MACRO PULSE

REPORT

September 2023

From the desk of the Chief Economist

Dear Readers,

Greetings from Acuité Ratings & Research!

We are happy to release the **thirty second** edition of **Acuité Macro Pulse (AMP)**.

India is in the midst of the great Indian festive season and the optimism in the economy remains strong. After a relatively weak July, Acuité Macroeconomic Performance index (AMEP index) has shown a moderate buoyancy in August with a sequential growth of 2.05% and an annualised growth of 6.44%. Among the sixteen high frequency indicators, the majority i.e., twelve of them have recorded good growth sequentially with three notching up MoM growth in double or high single digits. On an annualised basis, all of them were in the expansion domain in Aug-23 except the trade parameters i.e., exports and imports.

However, not all is rosy on the economic front. The monsoon has been inconsistent albeit the cumulative rainfall deficiency has reduced in Sep-23 to mid-single digits and ground reports indicate that the yields in the kharif crop may be lower than expected. While the government will surely continue to take steps to cool down food prices in a pre-election year, prices in categories like cereals and pulses may remain firm. Further, higher global crude oil prices is an elephant in the room which have the ability to disrupt the projected inflation trajectory apart from increasing the fiscal and the current account deficits. Higher inflation near the general elections can lead to higher than budgeted subsidies on fertilisers and agricultural sector, making it difficult to keep the fiscal deficit below 6.0%.

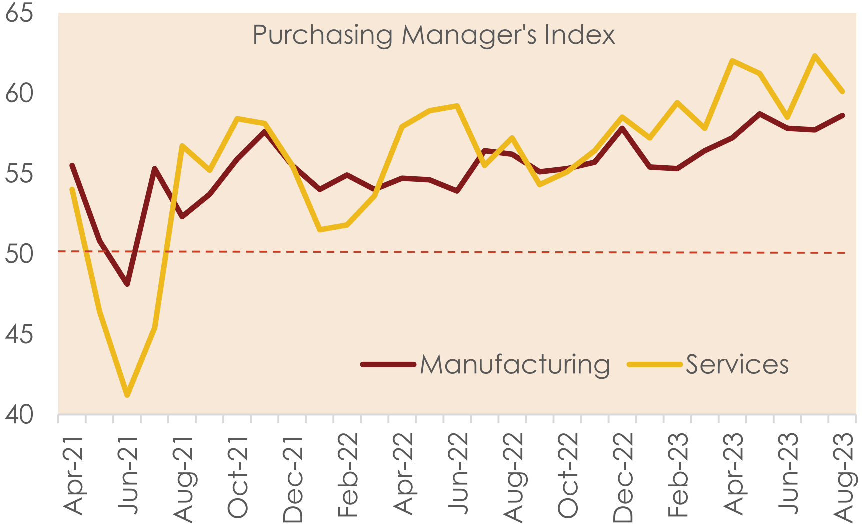
In such a scenario, a "wait and watch" with a "hawkish" eye is possibly the most appropriate stance for RBI MPC for the rest of the fiscal year. While long term bond yields are likely to remain largely stable, short term interest rates will remain relatively high, given the intent of the central bank on keeping the system liquidity on a slightly 'tight' leash and reduce inflationary expectations. Clearly, the 'higher for longer" rate theme is going to play out across most parts of the globe particularly in US amidst the observed growth resilience and the resultant market volatility will keep the traders busy.

- Suman Chowdhury, Chief Economist and Head – Research

Services continue to drive growth

Services growth continues to lead domestic economic recovery well into Q2 FY24, with PMI index for the sector remaining at a robust 60.1 as of Aug-23

Most high-frequency services-oriented indicators, especially on the transport/logistics side are displaying traction

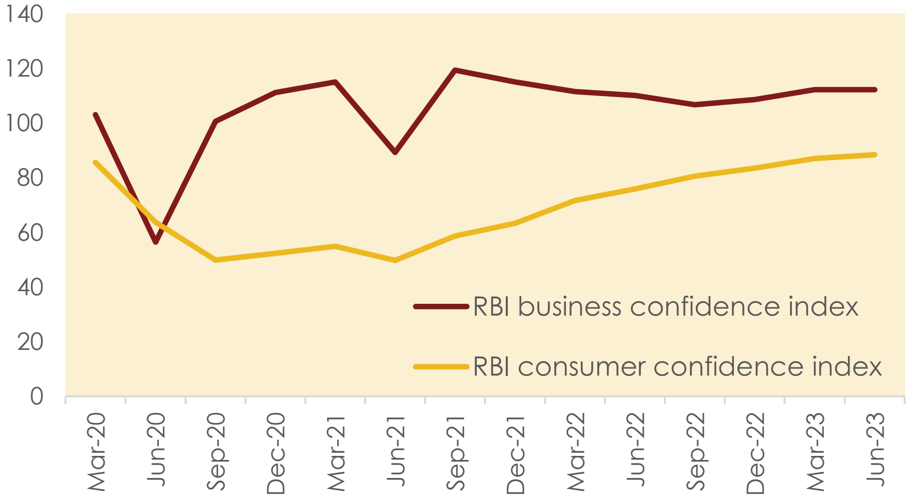


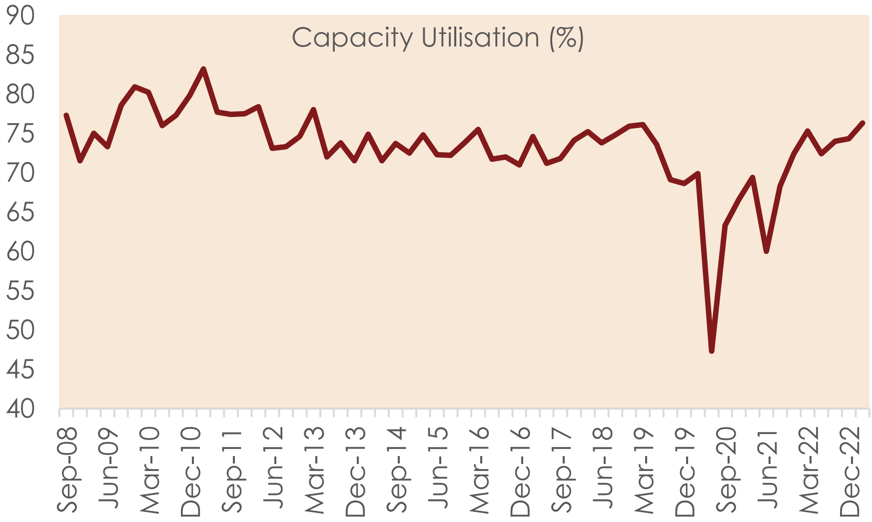
High frequency indicators: Services					
	Q3 FY23	Q4 FY23	Q1 FY23	Jul-23	Aug-23
Railway freight traffic (%YoY)	3.2	3.7	1.2	1.5	6.4
Port cargo traffic (%YoY)	5.3	8.6	1.7	4.3	4.4
Air Cargo traffic (%YoY)	-7.6	-0.1	-1.1	-1.2	6.9
Domestic Air passenger traffic (%YoY)	19.2	58.6	19.2	26.3	23.6
International Air Passenger traffic (%YoY)	99.5	97.3	35.6	23.6	21.5
GST E-way bills (cr)	8.1	8.5	8.6	8.8	9.3
Services PMI (index)	56.7	58.1	60.6	62.3	60.1

Growth optimism continues to be visible

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

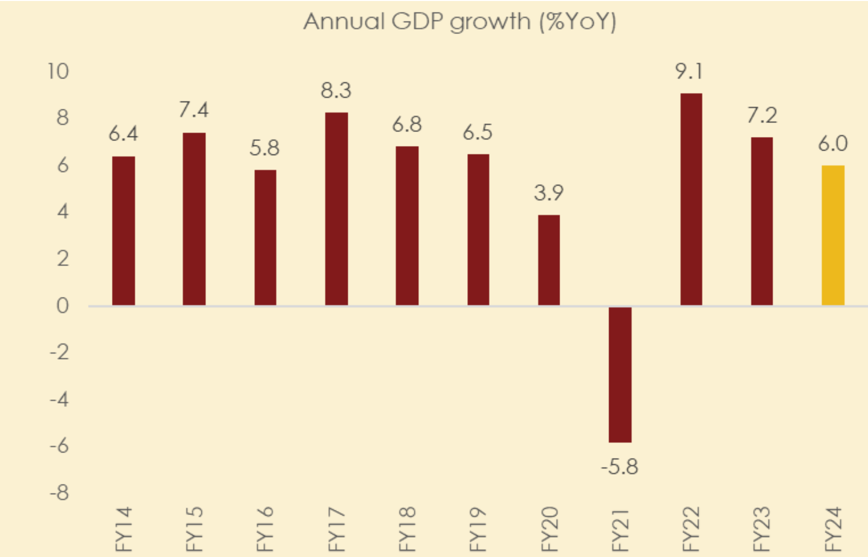
Strength in domestic consumption has been accompanied by continued improvement in capacity utilisation level, stood at 76.3% as of Mar-23 as per RBI's OBICUS survey. This is allowing a nascent recovery in private capex to take shape in select sectors (auto, infra)





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 :

- 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)
- Higher weather risks due to the impact of El Nino on not just to SW monsoon but on the winter rainfall

-1.6%

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

315 bps

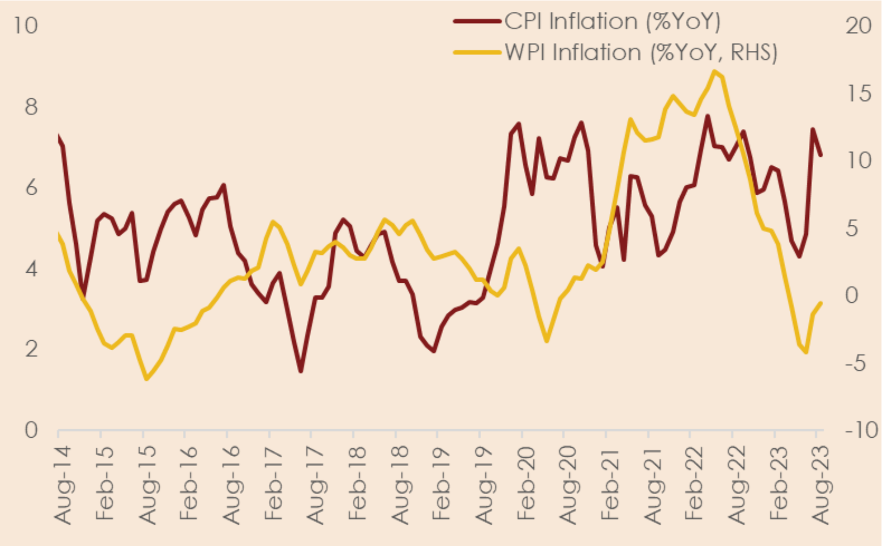
- Effective rate hike done by the RBI between Apr-22 and Feb-23

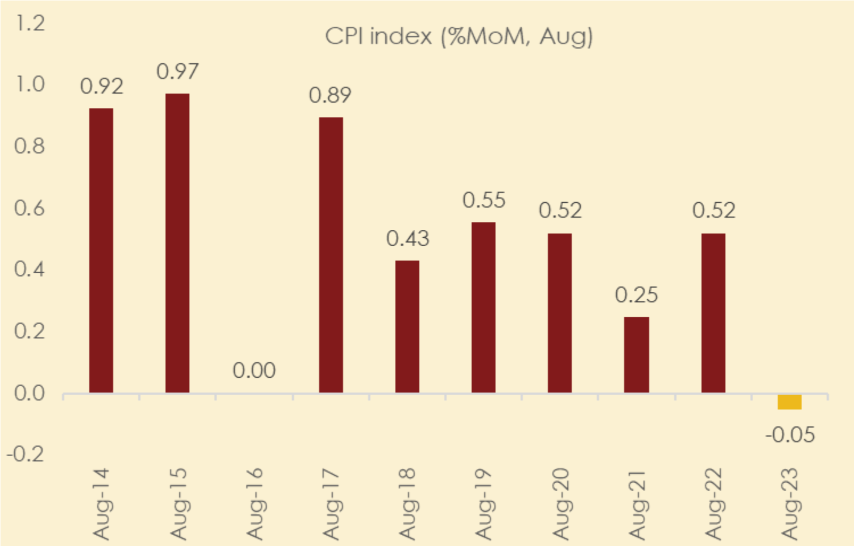
* Time period: 1995-2021

Veg inflation moderates quickly

India's CPI inflation moderated in Aug-23 slightly more than expected to 6.83%YoY from a 15-month high of 7.44% in Jul-23. On the other hand, while being in negative territory, WPI inflation increased to a 5-month high of -0.52% YoY from -1.36% in Jul-23.

Sequentially, CPI fell by 0.05% MoM, mainly driven by drop in increased vegetable prices. It was sharply lower than the series average of 0.70% MoM jump, usually seen in the month of August. Moreover, this is the first time that the index moved lower in August.



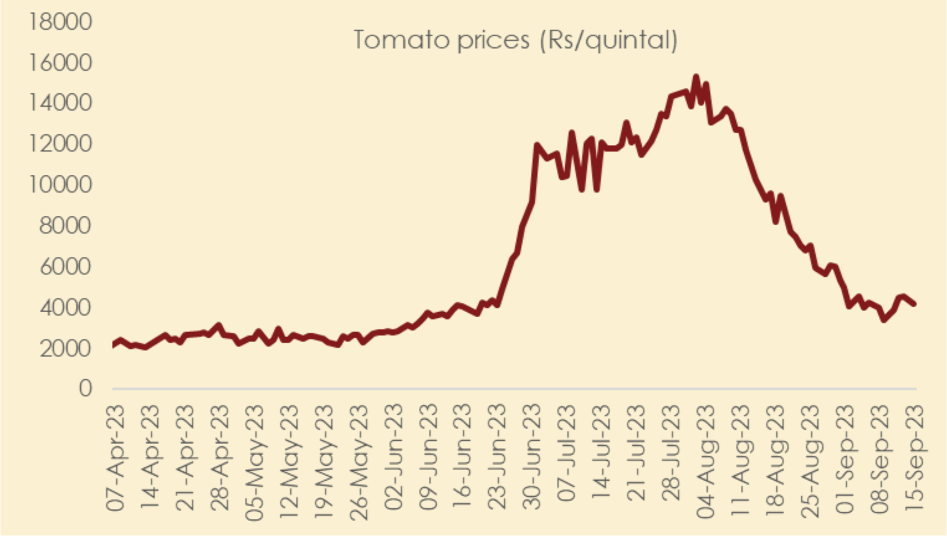


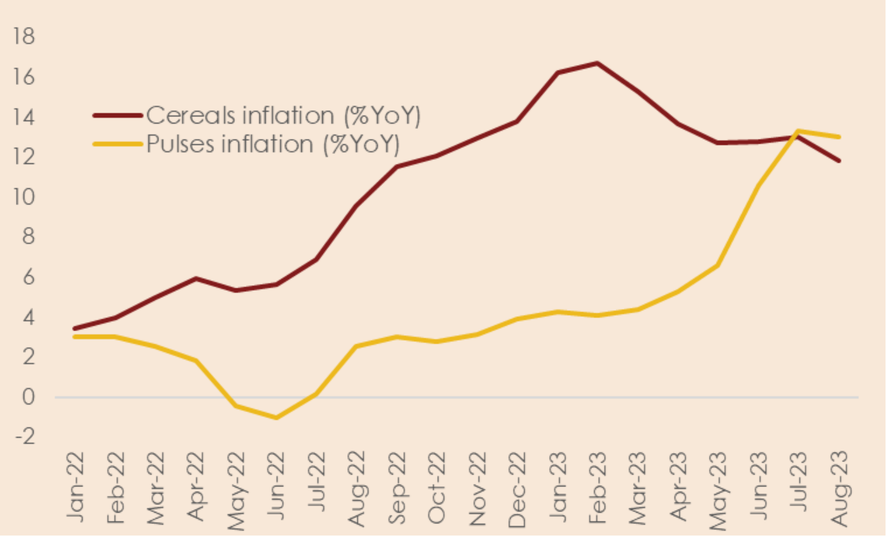
Still food remains a mixed bag

Relief emanated from the food basket, which saw 0.52% MoM fall, led by Vegetables, Egg and Meat & Fish.

- Tomatoes (with a ~22% MoM fall) dominated the price move in the Vegetable index, as supply started responding to the build-up in price since Jun-23.

Nevertheless, limiting the decline in overall food inflation was continued price pressure seen from Cereals and Pulses, which remain on watch in the near term

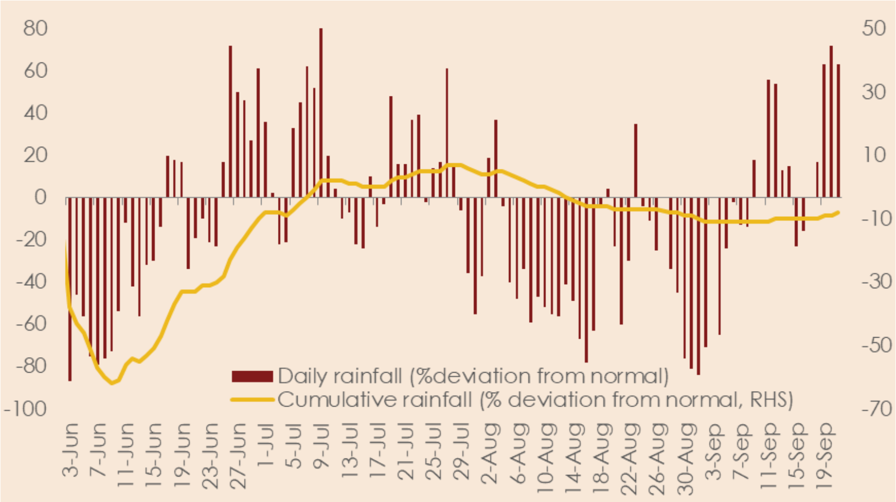




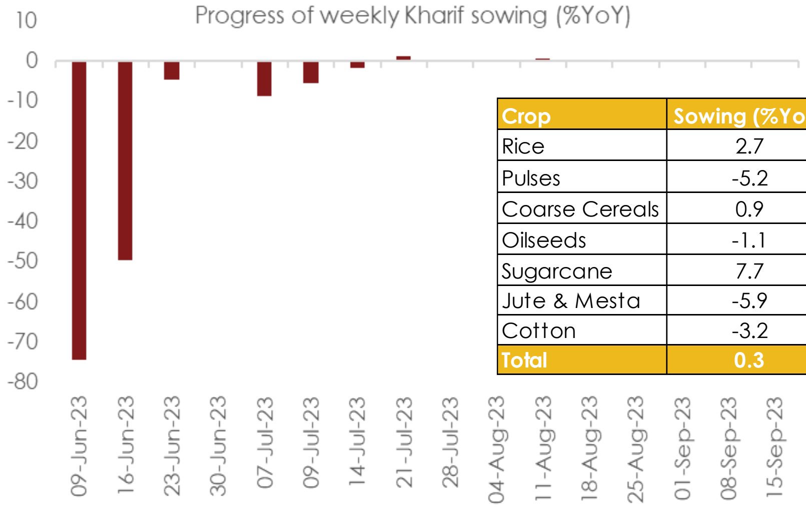
Irregular monsoon may impact kharif crop

Rainfall at 36% deficiency in Aug-23 weighed on season's cumulative rainfall performance that ended at 10% deficit as of month-end. In Sep-23, some pick up in rainfall activity has helped narrow cumulative rainfall deficiency to 6% (as of 28 th Sep-23)

Area sown under Kharif crops has been at par with last year's level. The intensification of El Nino and decline in rainfall activity over Aug-Sep-23 could possibly weigh on Kharif crop yields.



(as a % of LPA)



Crop	Sowing (%YoY)
Rice	2.7
Pulses	-5.2
Coarse Cereals	0.9
Oilseeds	-1.1
Sugarcane	7.7
Jute & Mesta	-5.9
Cotton	-3.2
Total	**0.3**

CPI inflation: Risks stacked on the upside

Upside risks to watch

Impact of OPEC+ decision to continue with production cuts on crude oil prices

Other global commodity prices have moved up, especially food, post the cessation of Ukraine grain deal and India's ban on export of Rice

Intensification of El Nino may impinge on global food production in the coming months

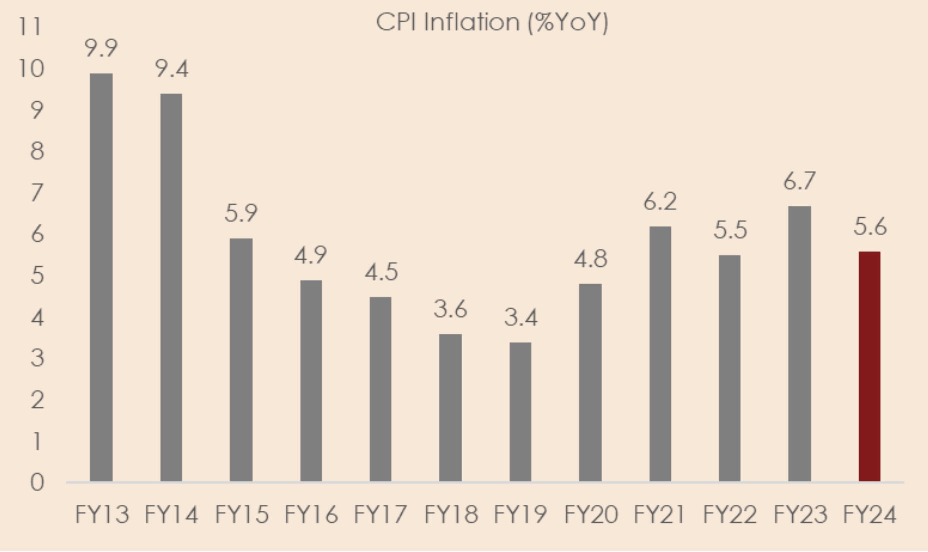
Durability of price pressures seen in cereals and pulses, despite administrative measures already announced by Government (such as open market sales, stock holding limits etc.)

Lack of consistency in monsoon on Kharif crop yields and on Rabi sowing

Having said so, the Rs 200 price reduction announced on LPG cylinder towards the end of Aug-23, is likely to offer 30-35 bps of comfort to Sep-23 CPI print translating into a downside of ~18-20 bps for average FY24 CPI estimate

For Q2 FY24, CPI inflation is expected to overshoot RBI's forecast of 6.2% by as much as 40-50 bps. Thereafter, the trajectory is expected to be broadly in line with RBI's forecast of 5.7% in Q3, followed by 5.2% in Q4 FY24.

Given the upside risks, we for now continue to hold on to our FY24 average CPI inflation estimate of 5.6%



Snapshot of YTD FY24 fiscal performance

The FYTD (Apr-Jul) accretion to fiscal deficit stood at 33.9% of budget estimates (BE) for FY24, higher than 19.7% seen in the corresponding period in FY23. The latest data shows that till Aug-23 the deficit stood at 36.0% vs 32.6% in the previous year. This was driven by relatively lower pace of tax revenue and divestments even as total expenditure momentum remained robust.

Key Fiscal Variables (Cumulative position, Apr-Jul)				
	% of FY Actual/Target		%YoY	
	FY23	FY24	FY23	FY24
Revenue Receipts	31.7	28.9	12.9	0.7
Net Tax	31.8	25.0	25.9	-12.6
Non-Tax	31.3	59.3	-36.0	99.6
Non-Debt Capital Receipts	41.7	16.3	112.9	-54.5
Total Receipts	**32.0**	**28.5**	**15.0**	**-1.4**
Revenue Expenditure	26.6	30.4	4.8	15.9
of which, Interest Payments	30.6	27.8	25.7	5.6
of which, Major Subsidies	21.0	37.6	-8.6	28.5
Capital Expenditure	28.3	31.7	62.5	52.0
Total Expenditure	**26.9**	**30.7**	**12.2**	**22.5**
Fiscal Deficit	**19.7**	**33.9**	**-**	**-**

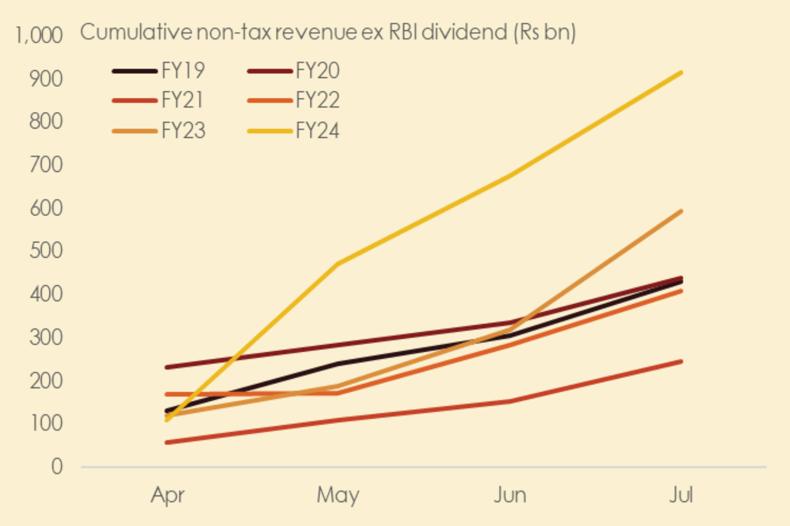
Revenues: A mixed bag

Gross tax collections have posted a subdued performance so far. Barring customs, all other sources of tax collection are running at a lower rate than BE (high statistical base effect from last year is partly at play). 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 recent increase in commodity prices that would benefit customs and IGST component of imports.

Growth in key tax categories	Apr-Jul FY23 (% YoY)	Apr-Jul FY24 (% YoY)	FY24 BE (% change*)
Gross Tax	**22.4**	**3.3**	**10.1**
Corporate Tax	34.7	-10.4	11.7
Income Tax	50.0	6.4	11.4
Customs	-12.0	27.5	9.2
Excise	-15.2	-10.5	6.3
GST	28.6	9.8	12.1

* Implied growth over FY23 actuals

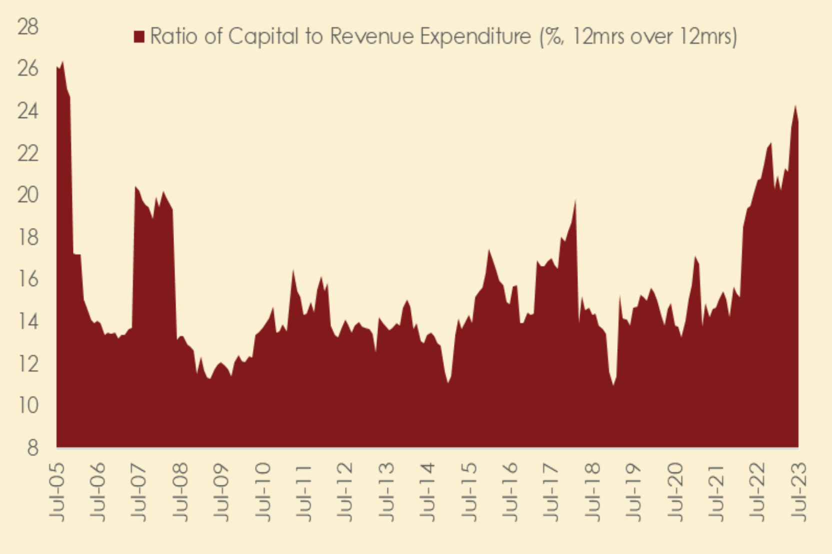
Compensating for subdued tax collection is non-tax revenue. This has not just benefitted from the higher than budgeted surplus transfer from the RBI but continues to find support from strong dividend payout from PSUs and spectrum income. However, divestment activity is slow (Rs 55 bn until Jul-23 vs. Rs 246 bn until Jul-22) and needs considerable traction.

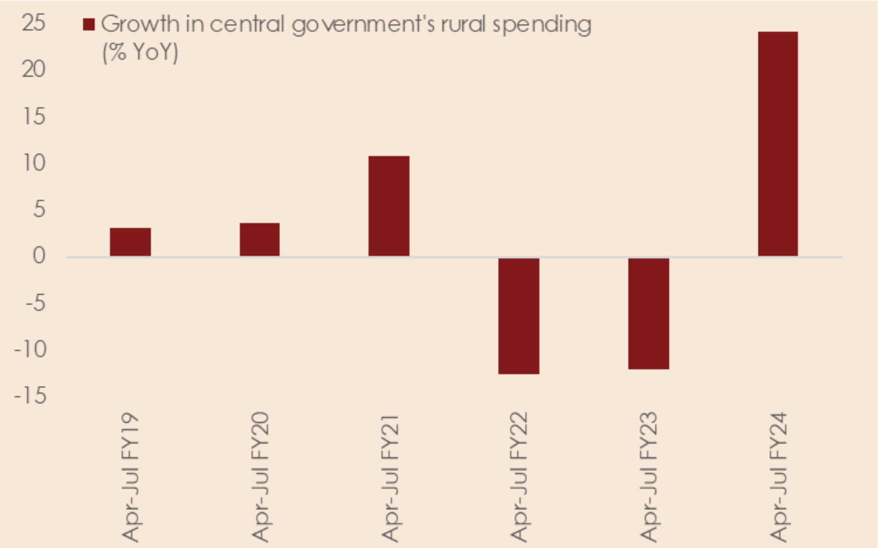


Quality expenditure in focus; fiscal risks appear manageable, but need monitoring

Central government continues to prioritize capex vis-à-vis revex. However, risk of an overshoot in subsidy payments exists on account of fertilizer and higher oil prices.

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.



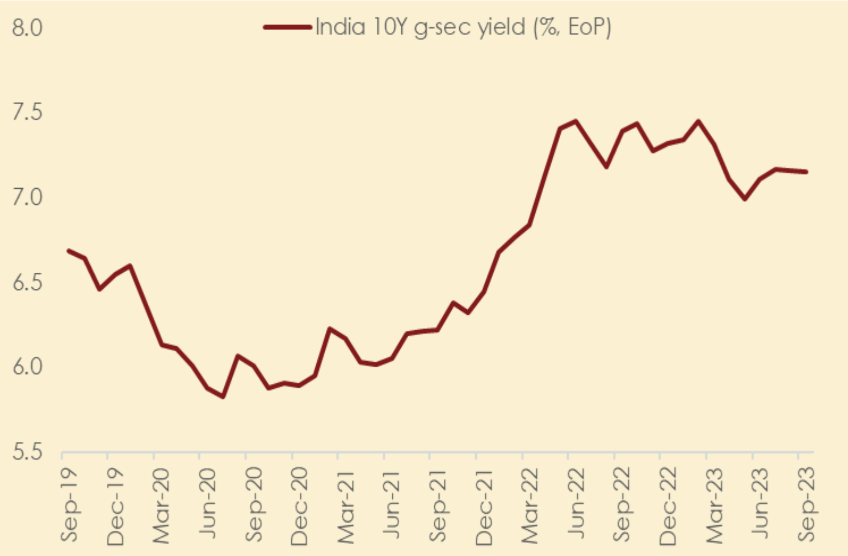


Note: Includes revenue spend by 9 ministries/departments with rural focus

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

G-sec yields stabilize in a narrow range

After touching 7.25% in Aug-23, India's 10Y g-sec yield seems to have stabilized in the 7.10-7.20% range.



Reversal of record high tomato prices and a substantial cut in LPG price has attenuated extreme risks on headline CPI inflation after the sharp acceleration seen in Jul-23.

Aug

Key price changes

- **Tomatoes (-21.7% MoM)**

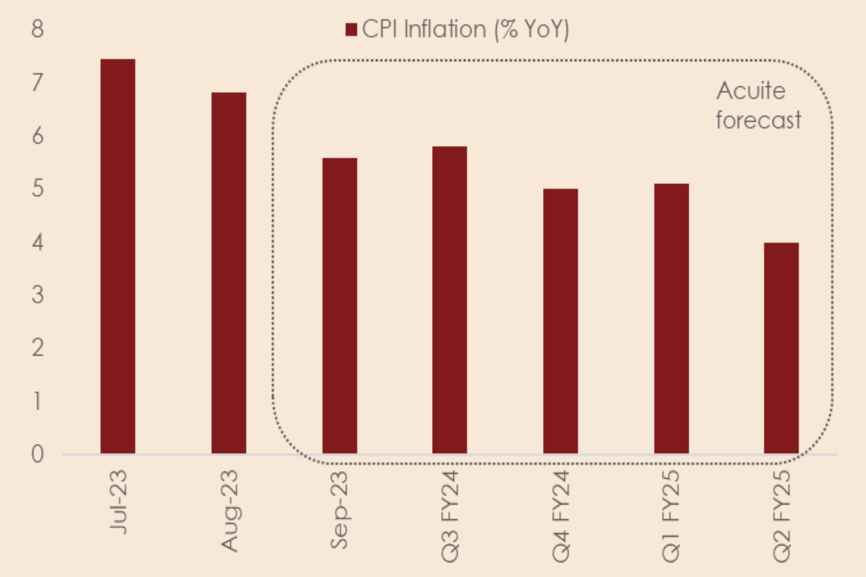
Sep

Key price changes

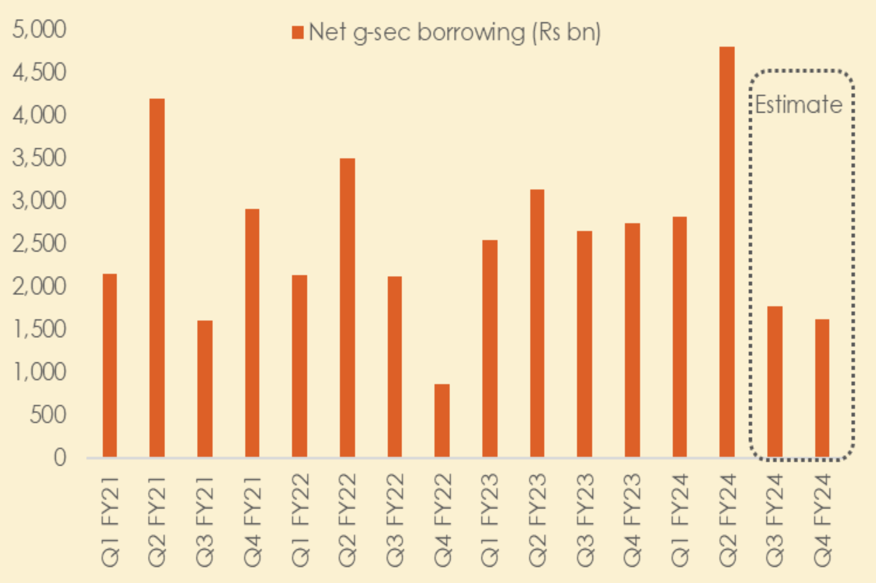
- **Tomatoes (-53.6% MoM)**
- **LPG (-18.1% MoM)**

Domestic factors to turn favorable in H2 FY24

After peaking at 7.44% in Jul-23, CPI inflation is projected to moderate to 5.2% in Q4 FY24, and further towards ~4% in Q2 FY25

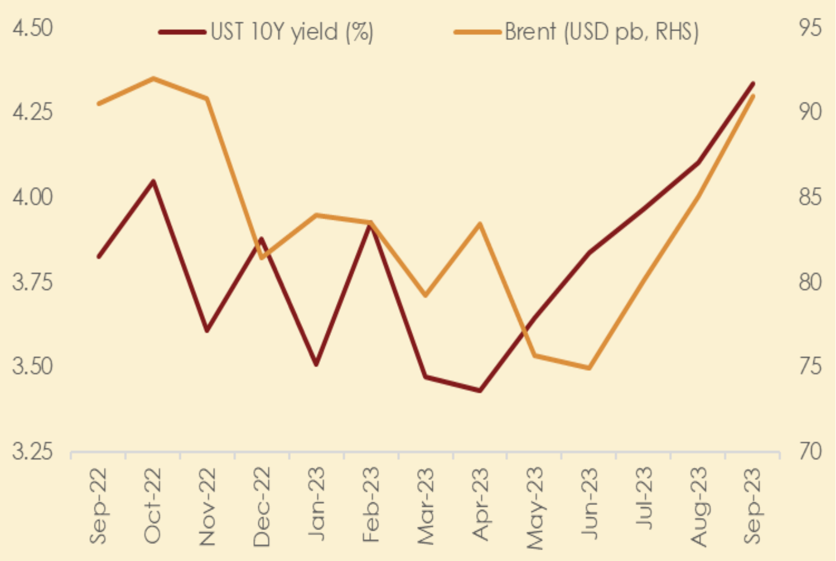


Although net g-sec borrowing is at its post Covid high in Q2 FY24, it is projected to decline considerably in H2 FY24.

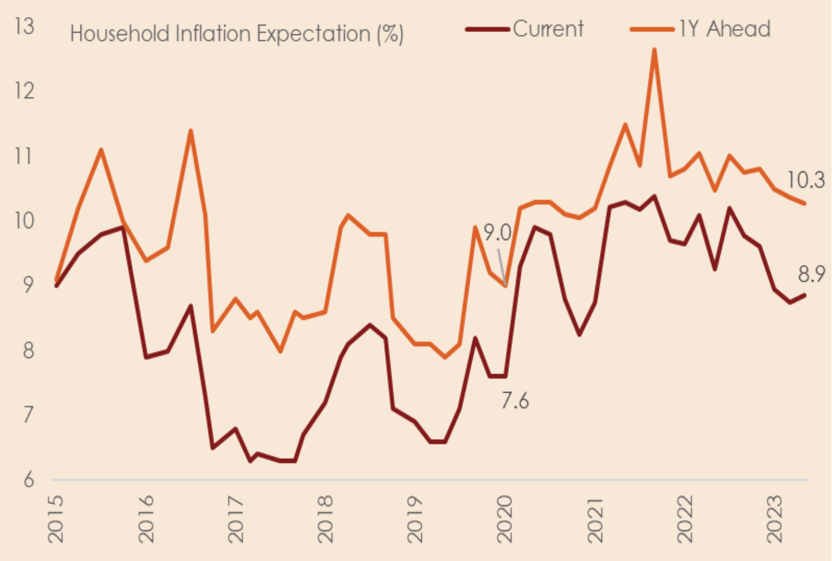


However, MPC is likely to remain cautious…

US yields are currently trading at their highest levels (at near 4.6%) since 2007 on the back of 'higher for longer' narrative on monetary policy rate. Meanwhile, commodity prices, esp. crude oil, have jumped sharply in response to OPEC's extended supply cut and monetary easing in China.



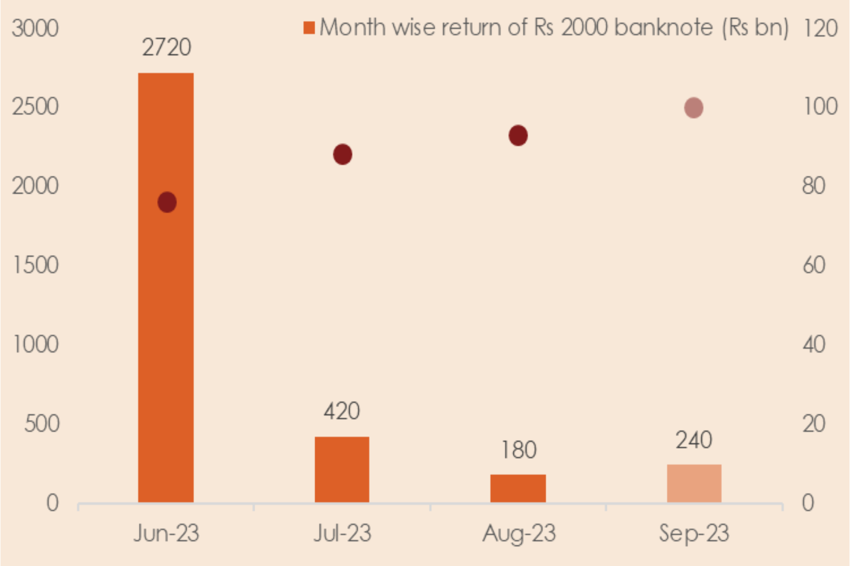
On the domestic front, notwithstanding some moderation, inflation expectations continue to remain above pre Covid levels due to rising oil prices and the uncertainty around El Nino.

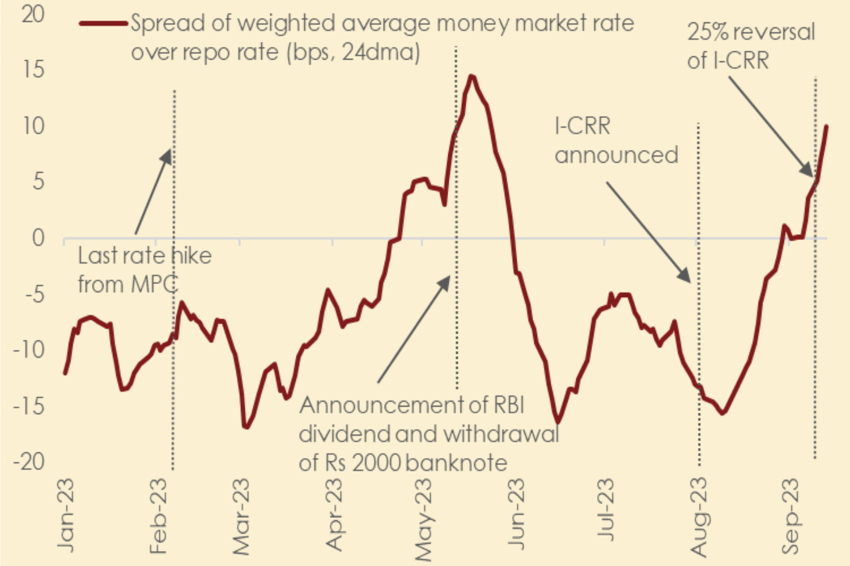


…with continued calibration of liquidity surplus

Withdrawal of Rs 2000 banknote from circulation increased core liquidity as ~87% of the returned notes were in the form of bank deposits.

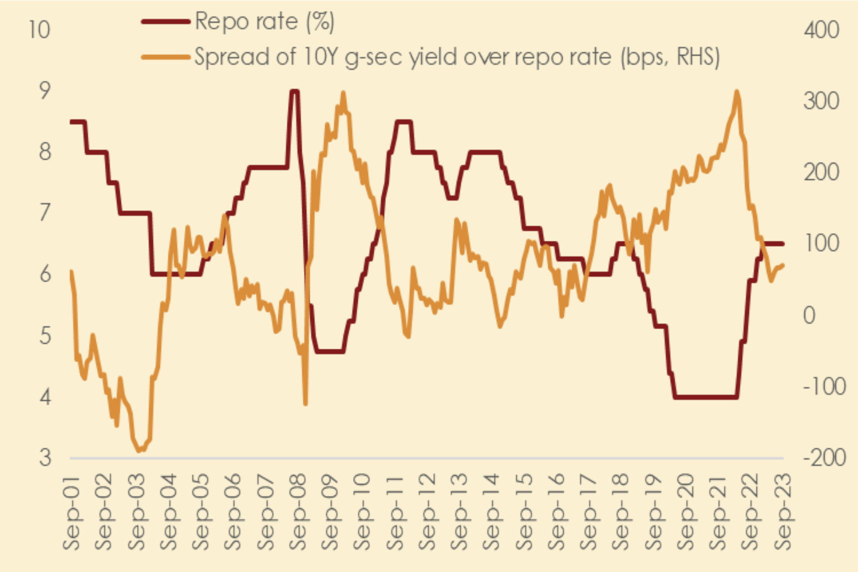
I-CRR hike in Aug-23 was announced to temporarily sterilize impact of Rs 2000 banknote withdrawal and push short-term rates above repo rate. The roadmap for withdrawal of I-CRR has been phased, with 25% on Sep 9 th, 25% and Sep 23 rd, and the remaining 50% on Oct 7th.



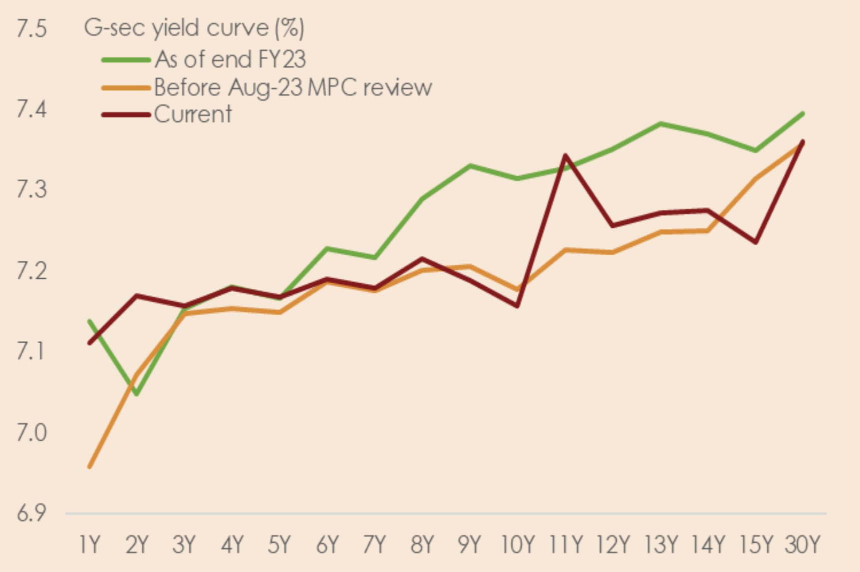


Rates outlook

10Y yield is currently trading 70 bps above policy rate – this could compress with visibility of rate easing cycle emerging in the coming quarters.



Near term inflation risks will continue to flatten the g-sec yield curve.

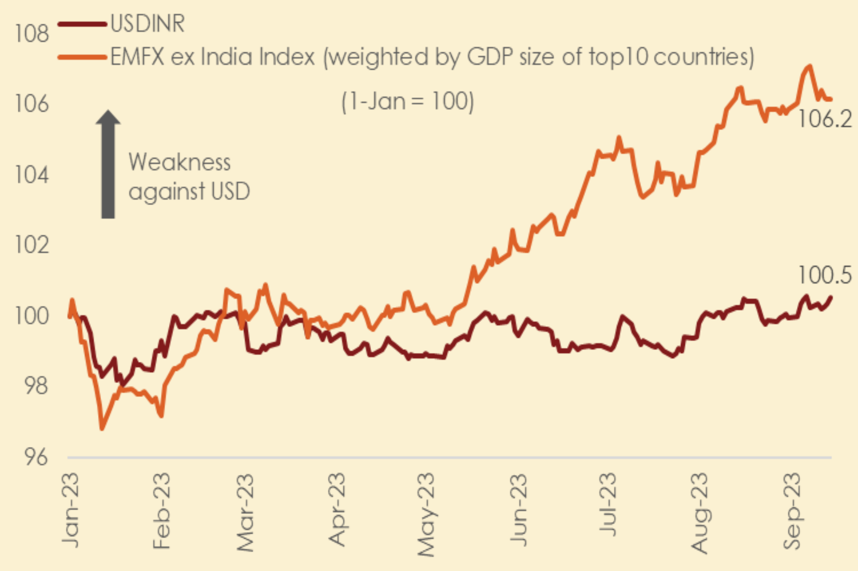


We continue to expect a prolonged pause from the MPC through FY24. While inflation anxiety and supply concerns could keep 10Y g-sec yield elevated in the near-term (with 7.25% as top), **we continue to expect 10Y g-sec yield to moderate towards 7.00% by Mar-24**.

INR trading close to record low levels

USDINR is currently trading close to over 83 levels, the weakest in history

US economic resilience is aiding the dollar – the DXY index is currently trading at a 10-month high.



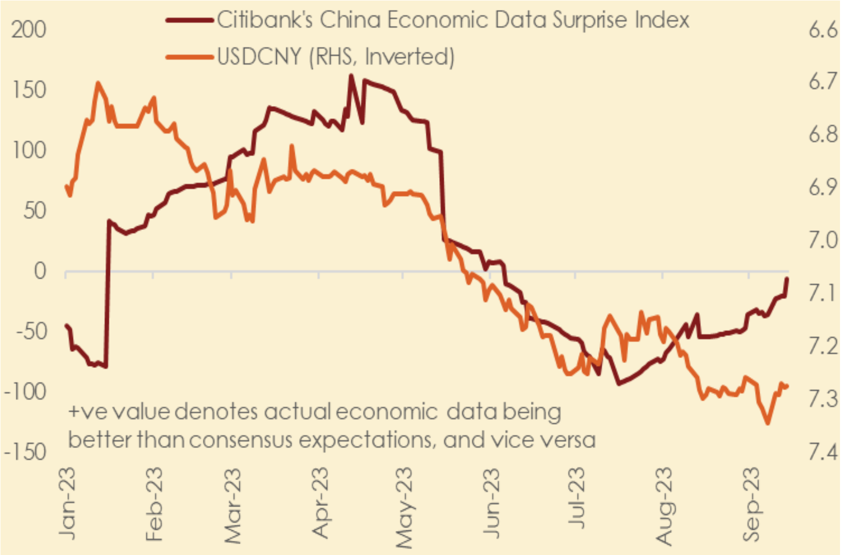
Stronger USD, weaker CNY = Weaker INR

The Fed could still opt for one more round of final rate hike, thereby supporting the USD. The upcoming FOMC review on Sep 20th will update the dot plot and hopefully provide clarity on the terminal rate (market participants currently stand divided on the prospect of another rate hike).

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%

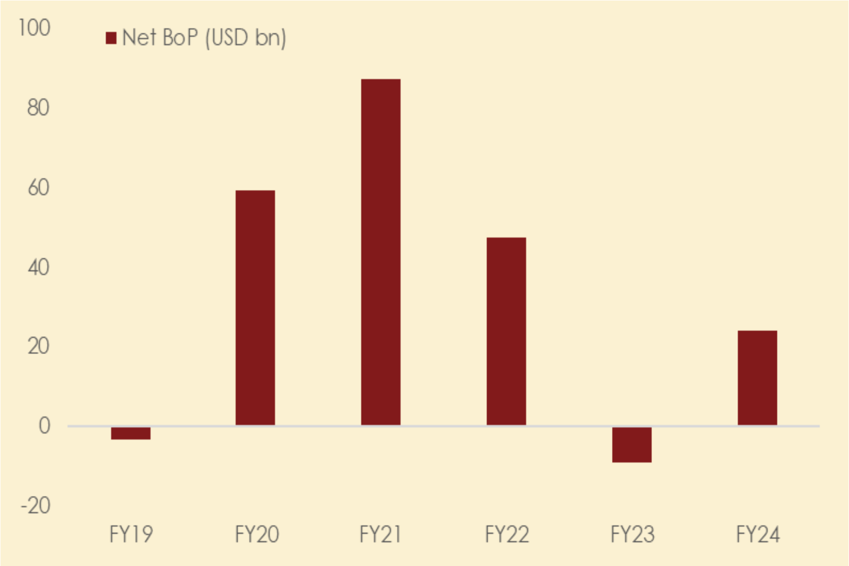
Notwithstanding recent improvement in Chinese economic data, the trend so far suggests dominance of downward surprises. This has put pressure on the CNY, which is also weighed down by PBoC easing.

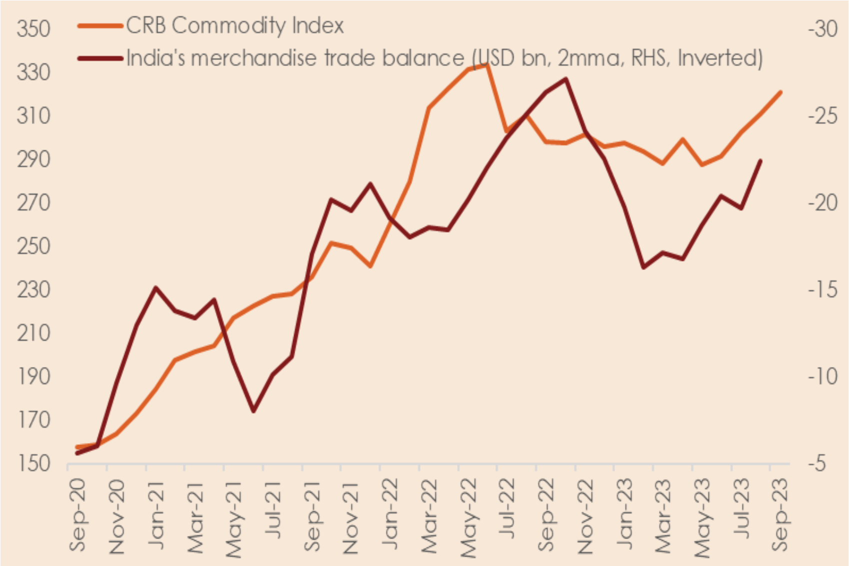


BoP support waning on higher commodity prices

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.

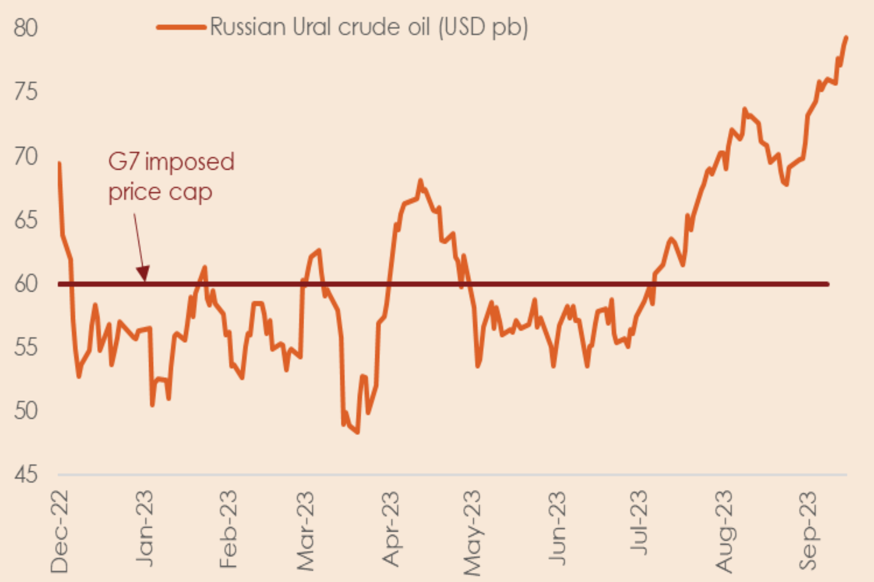
However, hardening of commodity prices has started to put pressure on monthly merchandise trade deficit, which rose to a 10-month high of USD 24.2 bn in Aug-23. This could impart an upside risk to our FY24 CAD estimate.



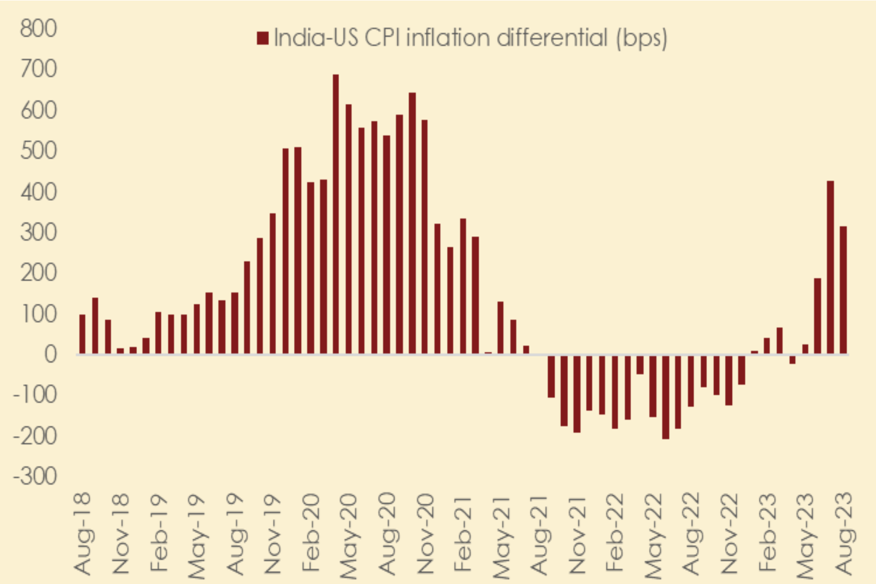


Swing factors no longer in support

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.

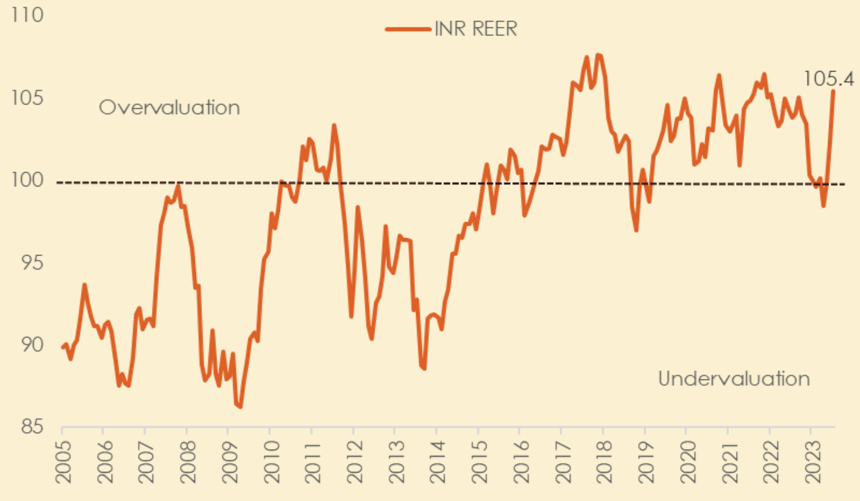


With inflation differential with the US turning against India, INR could continue to face some pressure in the near-term.

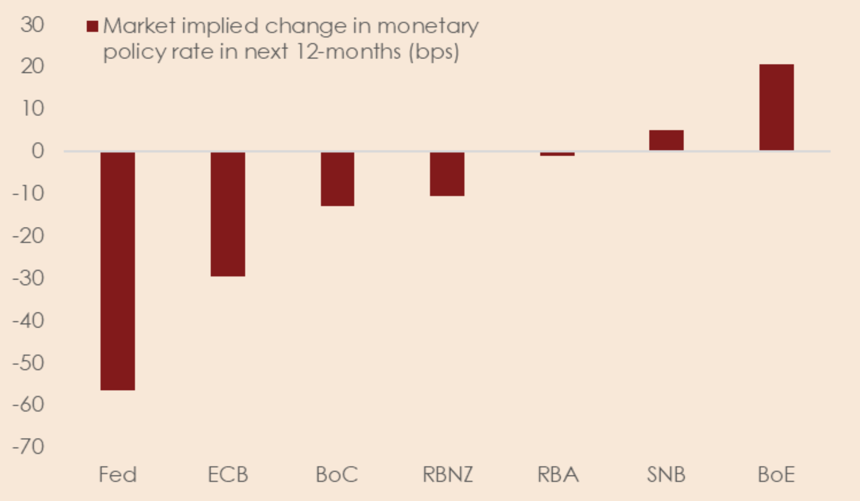


Rupee outlook

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.



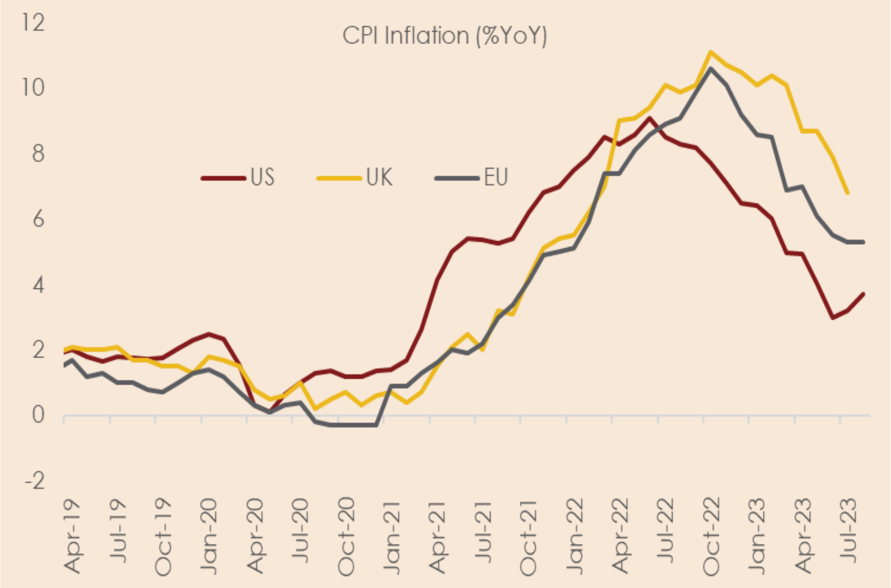
Market participants expect US Fed to lead DM central banks in the rate cutting cycle in 2024. This could weigh on the USD.



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 putting pressure on INR. As such, we expect INR to weaken towards 84 levels in the next 3-months. We maintain our moderately constructive view on INR, with a move towards 82 by Mar-24.

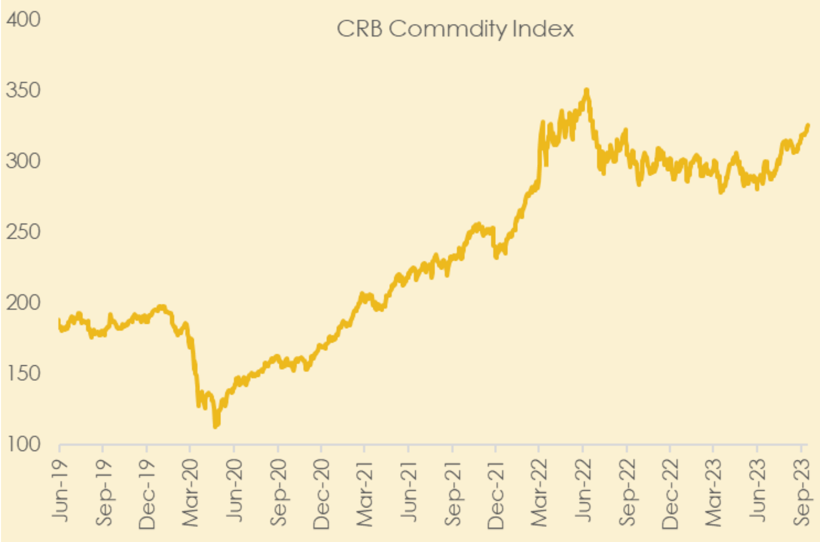
Commodity prices upturn can slow down the global inflation descent

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



That said, the recent upturn in commodity prices, particularly oil, could threaten to aggravate the stickiness of above-target inflation beyond the very near term.

US CPI inflation in Aug-23 rose more than expected by 0.6%MoM, translating into an annualized increase of 3.7% compared to 3.2% in Jul-23



US growth outperformance continues…

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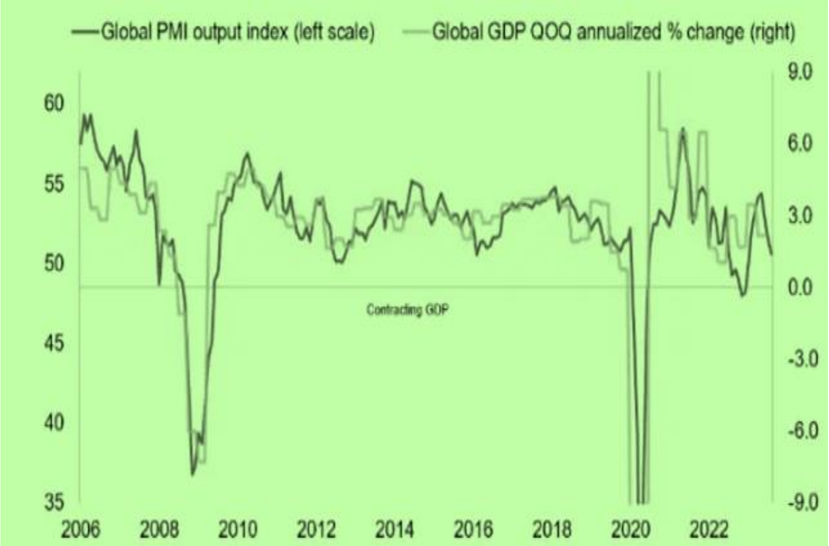
Global growth continues to show positive momentum, especially in the US where the possibility of a recession is now a fading risk.

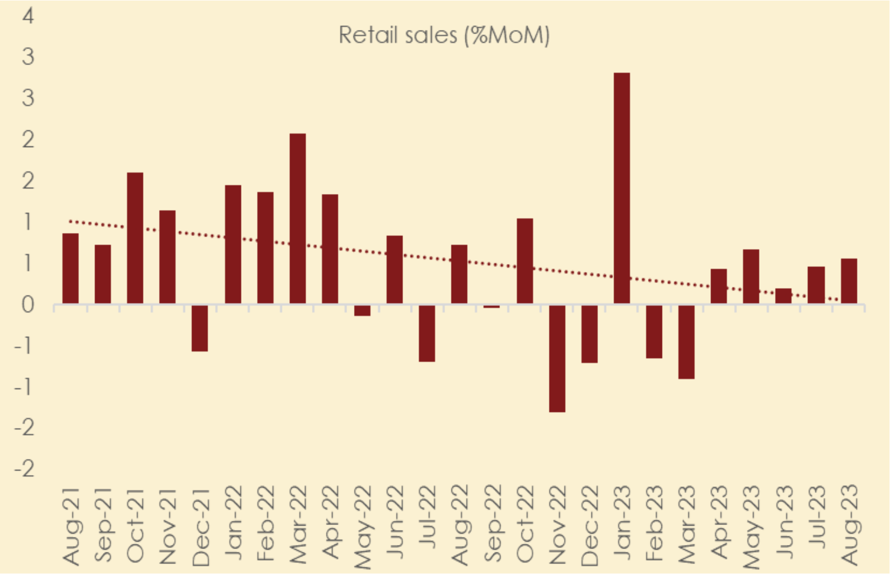
Having said so, growth momentum could slow at a faster clip heading into H2-2023 with global trade remaining on a weak footing

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

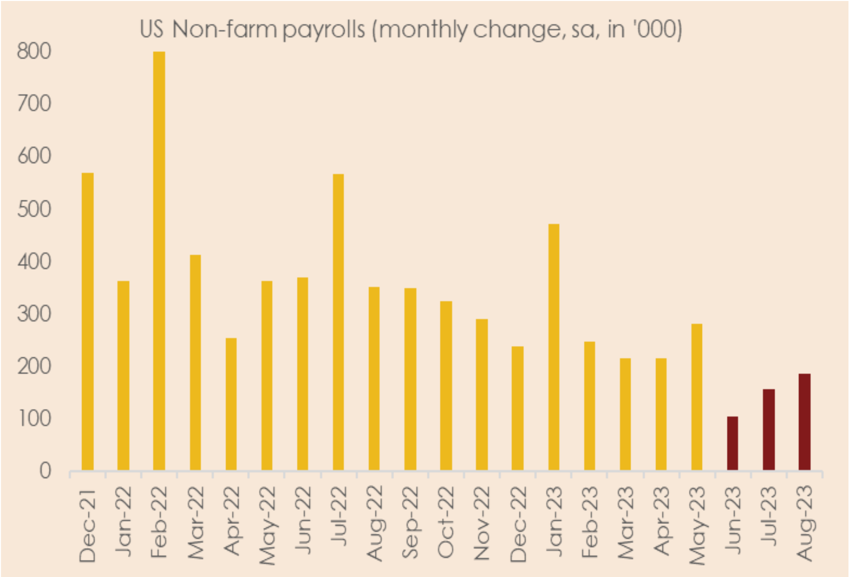


…but seeds of growth moderation gaining root

US retail sales momentum has edged lower on trend basis. For Aug-23, while retail sales grew at a faster clip by 0.6%MoM, in large part were driven by spike in gas prices



Non-farm payroll run-rate has dipped substantially over the last 3 months (150k) compared to the previous 3 months (430k)



ECB delivers a dovish hike

ECB delivered a dovish hike in Sep (14th Sep-23), by choosing to tighten monetary policy further by 25 bps, but at the same time, signaled that the tightening cycle was likely over

It now expects –

- HICP inflation to decrease from an average of 8.4% in 2022 to 5.6% in 2023, 3.2% in 2024 and 2.1% in 2025.
- Economy to expand by just 0.7% in 2023, 1.0% in 2024 and 1.5% in 2025 implying a deterioration in growth outlook

Growth and inflation projections for the euro area

(annual percentage changes)

	September 2023					June 2023			
	2021	2022	2023	2024	2025	2022	2023	2024	2025
Real GDP	5.6	3.4	0.7	1.0	1.5	3.5	0.9	1.5	1.6
HICP	2.6	8.4	5.6	3.2	2.1	8.4	5.4	3.0	2.2

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