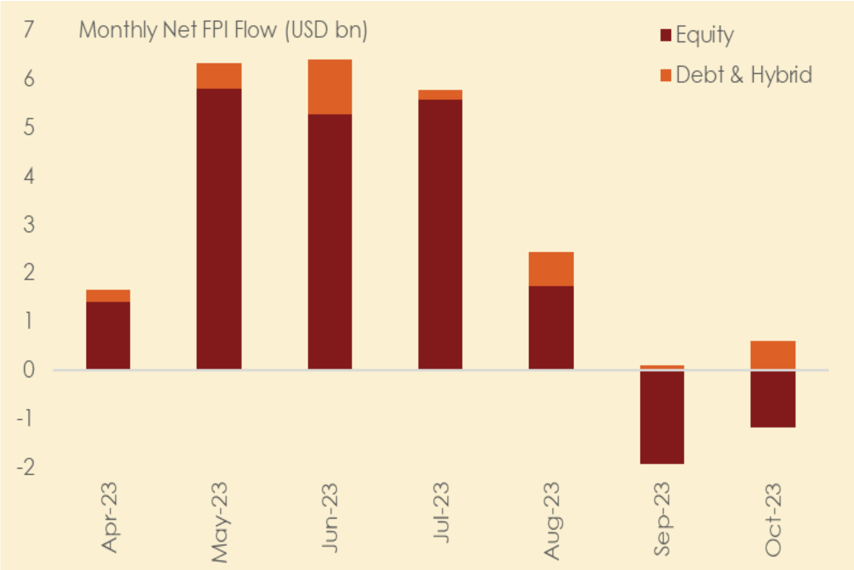
Generic Commodity Index	4-m change	1-y change
Bloomberg Commodity Index	2.7%	-7.5%
Agriculture Commodities	-5.6%	-11.9%
Grains	-9.1%	-22.0%
Energy	22.0%	-19.2%
Petroleum	15.9%	-4.5%
Industrial Metals	-7.1%	-2.2%
Precious Metals	-2.7%	17.5%

Higher headwinds on external front in H2

Although merchandise and services trade balance provided comfort in H1 FY24, we could see some deterioration in H2 on account of jump in commodity prices, global slowdown, and spike in geopolitical risk.

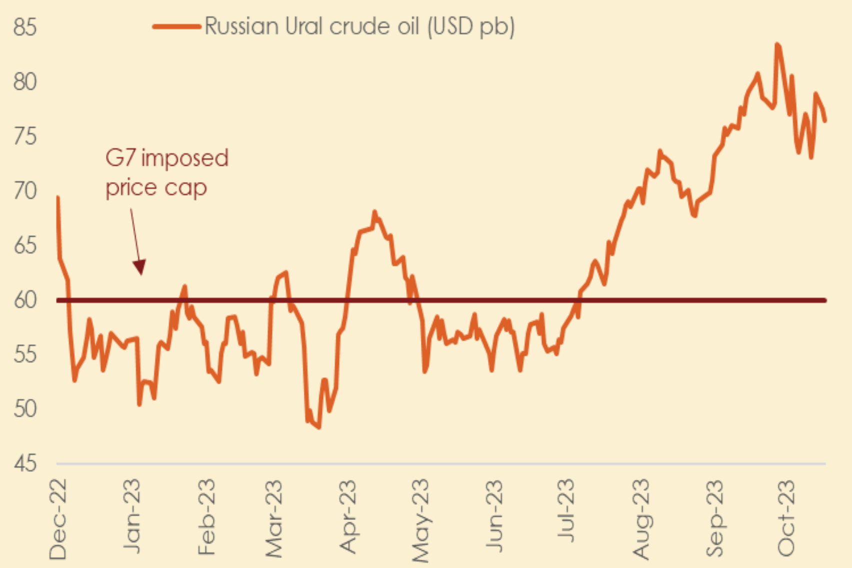
Narrative of 'higher for longer' rates in the US and spike in geopolitical risk premium (with adverse impact on energy prices) has weighed upon portfolio investors.



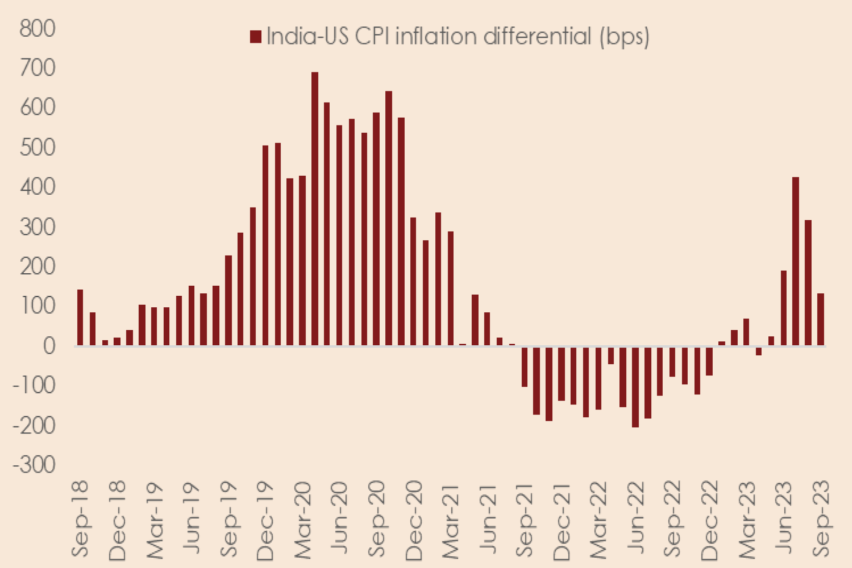


Swing factors no longer in favor

Jump in price of Russian crude oil (above the G7 implied price cap) has started to erode the strategic benefit for India's current account.



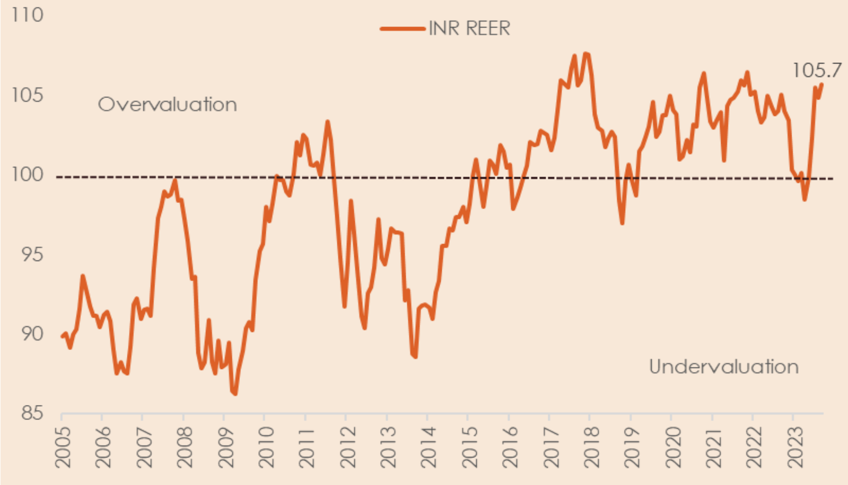
With inflation differential with the US remaining against India in recent months, INR could continue to face some pressure in the near-term.

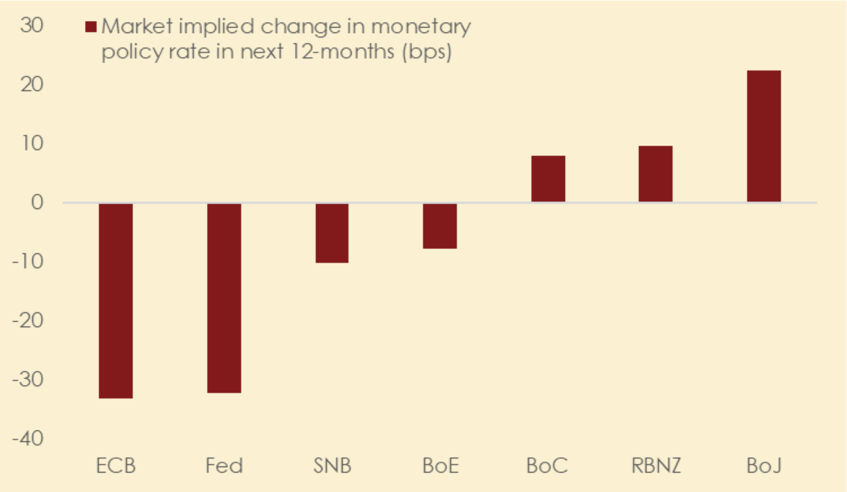


Rupee outlook

Since Jun-23, while INR has been stable, the EM currency pack has weakened vs. the USD, thereby resulting in increase in INR's overvaluation. This could make RBI somewhat tolerant of near-term adjustment.

Market participants have been paring their Fed rate cut expectations for 2024. For the first time, markets now expect Fed and the ECB to deliver identical quantum of rate cuts in next 1Y.



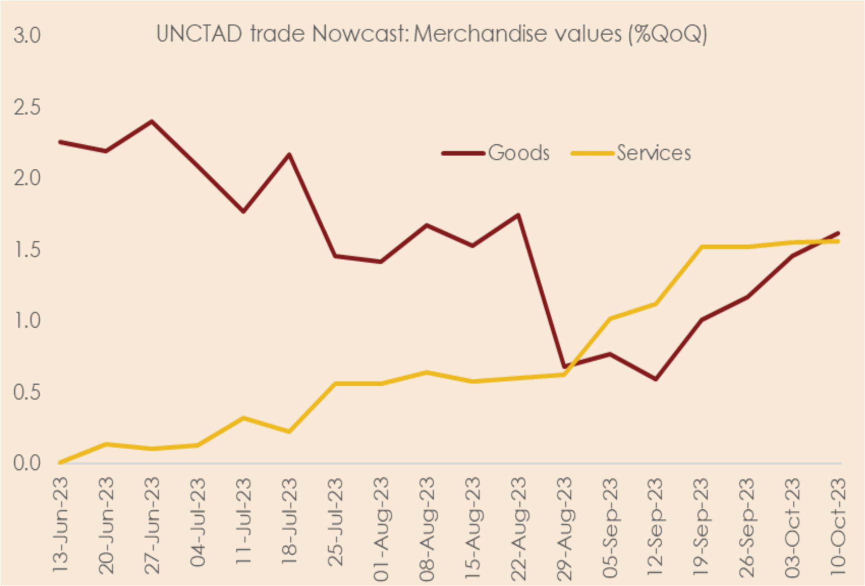


A BoP surplus and a backloaded dollar negative backdrop would support INR in the medium term. However, near-term pressure points in the form of a stronger USD and a weaker CNY, both individually been putting pressure on INR. As such, INR may weaken towards 84 levels by Dec-23. We maintain our moderately constructive view on INR, with a move towards 82 by Mar-24. However, with fast paring of Fed rate cut expectations, our Mar-24 view could carry some downside risk.

Global economic activity remains weak

Global PMI remained in contraction in Sep-23, at 49.7 compared to 49.4 in Aug-23 – indicating a fall in output in 10 of the last 14 months. Services driving the current recovery too, have seen losing some momentum of late

Global trade remains on a weak footing, with growth in services tapering off in Q3-23 while goods ended the quarter with a marginally better growth, as per UNCTAD's trade NowCast

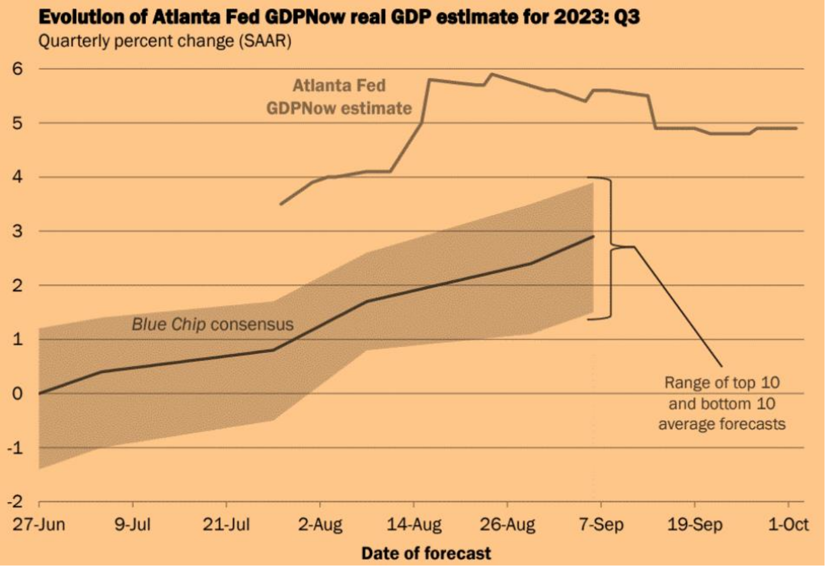


US growth outperformance continue but headwinds could get stronger

US economic resilience continues to hold out and the possibility of a recession is now a fading risk

Consensus growth estimates for US in Q3 stands at 4.3%. Having said so, headwinds from moderation in business loans already underway, weakening household balance sheet as wage growth slows and interest costs remain high, is likely to translate into growth moderation in the coming quarters.

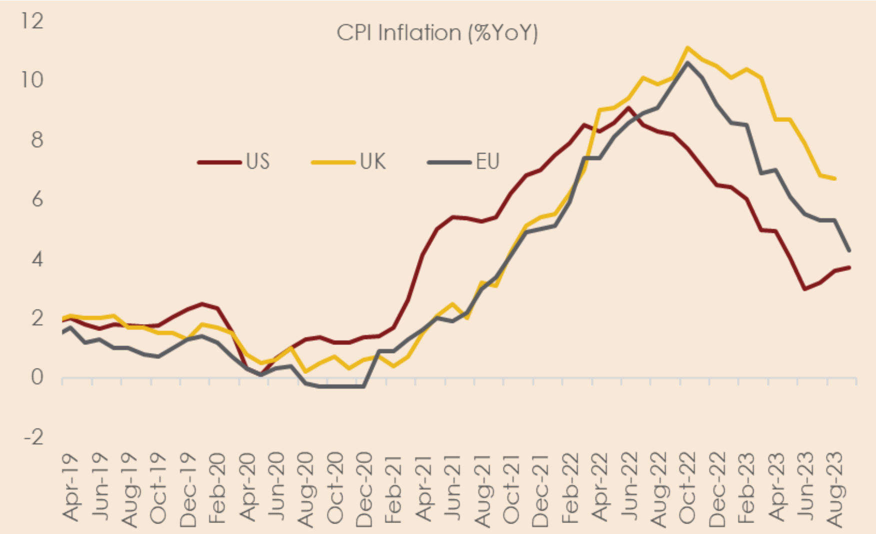
GDP growth (%YoY)						
Economies	**Q1 22**	**Q2 22**	**Q3 22**	**Q4 22**	**Q1 23**	**Q2 23**
US	3.7	1.8	1.9	0.9	1.8	2.6
Eurozone	5.5	4.4	2.5	1.8	1.1	0.5
Japan	0.6	1.5	1.6	0.4	2.0	1.6
UK	10.6	3.8	2.0	0.6	0.2	0.4
Canada	3.2	4.7	3.8	2.1	2.1	1.1
China	4.8	0.4	3.9	2.9	4.5	6.3
Korea	3.1	3.0	3.1	1.3	0.9	0.9
Brazil	2.4	3.7	3.6	1.9	4.0	3.4
Mexico	1.9	2.2	4.4	3.6	3.7	3.7
Indonesia	5.0	5.5	5.7	5.0	5.1	5.2

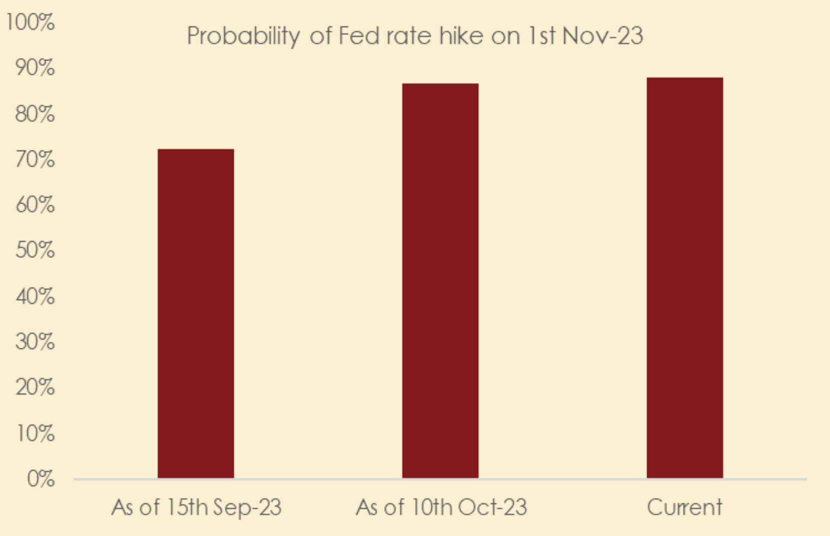


Inflation sticky, risks of a further Fed hike

Inflation descent has moderated, with the recent spike in energy prices pushing incremental headline inflation prints marginally higher.

Market participants are expecting another rate hike of 25 bps on 1st Nov-23 from the US Federal Reserve, with the central bank expected to keep rates higher for longer well into next year





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