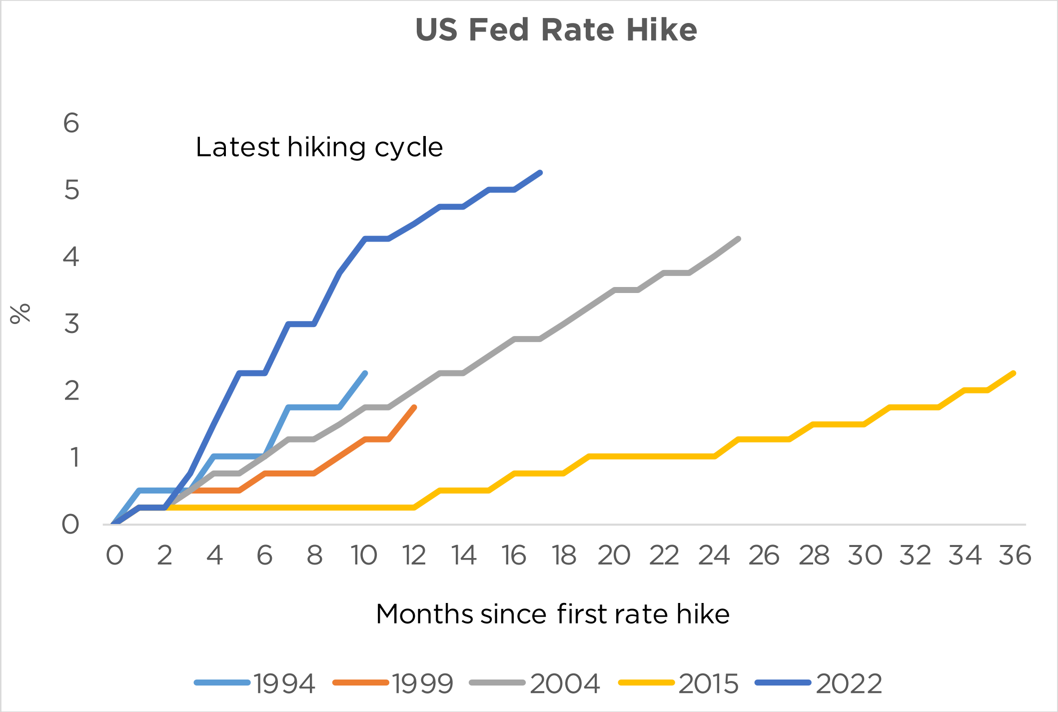
India: The Economic Pathway

August 2023

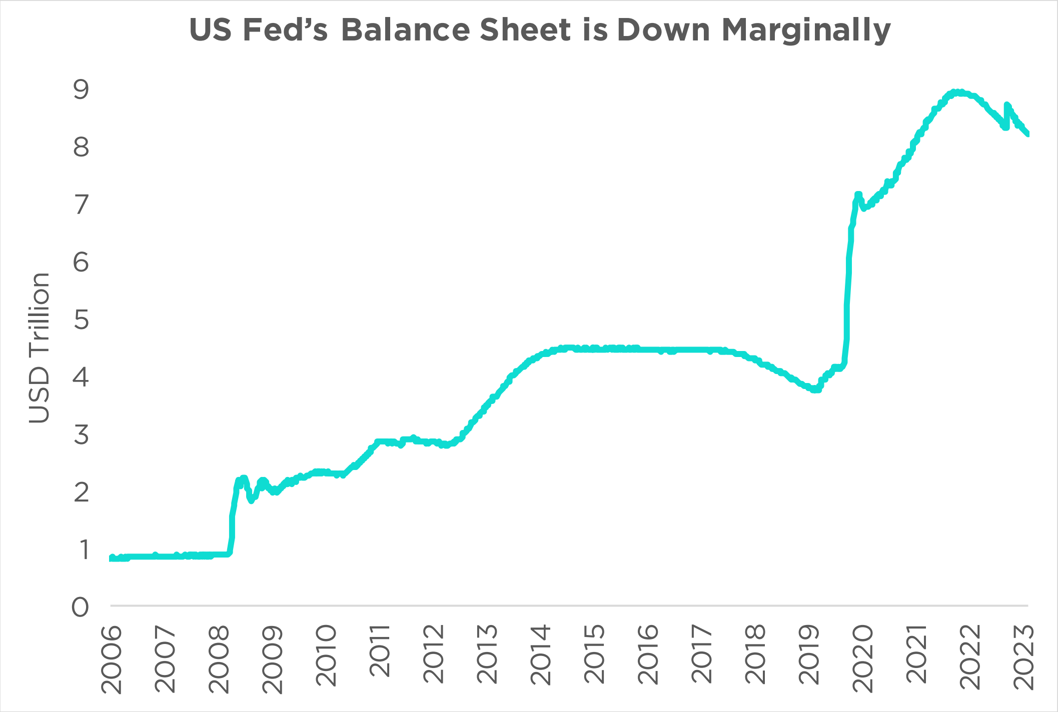
Global Economy

US: Present Hiking Cycle the Fastest, but Liquidity Remains Comfortable

CareEdge RATINGS



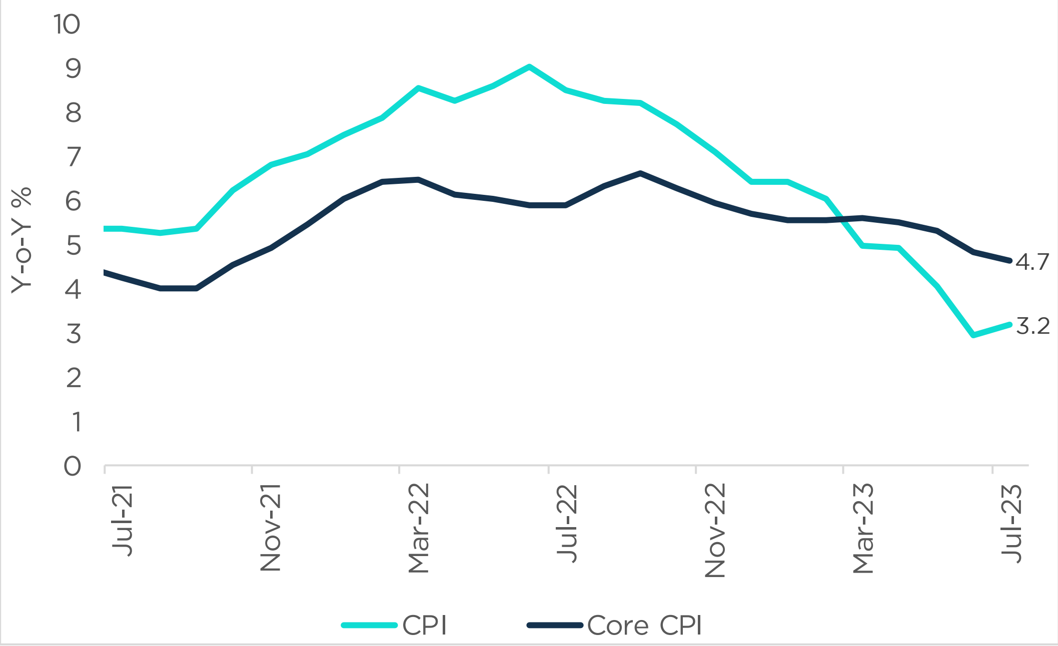
Source: CEIC



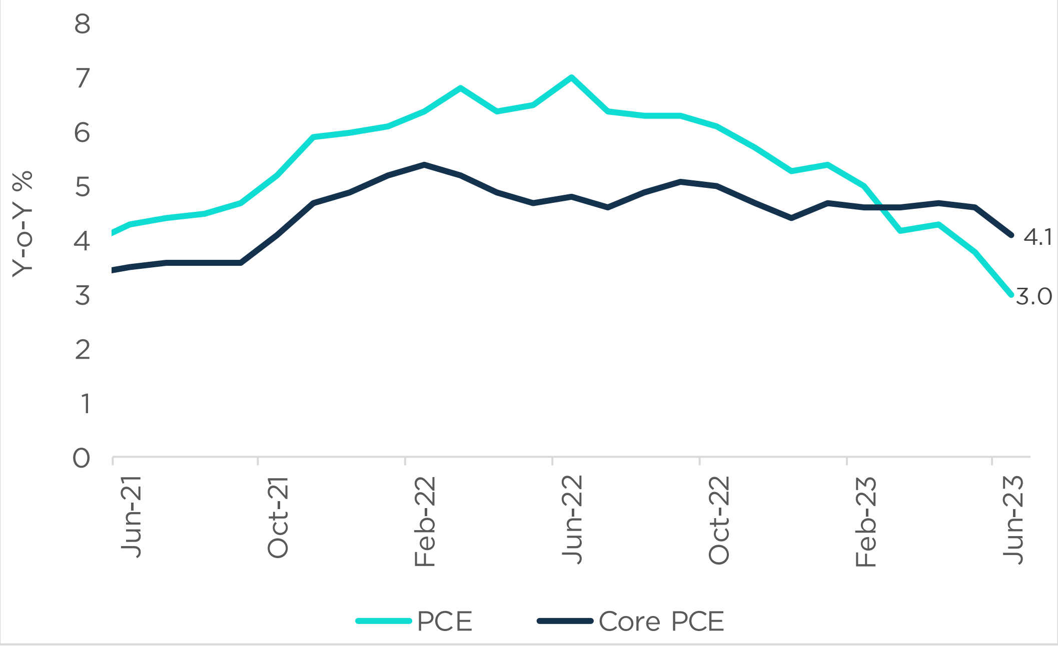
Source: CEIC

- Current rate hiking cycle had the fastest pace of policy tightening and the highest quantum of the rate hike since the 1990s.
- However, Quantitative Tightening (QT) has not been very aggressive, with the Federal Reserve balance sheet down ~USD 757 bn from its peak.
- Even though the cost of money has risen, comfortable liquidity conditions continue to support the US economy.
- The market anticipates at most one or no Fed rate hike going ahead.

Inflation Threat in the US Reduces



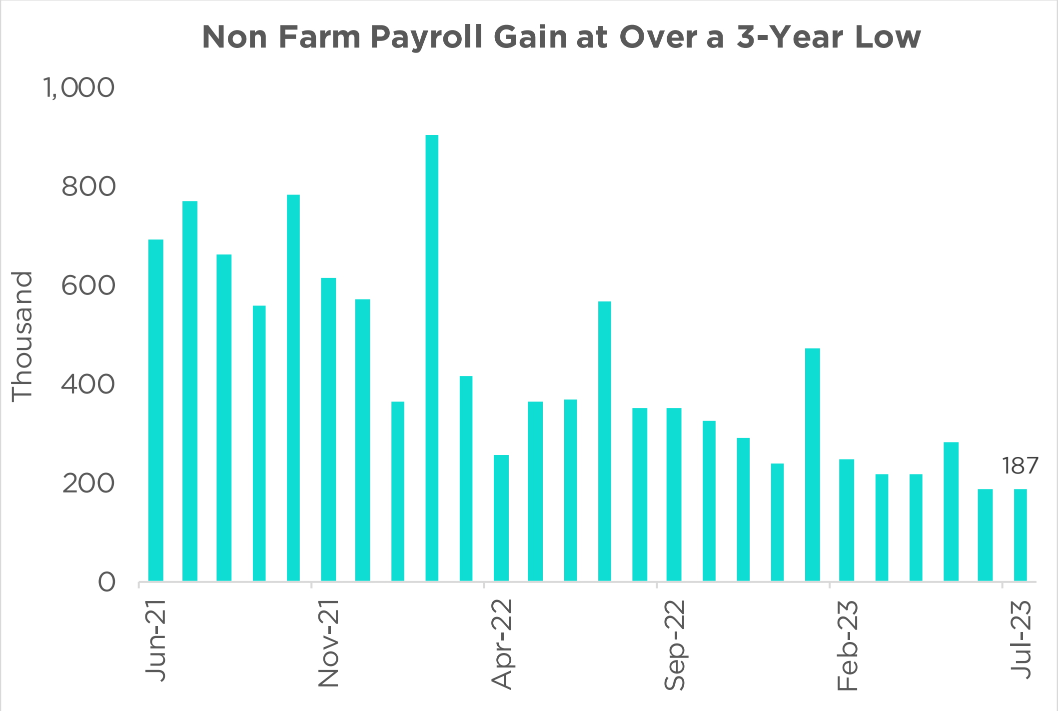
Source: Refinitiv



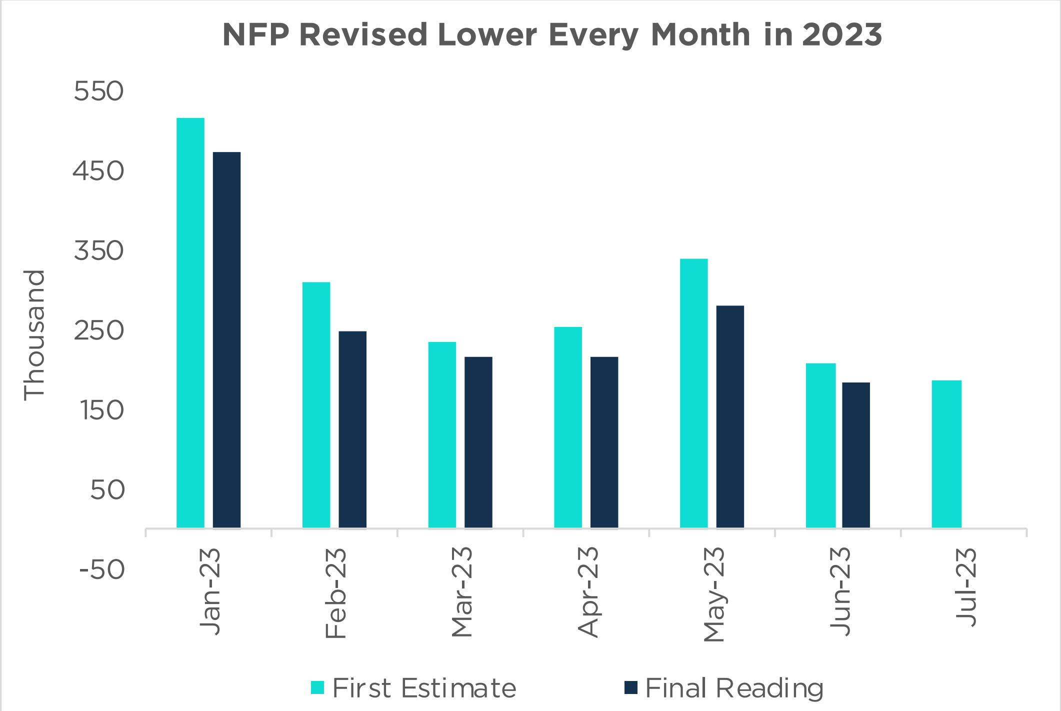
Source: Refinitiv

- US CPI inflation rose 3.2% y-o-y in July below market expectations of 3.3%, while core CPI eased to 4.7% in July.
- Fed’s preferred inflation gauge i.e. PCE eased to 3% y-o-y in June, the lowest in over two years.
- July FOMC minutes however highlighted that participants remained wary about upside risks to inflation, leaving the door open for more rate increases.

US Labour Market Cools



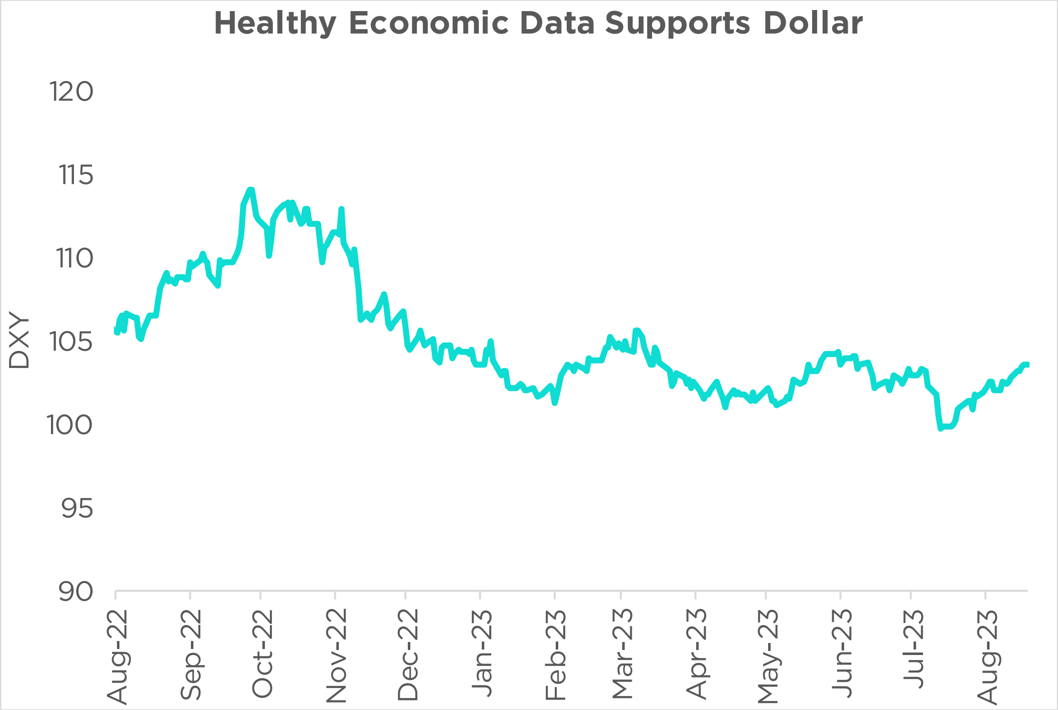
Source: Refinitiv



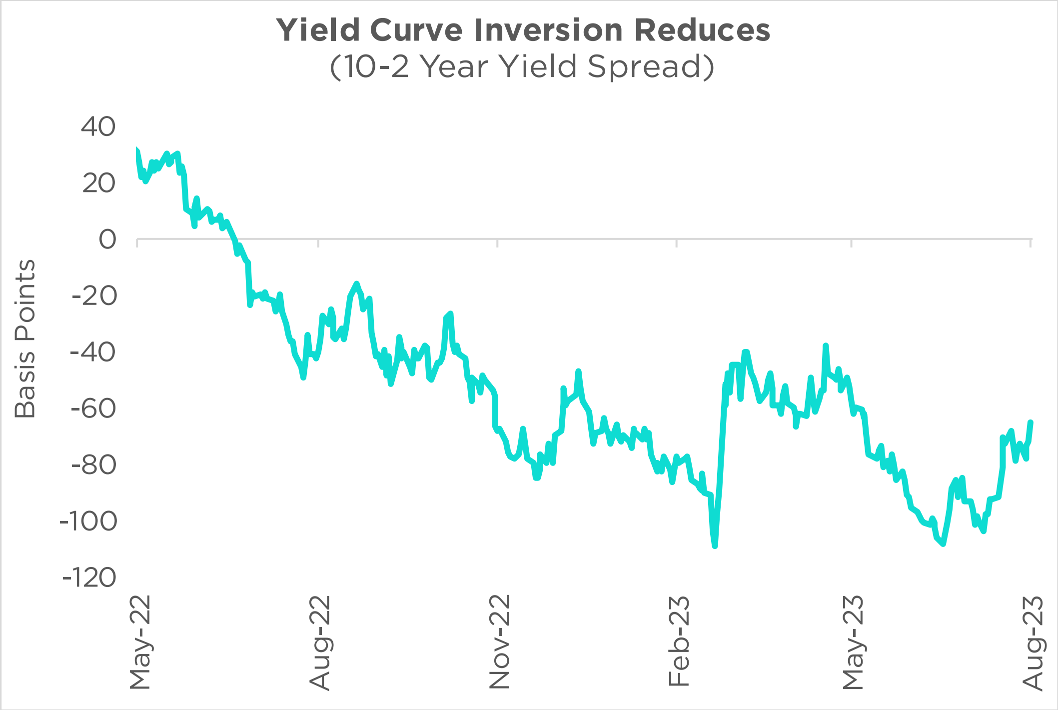
Source: Refinitiv

- Nonfarm payrolls (NFP) rose by 187K in July, lower than the average monthly gain of 312K over the prior 12 months.
- Notably, NFP gains have been revised lower in every month of 2023. Cumulative revisions represent a loss of 245K jobs.
- Unemployment rate, however, inched lower to 3.5% in July, from 3.6% in June.
- With growth holding up well, and inflation and the labour market showing signs of cooling, rate action at the September FOMC meeting would be a close call.

Strong Economy Aids USD; US Yields Climb



Source: Refinitiv



Source: Refinitiv

- DXY surged nearly 4% off the yearly lows on the back of strong economic data.
- 10-year US Treasury yield rose to a 10-month high in August as markets downsized the extent of future rate cuts.
- With the longer-end yields rising at a faster pace the yield curve inversion has reduced.
- Dollar and treasury yield upside likely to remain capped as Fed could end its rate hike cycle before other developed market central banks like ECB and BOE.

China's Property Sector Woes Set Alarm Bells Ringing

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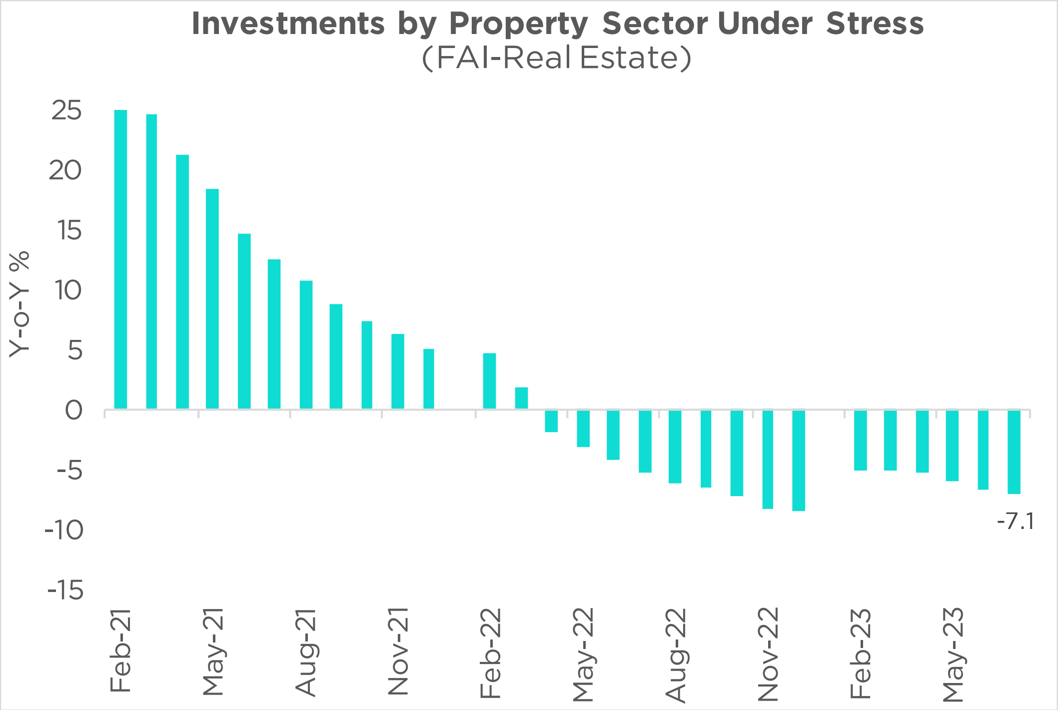
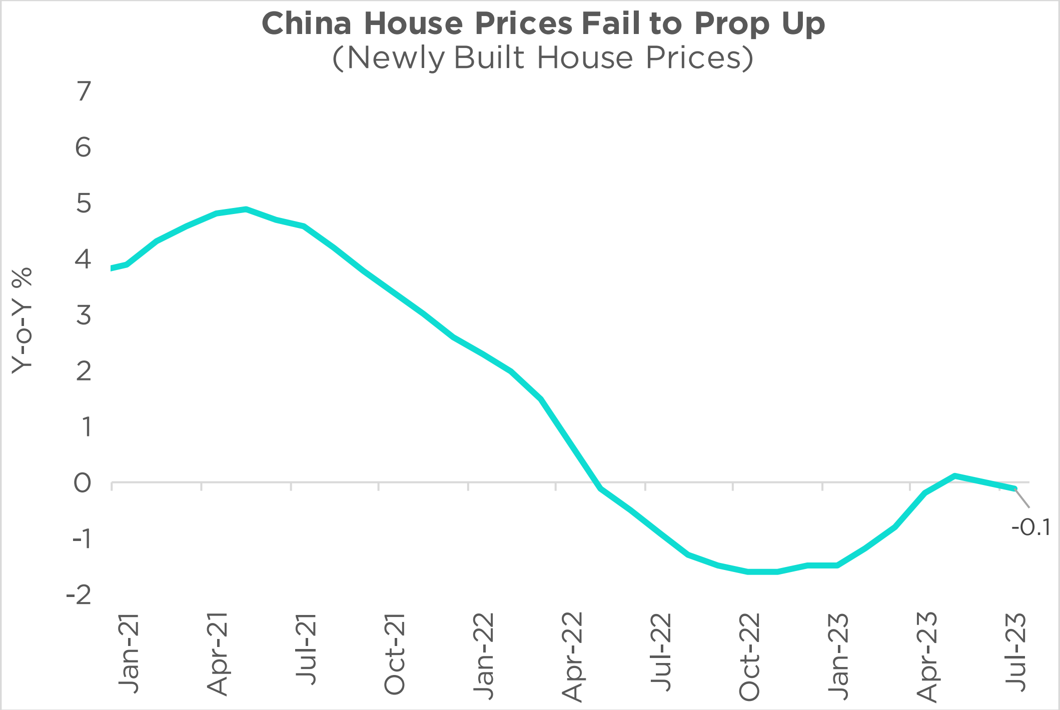


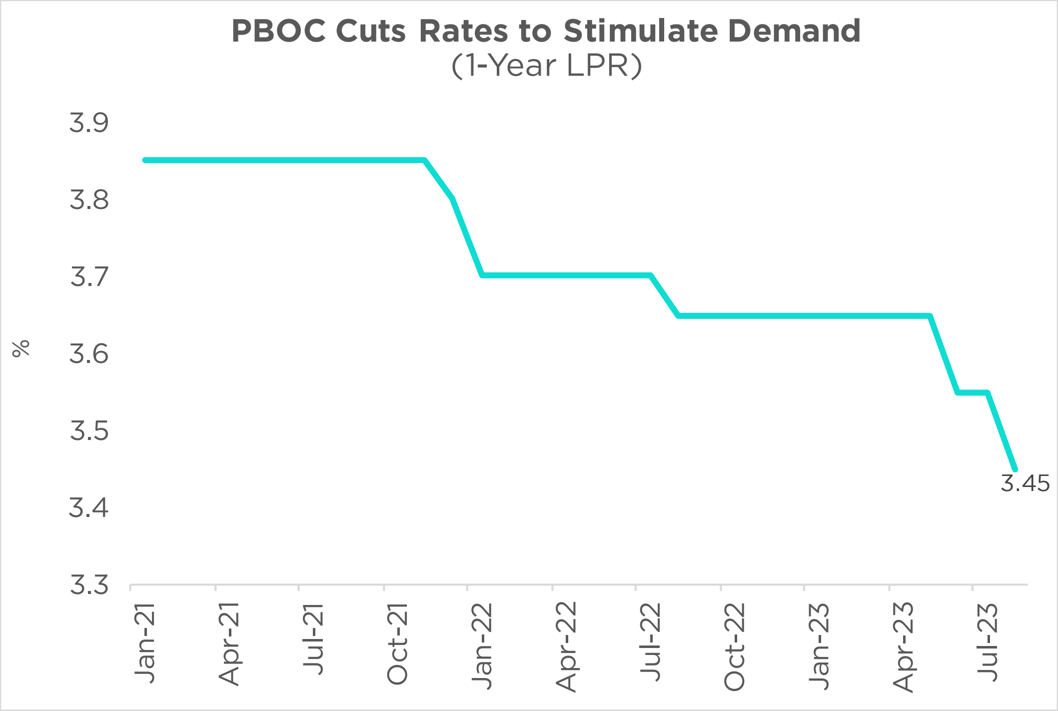
Source: Refinitiv



Source: Refinitiv

- Fixed asset investment (FAI) growth moderated in July amidst a continued decline in investment in the real estate sector.
- Rising unemployment, weak consumer confidence and declining house prices highlight the concerns around China's property sector.
- Markets remain wary over deepening property crisis and spillover risks to other parts of the economy.

PBOC Cuts Rates; Chinese Yuan Drops to Near 2-Decade Low



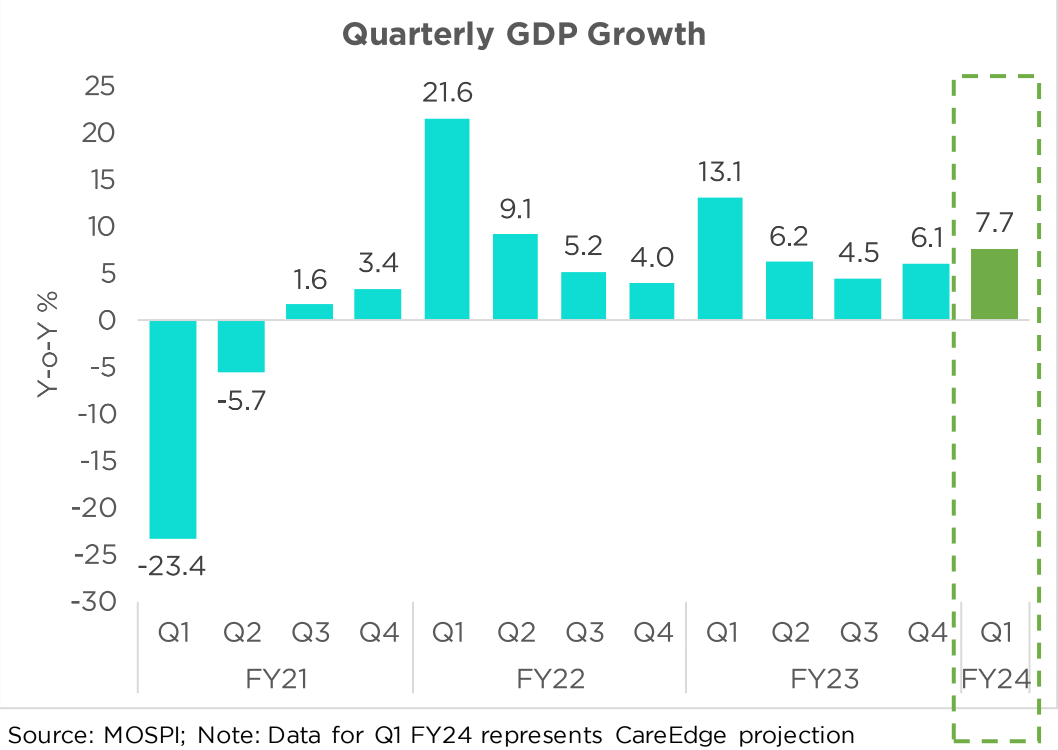
Source: Refinitiv

Source: Refinitiv

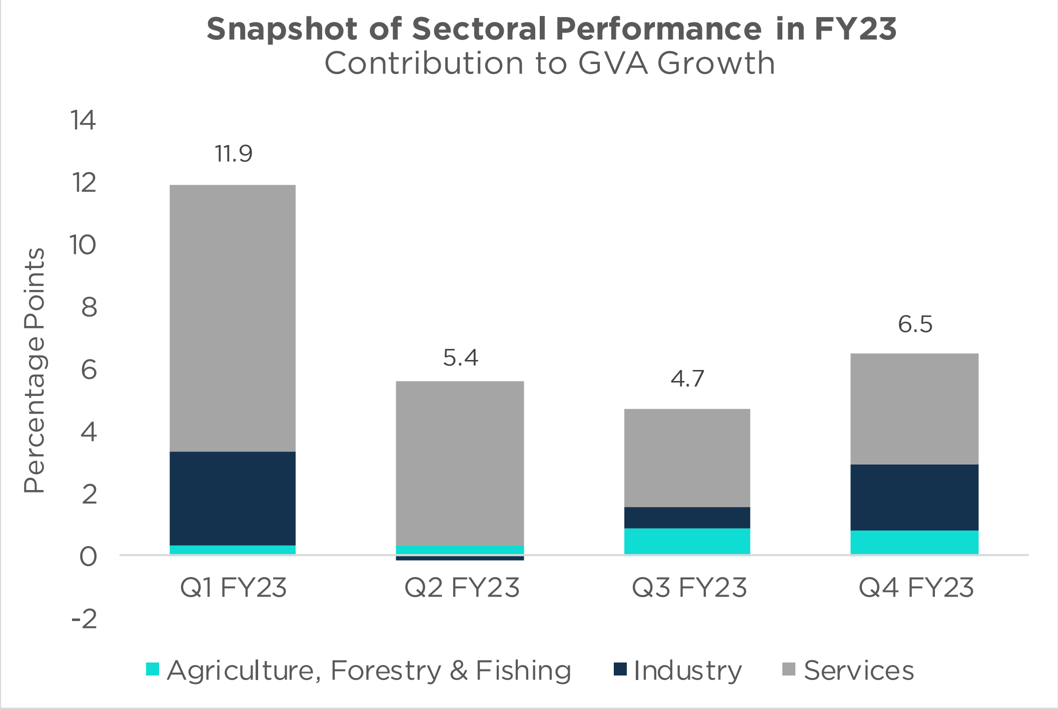
- People's Bank of China (PBoC) slashed the 1-year Loan Prime Rate (LPR) by 10 bps to 3.45%.
- 5-year LPR which influences the pricing of mortgages was however left unchanged at 4.2%, as against market expectations of a cut.

Domestic Economy

GDP Projected at 7.7% in Q1 FY24



Source: MOSPI; Note: Data for Q1 FY24 represents CareEdge projection



Source: MOSPI & CareEdge

- In Q1 FY24, growth is expected to inch up with improved momentum in manufacturing, improvement in construction activities, and an upbeat services sector.
- In FY24, we project growth to moderate to 6.5% (from 7.2% in FY23).
- Base normalisation, weather-related risks to agriculture output, moderation in pent-up demand, and external sector weakness to weigh on growth prospects in FY24.

Consumption Signals Mixed

Urban

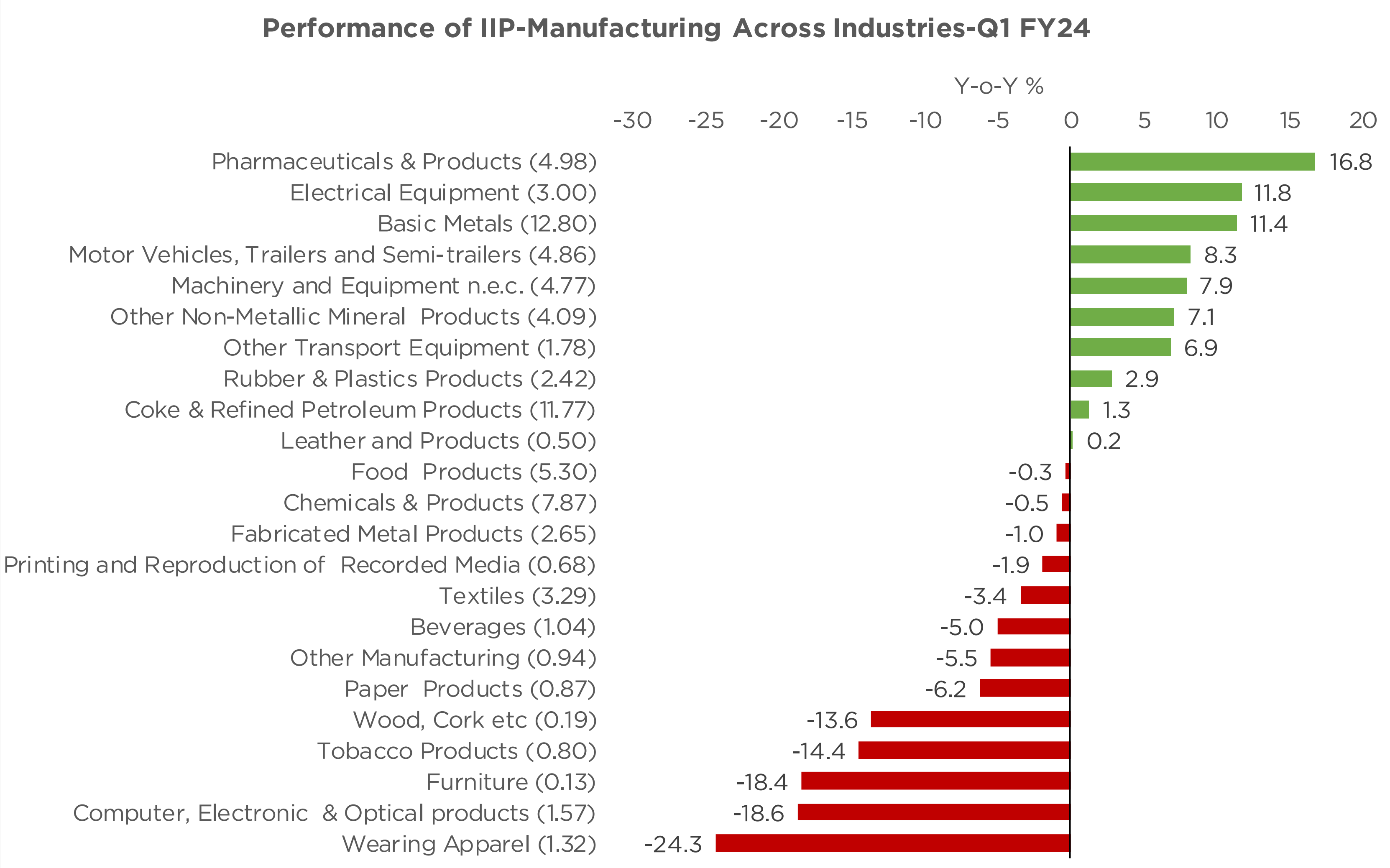
Rural

Consumption Demand Heatmap		Unit	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23
Urban Demand	Passenger Vehicle Sales	YoY	21.1	92.0	28.6	28.1	7.2	17.2	11.0	4.5	31.7	13.5	2.0	19.2
	Domestic Air Passenger Traffic	YoY	54.9	49.0	30.4	12.6	14.6	96.8	57.4	21.6	22.6	15.7	19.2	--
	Petrol Consumption	YoY	11.6	8.8	8.9	8.2	6.0	14.3	8.9	6.8	2.9	11.0	6.2	6.3
	E-way Bill	YoY	18.7	23.7	4.6	32.0	17.5	19.7	18.4	16.3	12.2	19.7	15.5	16.4
Finance	Retail Credit Outstanding	YoY	19.4	19.4	20.1	19.6	20.0	20.4	20.4	20.6	19.4	19.2	20.9	--
	Credit Card Transactions	YoY	44.5	52.2	27.8	28.7	34.7	45.5	37.9	28.2	25.9	23.7	26.2	--
Urban Labour Market/Consumer sentiments	Urban Unemployment Rate	%	9.6	7.7	7.3	8.9	10.1	8.6	7.9	8.6	10.3	9.1	7.9	8.1
	Naukri Jobspeak Index	YoY	5.8	12.7	-2.7	42.9	4.3	1.7	-2.2	5.2	-5.2	-0.5	-2.9	-18.8
	Urban Consumer Sentiment	YoY	39.1	46.9	47.7	49.5	54.3	50.0	56.4	55.0	53.6	43.3	44.1	34.2
IIP and imports	Electronics Import	YoY	21.9	2.0	-10.4	0.6	-2.6	-20.7	-12.7	-19.0	-7.0	17.1	8.4	--
	Non-Oil & Non-Gold Imports	YoY	40.6	20.6	4.6	6.6	2.7	-3.8	-2.0	-4.7	-12.5	1.7	-14.5	-7.5
	Consumer durables IIP	YoY	-4.4	-5.5	-18.1	5.0	-11.2	-8.2	-4.1	-8.0	-2.5	1.2	-6.9	--
	Consumer non durbales IIP	YoY	-9.0	-5.7	-13.0	10.0	7.9	6.5	12.5	-1.9	10.8	8.4	1.2	--
Rural Demand	Two Wheeler Sales	YoY	17.0	13.5	2.3	17.7	3.9	5.0	8.8	9.0	16.5	17.4	1.7	-7.2
	Diesel Consumption	YoY	13.2	13.4	5.6	19.3	6.6	12.8	7.6	1.2	8.6	12.7	3.1	3.9
	Domestic Tractor sales	YoY	-1.9	23.0	6.8	6.5	25.6	24.4	20.0	13.7	-11.1	1.2	4.2	6.1
Government Spending	Govt. Spending on Rural Development	YoY	-10.7	12.1	69.8	3.8	-16.1	26.5	138.8	17.8	-87.6	82.0	-12.0	--
	Govt. Revex ex Interest Payments	YoY	-6.5	19.5	48.8	18.0	-12.3	12.6	4.3	2.5	14.9	-22.3	5.8	--
Rural Labour Market / Consumer sentiments	NREGA Jobs demanded (Persons)	YoY	-39.6	-33.4	-27.2	-11.8	-13.8	-13.2	-14.6	-10.3	-3.4	-2.1	2.2	15.2
	Real Wage Rural	YoY	-1.4	-1.8	-1.0	0.4	0.4	-0.2	-0.4	0.4	--	--	--	--
	Rural Consumer Sentiment	YoY	31.8	29.5	35.3	28.8	33.1	34.6	33.9	31.7	32.7	36.7	39.5	31.5
	Rural Unemployment Rate	%	7.7	5.8	8.2	7.6	7.4	6.4	7.2	7.8	7.7	7.0	8.7	7.9

Source: CEIC & CMIE, CareEdge

- Consumer sentiments (both rural and urban) declined in July. However, strong growth in retail credit and growing credit card transactions will support consumption.
- **Rural Labor Market**: MNREGA job demand – an indicator of distress in the rural labour market is up.
- **Urban Labor Market**: Slowdown in developed markets has cooled hiring activity in IT-ITES sector.
- Going ahead, elevated food inflation and weather-related uncertainties may pose headwinds for consumption.

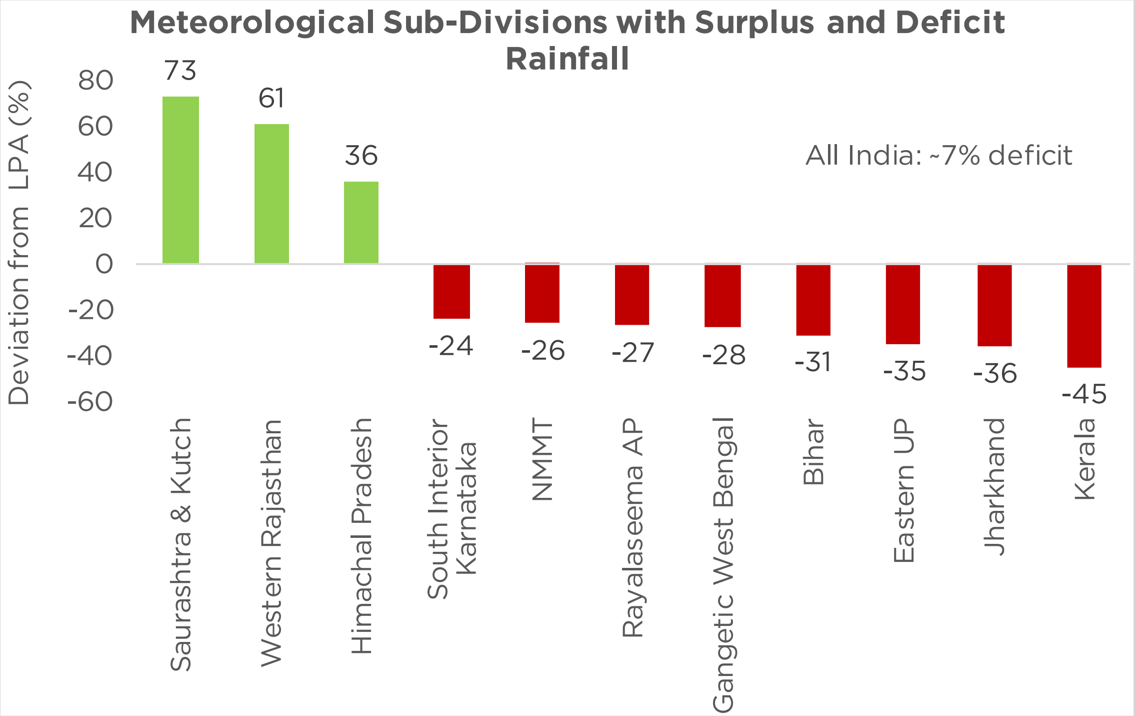
Industrial Growth Disappoints



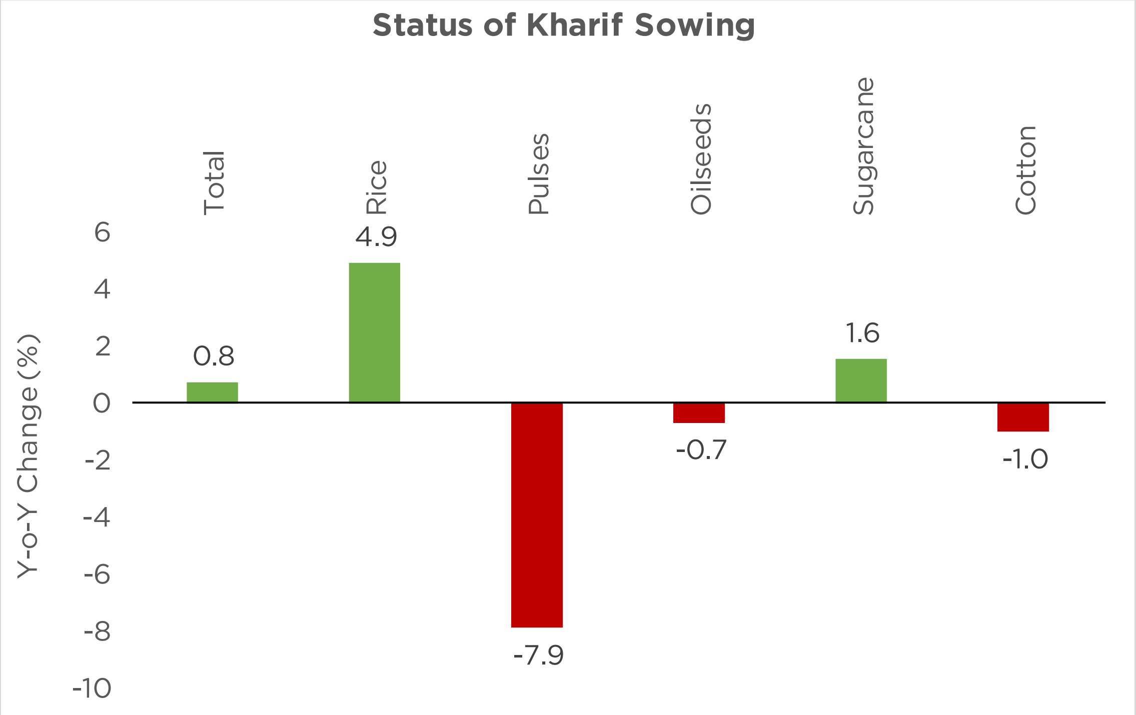
Source: MOSPI; Figures in brackets represent weights in overall IIP

- Industrial output moderated to 4.5% in Q1 FY24 as against 12.8% last year.
- Metals, pharma, motor vehicles, machinery, electrical equipment and non-metallic mineral items logged healthy growth.
- Export-intensive industries such as textiles and wearing apparel continued to exhibit weakness amid subdued external demand conditions.
- Going ahead, a durable domestic demand recovery remains crucial for industrial activity.

Skewed Rainfall, Pulses Sowing Lags



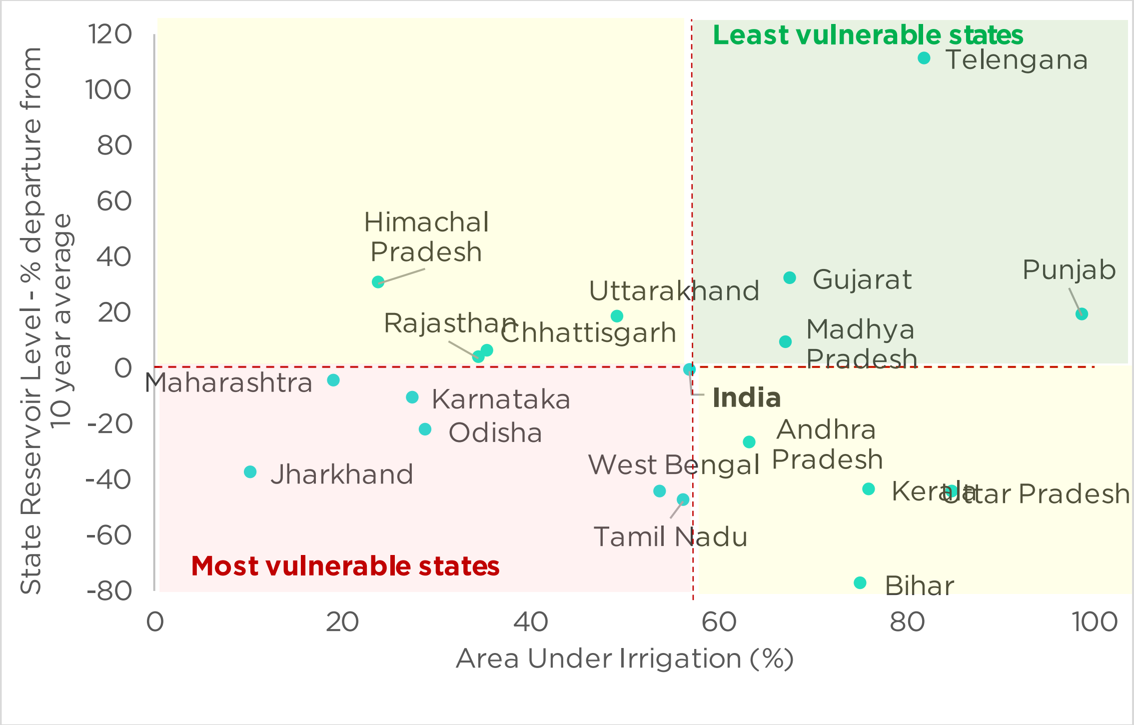
Source: CEIC; CareEdge. Data as on 20th August 2023, NNMT is Nagaland, Manipur, Mizoram and Tripura



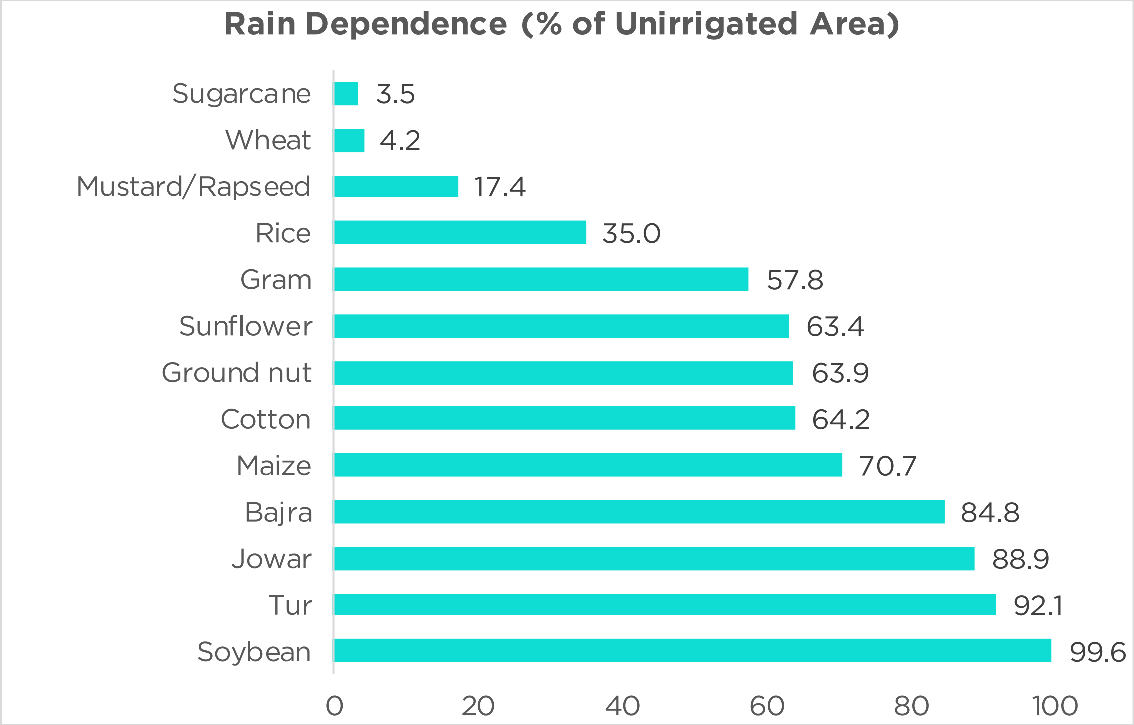
Source: CEIC; CareEdge. Data as on 11th August 2023

- Progress of the southwest monsoon has spatial as well as temporal variations.
- Eastern Gangetic plains and parts of Southern India continue to witness a significant deficit in rainfall.
- Sowing of pulses is significantly lower due to below-normal rainfall. Buffer rice and wheat stocks remain comfortable.
- Damage to food crops due to deficit rainfall in eastern and southern India, along with flooding in certain parts of northwest India, can add to upside risks to inflationary pressures over the near term.

Most Vulnerable States Account for a Third of India's Agri GVA



Source: Central Water Commission, Ministry of Agriculture & Farmers Welfare, CareEdge. Reservoir data as of 17th August 2023.



Source: CEIC

- Pulses and coarse grains are the most rain-dependent crops with the highest share of unirrigated areas. Lagging kharif sowing of pulses increases further risk to their output.
- Given the current status of reservoir level, six states - Maharashtra, Jharkhand, Karnataka, Odisha, West Bengal, and Tamil Nadu remain the most vulnerable states, together accounting for more than 30% of India's agriculture GVA.
- Apart from the risk to Kharif output, Rabi output in these six states can also get impacted due to the higher dependency of rabi crops on irrigation.

Food Prices Keeps Retail Inflation Elevated

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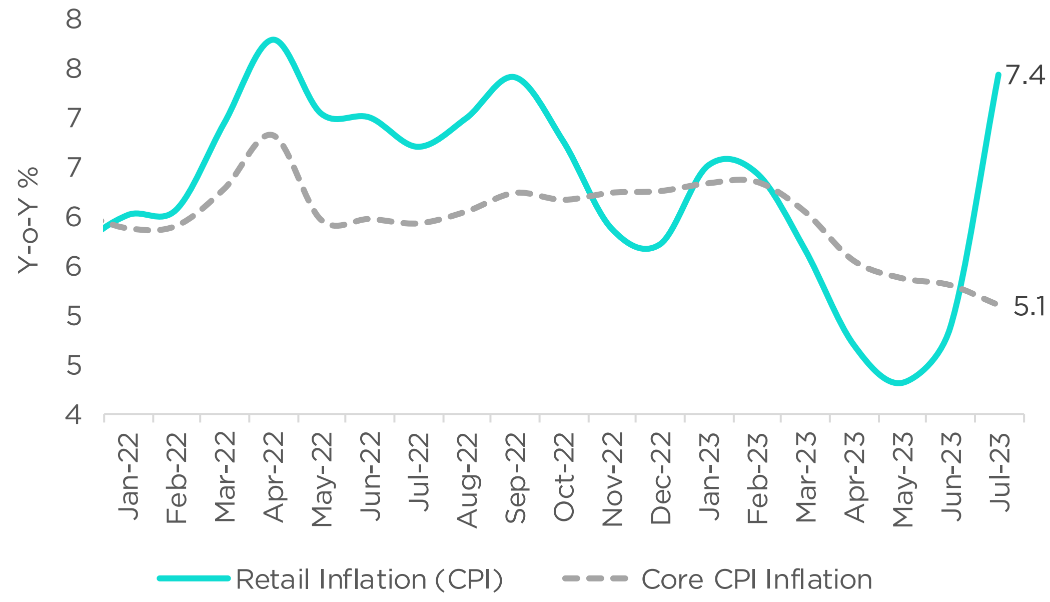
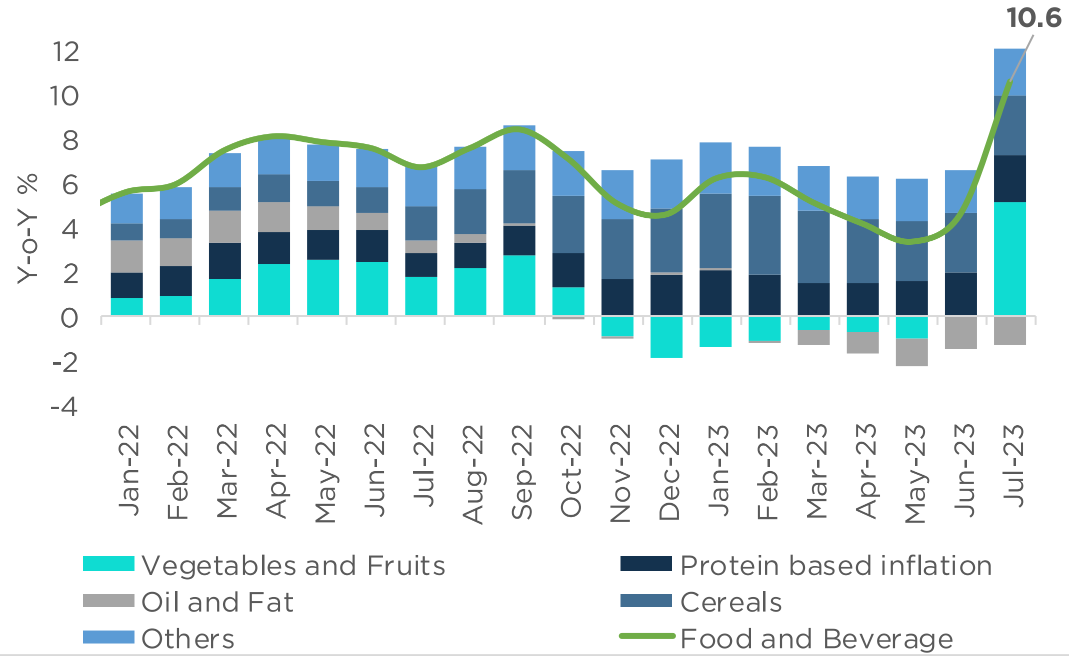
Retail Inflation Spiked; Core Inflation Eased Slightly



Source: MOSPI & CareEdge

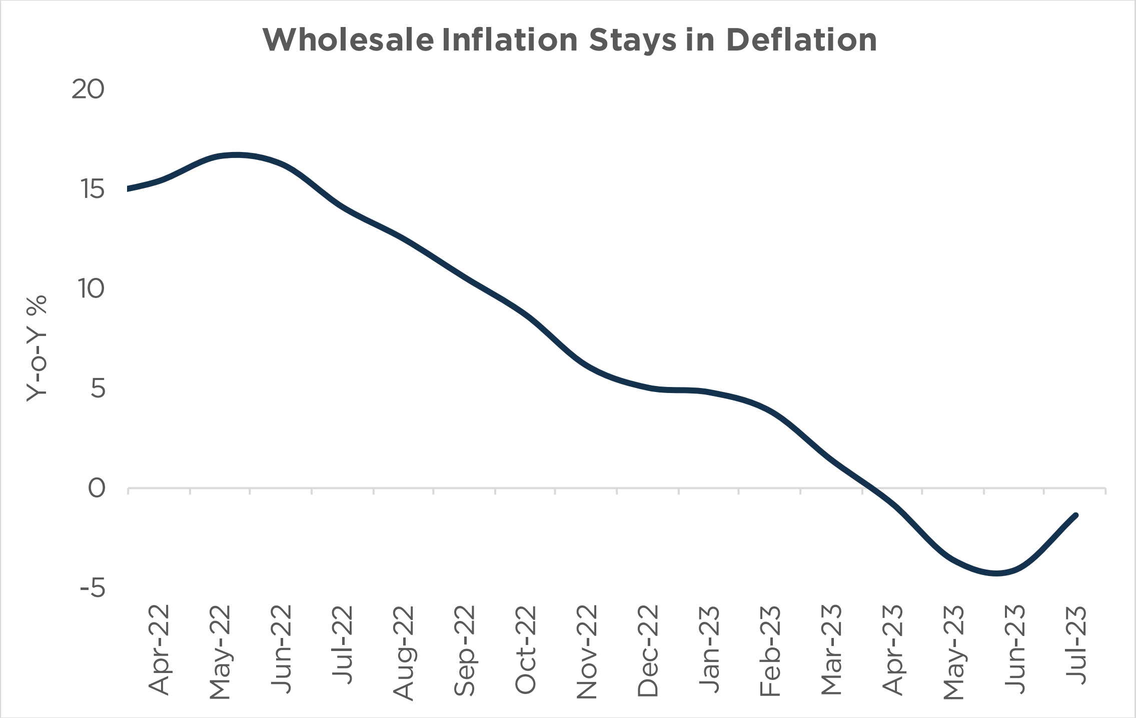
Contributions to Food Inflation



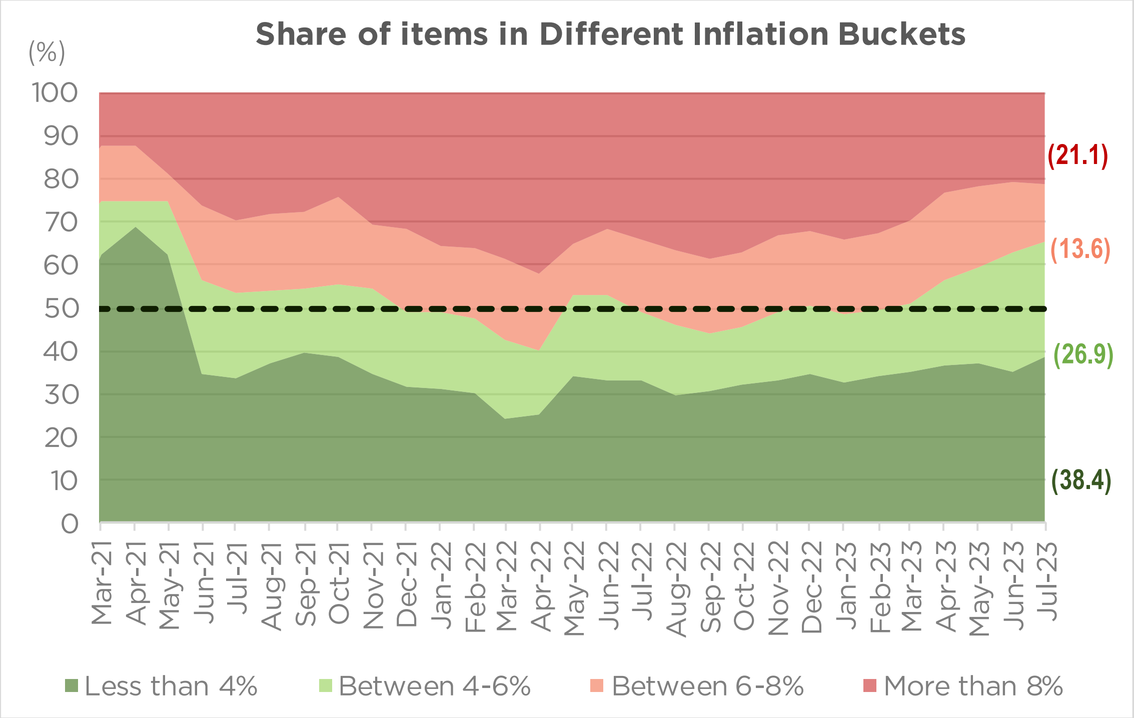
Source: MOSPI; CareEdge

- Rise in retail inflation has been led mainly by specific components in food baskets and personal care items.
- Seasonal uptick in vegetable prices and elevated cereal, pulses, and milk inflation pushed food & beverages inflation to 10.6% in July.
- Recent softening in domestic edible oil prices can reverse due to a significant spike in global edible oil prices.
- FAO Vegetable Oil Price Index surged 12.1% MoM in July of 2023 due to renewed uncertainties surrounding the exportable supplies out of the Black Sea region and lower production of palm oil in Malaysia and Indonesia.
- We project retail inflation to stay elevated, averaging 7.0%, 5.8% and 5.2% in Q2, Q3 and Q4, respectively.

Recent Spike is not Broad-based and Looks Transient



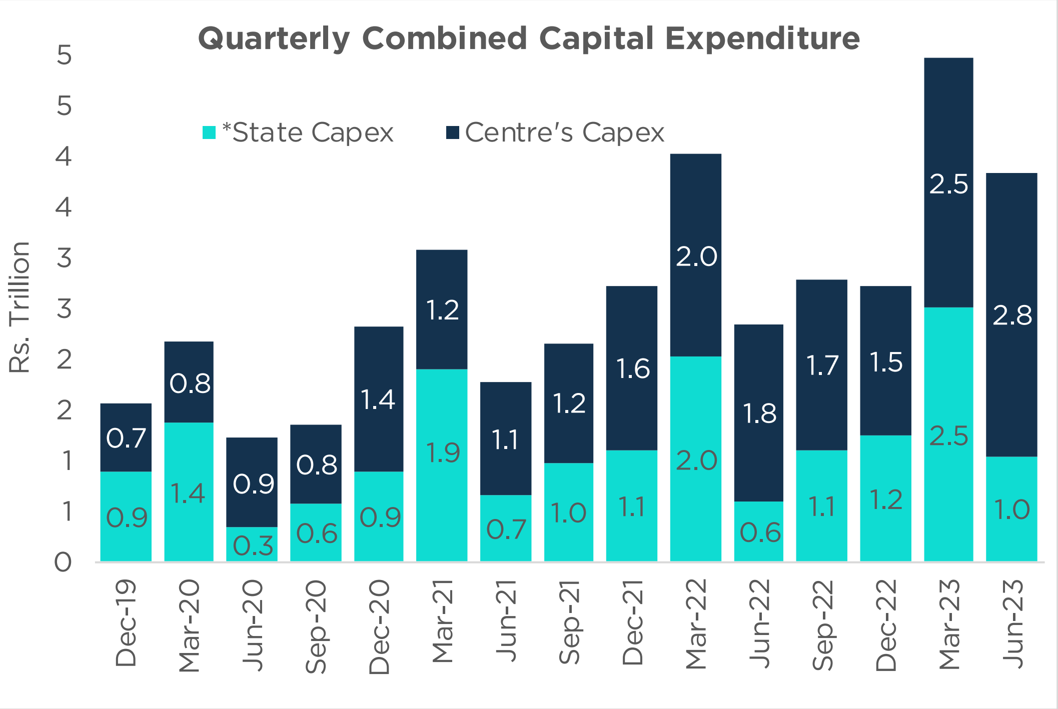
Source: MOSPI & CareEdge



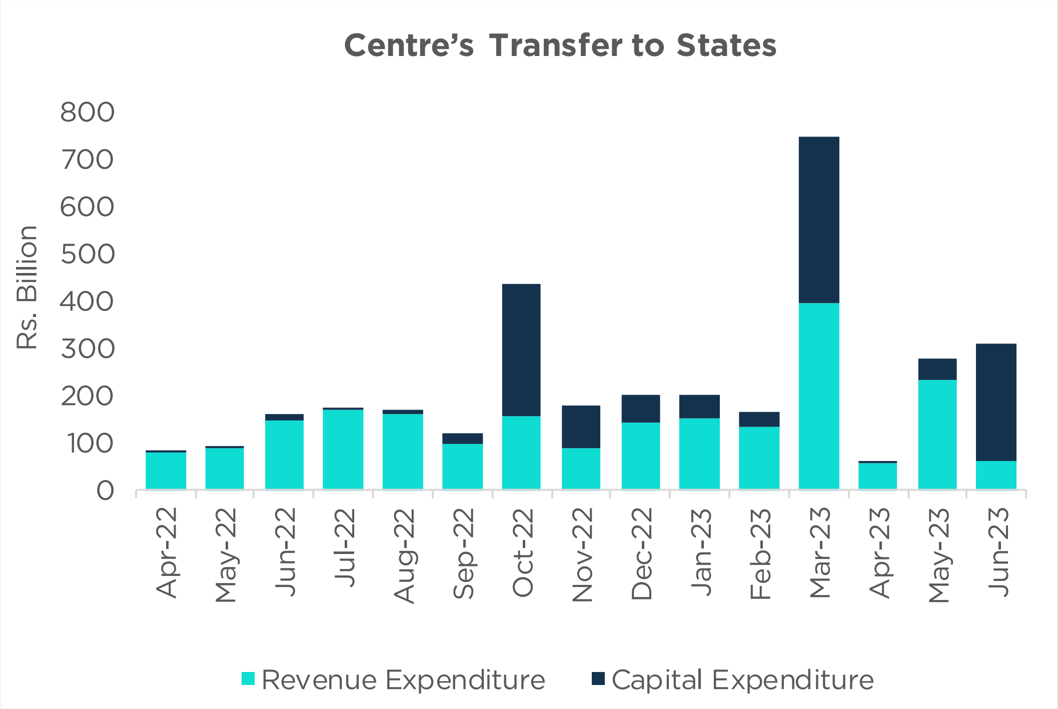
Source: MOSPI & CareEdge. Figure in the bracket show latest share.

- However, the recent rise in food inflation is expected to be transient. Unlike in the past, the recent spike in inflation is not broad-based and is limited to certain items in the CPI basket.
- Contracting WPI, softer core inflation and softness in many global commodity prices will cushion the rising inflationary pressures with a lag.

Public Capex Stays Strong in Q1 FY24



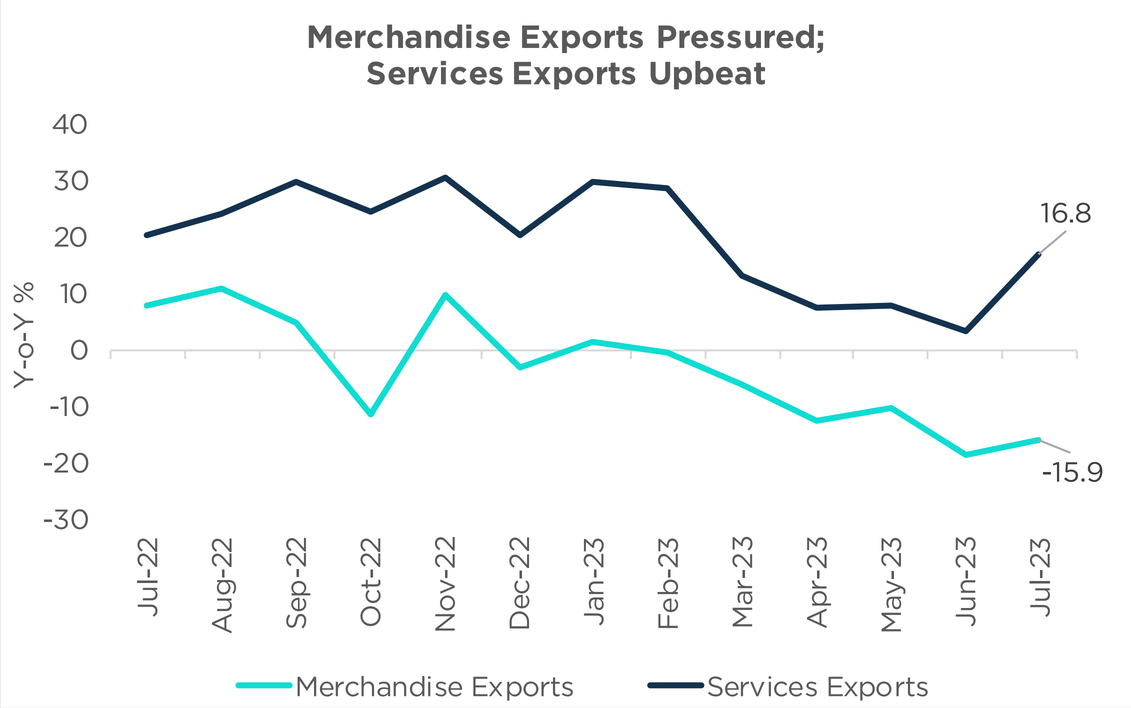
Source: CAG, CEIC. *State data includes top 19 states and excludes Goa, Sikkim and North-Eastern States



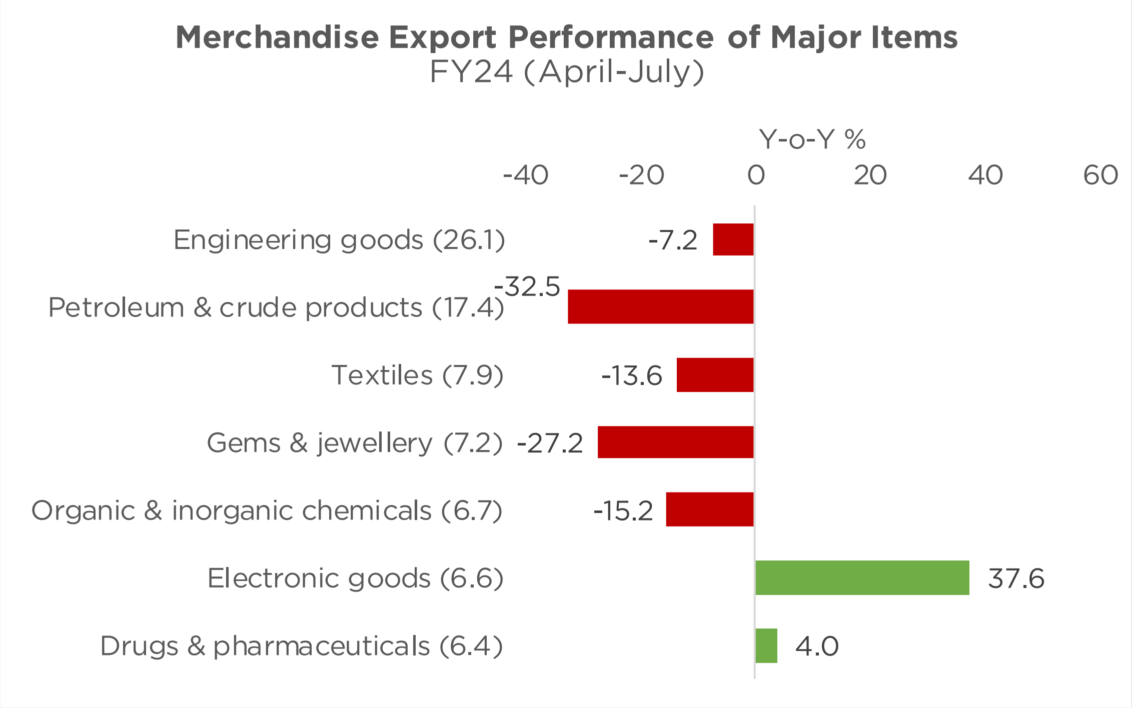
Source: CAG, CEIC

- Q1FY24 Centre's capex stood at Rs 2.8 trillion after an annualized growth of 59.1%. State capex in Q1FY24 also remained strong at Rs 1.04 trillion with an annualized growth of 75.6%.
- Andhra Pradesh, Telangana, Uttar Pradesh, Rajasthan, and Uttarakhand registered above 100% growth in state capex expenditure in Q1FY24. Capex growth remains weak in Maharashtra, Karnataka, and Himachal Pradesh.
- Conditions for availing tranches of the interest-free loan from Centre under 'Special Assistance to States for Capital Investment' have resulted in an uptick in state capex in Q1FY24.

Snapshot of India’s Export Performance



Source: CMIE & CEIC



Source: CMIE; Note: Figures in brackets represent % share in total

- Merchandise exports recorded a double-digit contraction for the fourth consecutive month in July; more concerning is the contraction in non-oil exports at 8.3%.
- Services export growth rebounded in July following some moderation in the last three months.

BoP Situation Improves

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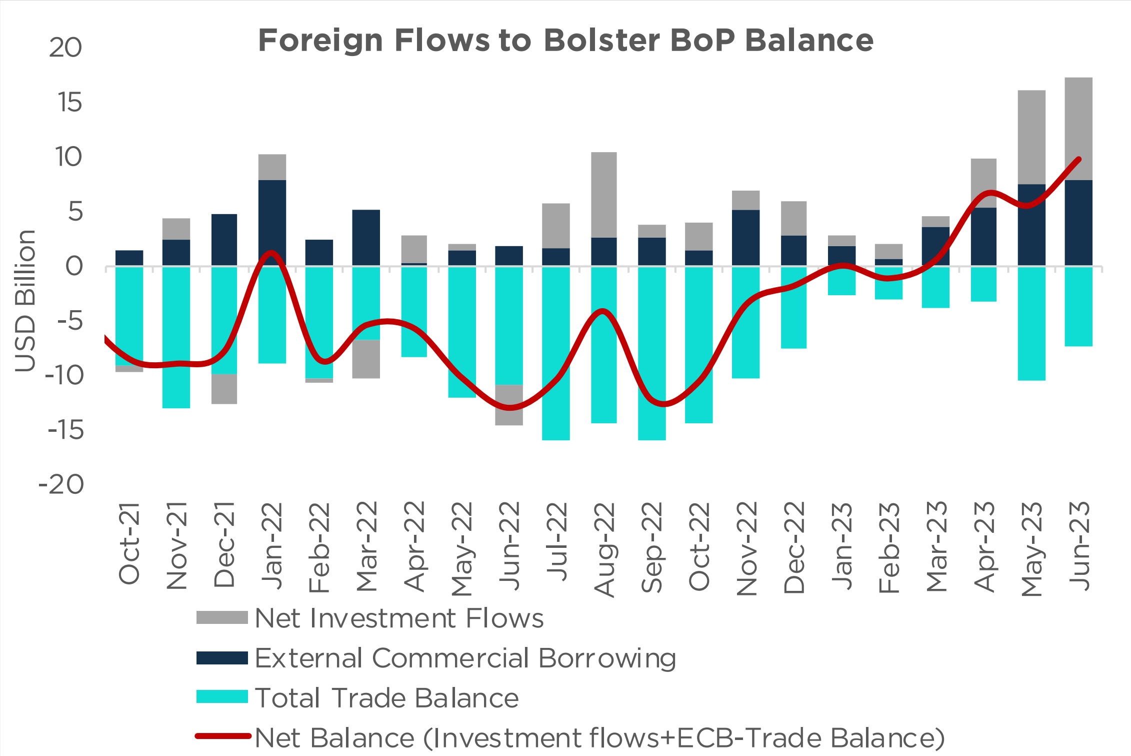
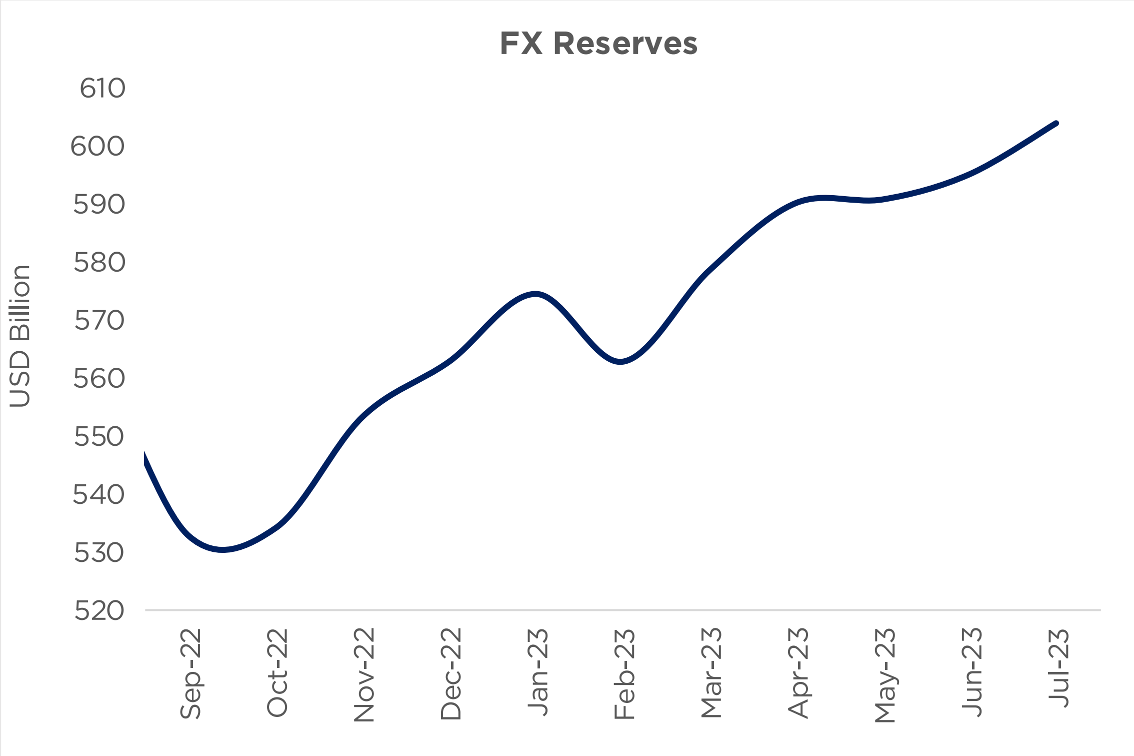


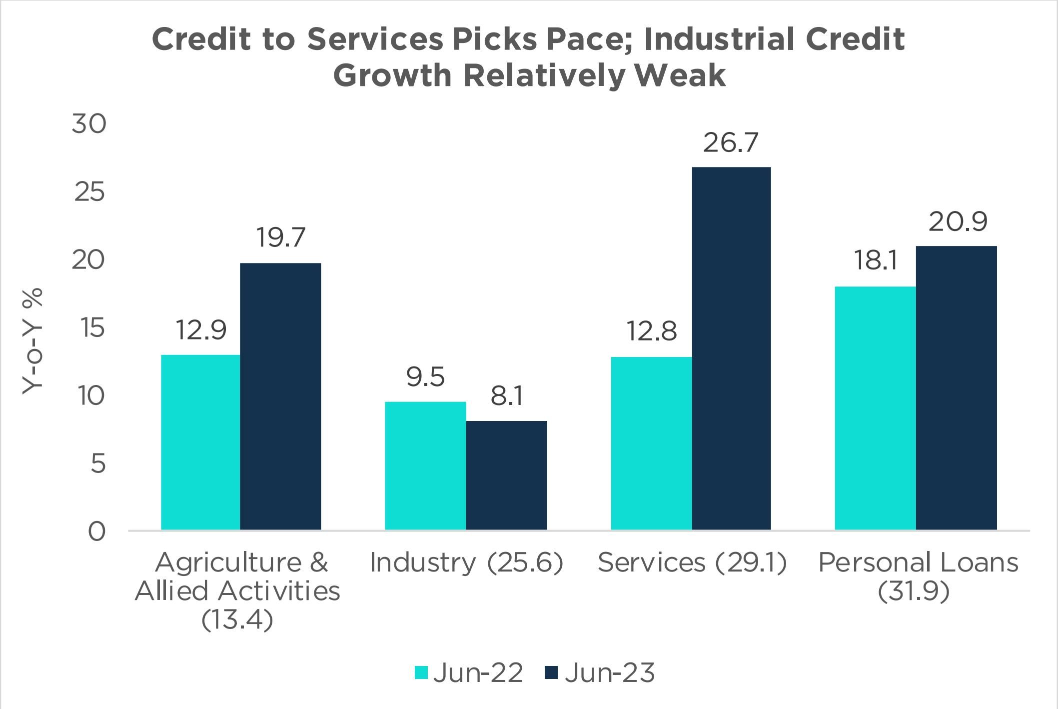
Source: CEIC. Net investment flows includes FPI and FDI inflows. Trade balance includes good and services.



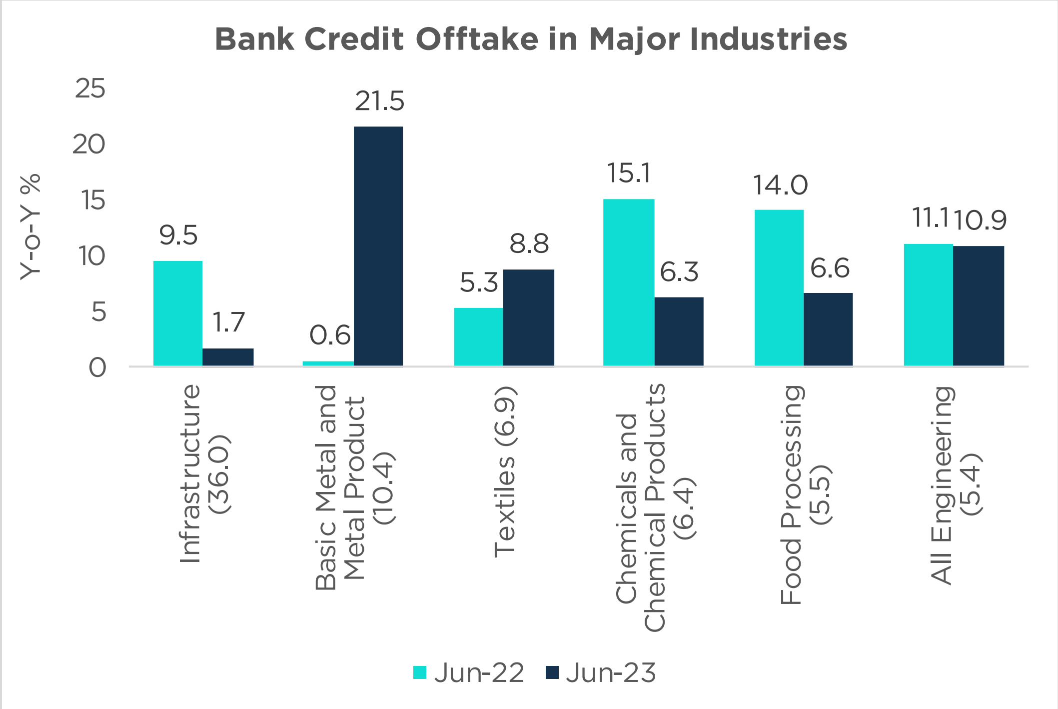
Source: CEIC

- High investment flows along with growing ECB borrowing improved the overall BoP situation.
- Favorable inflows bolstered FX reserves which is at comfortable levels above USD 600 billion.
- RBI estimates Balance of Payments to move from a surplus of USD 5.6 billion in Q4FY23 to USD 24.4 billion in Q1FY24.

Bank Credit Growth Healthy



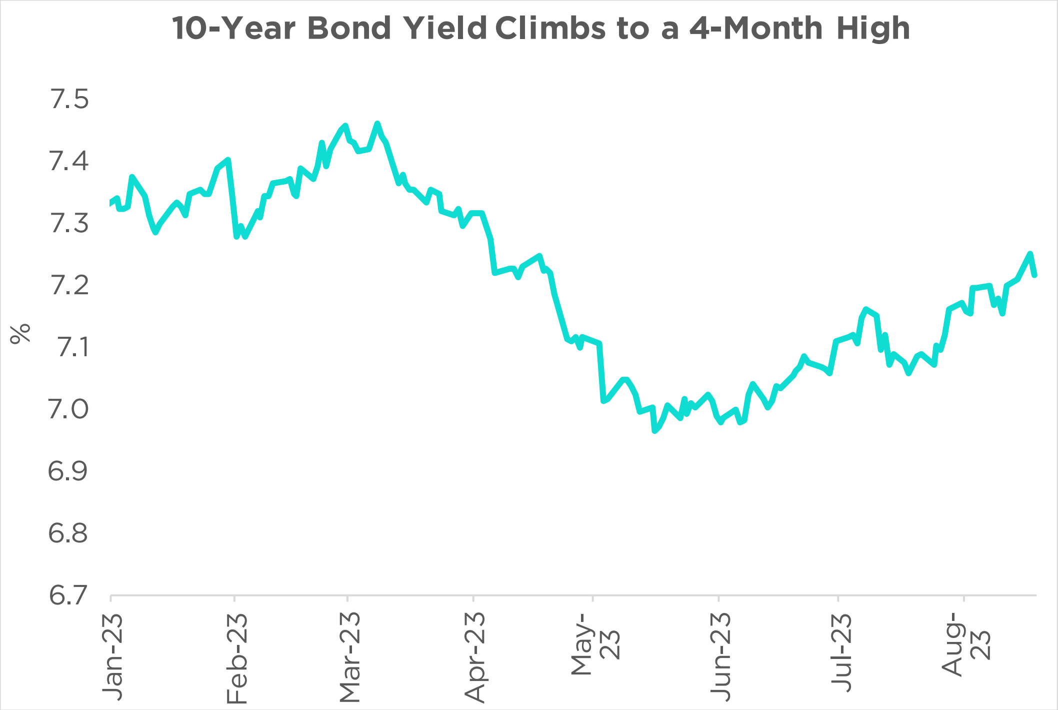
Source: RBI



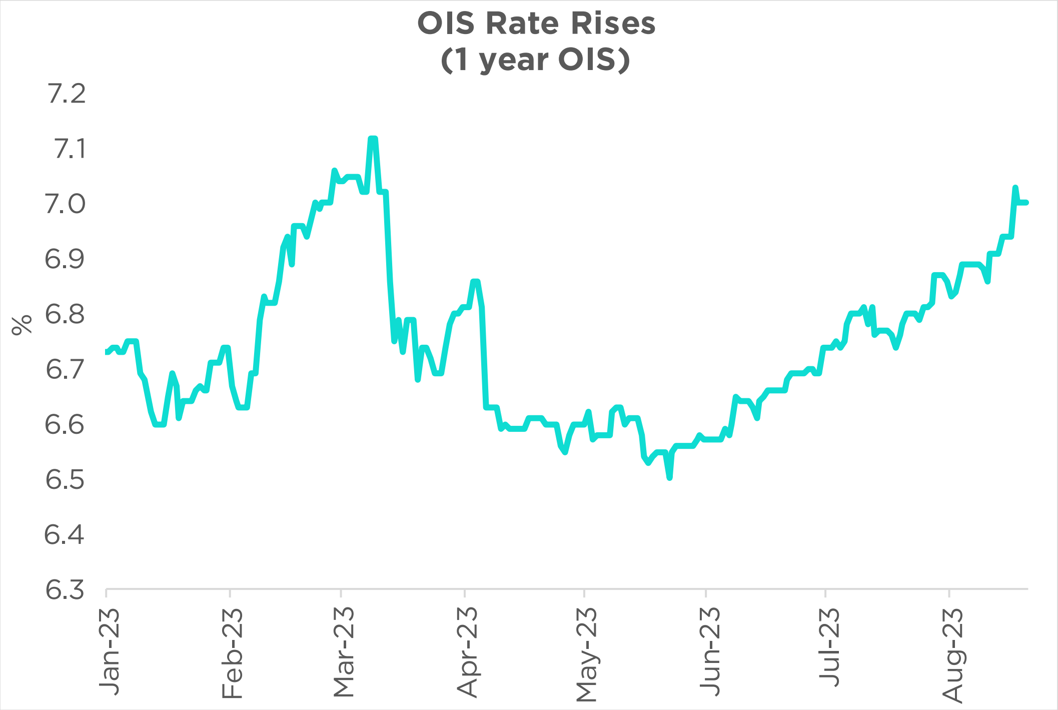
Source: RBI

- Credit to large enterprises (74% share in total industrial credit) picked up to 6.4% as against 3.2% last year.
- Credit growth in services driven by upbeat credit offtake in trade and the NBFC sector.
- Retail credit growth supported by demand in the housing, vehicle, and other personal loans segment.

Bond Yield Rise, OIS Rates Jump on Inflation Worries



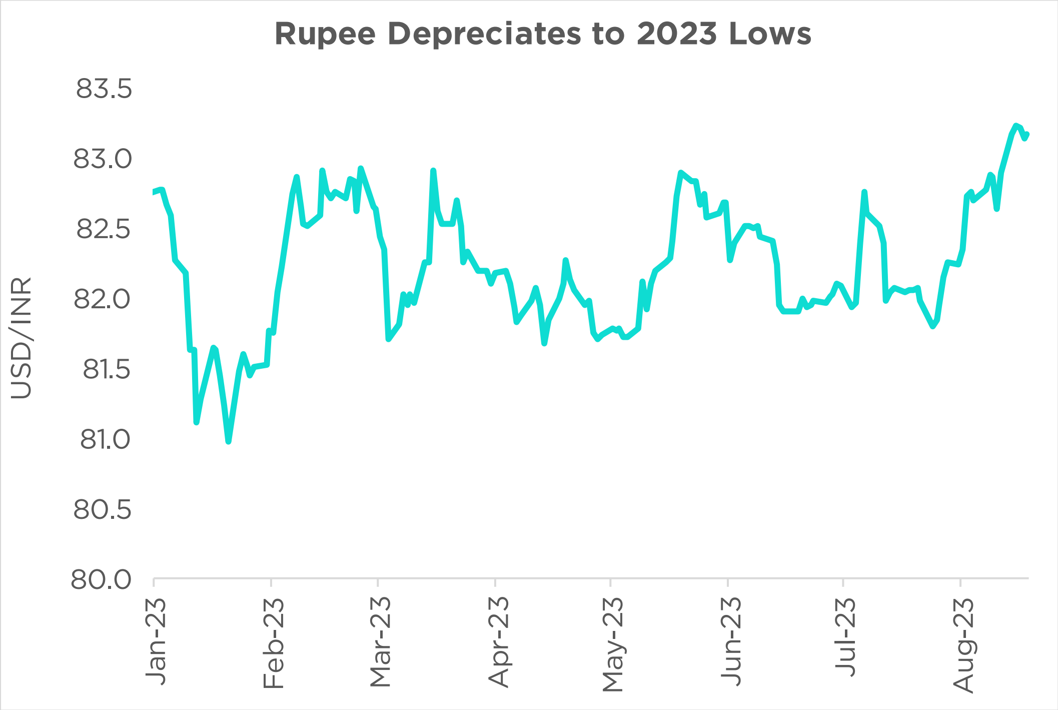
Source: Refinitiv



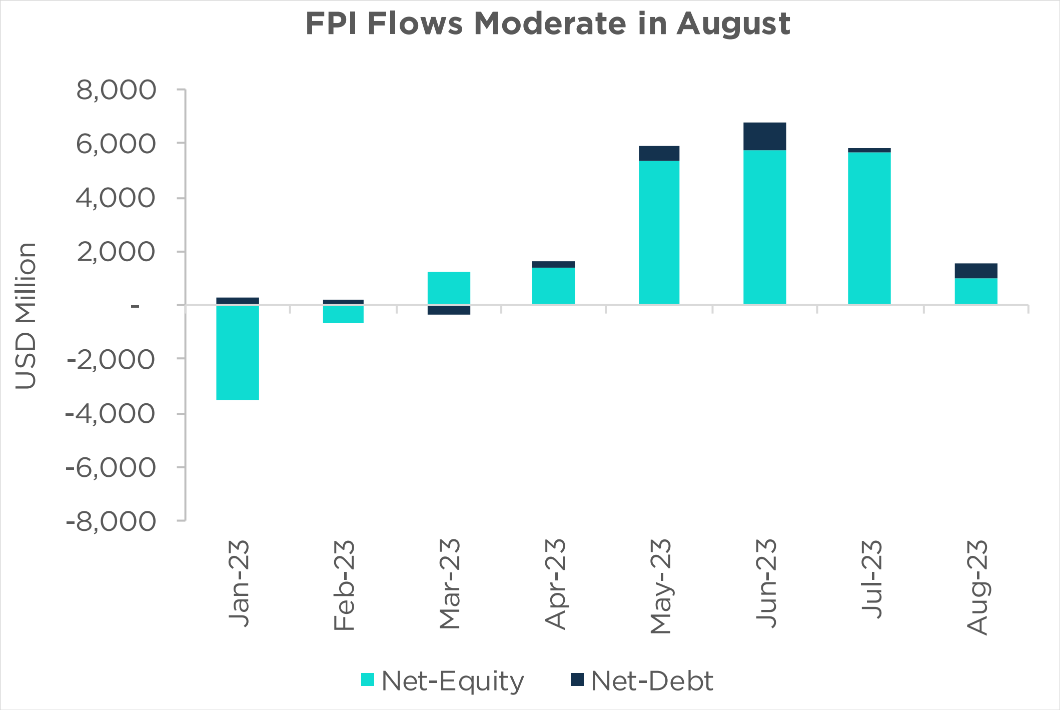
Source: Refinitiv

- 10-year bond yield rose to a 4-month high of 7.25% on the back of higher-than-expected inflation reading for July and rising US yields.
- We expect RBI to maintain an extended pause in rates in FY24.

Rupee Depreciates Amidst Strong Dollar, Waning FPI Flows



Source: CEIC (Data for Aug 2023 up to Aug 20)



Source: CEIC (Note: Net Debt includes VRR; Data for August 23 up to Aug 18)

- Rupee depreciated to its lowest level in 2023 amidst a narrowing yield differential, slowing FPI flows, and a sharp decline in the Chinese yuan.
- Continued RBI FX intervention expected to aid rupee stability going ahead.

Rupee Remains Stable in 2023 Compared to Global Peers

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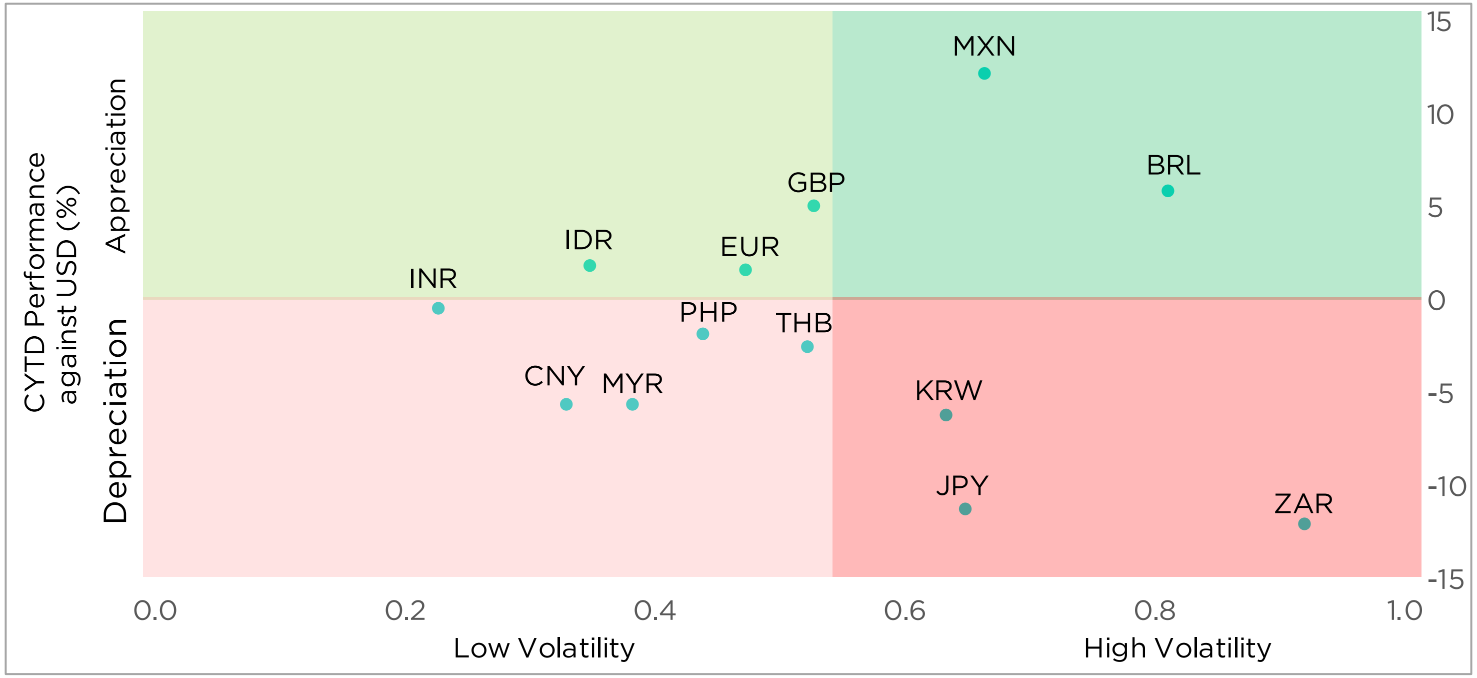
INR vs Peers - Comparative Performance in 2023

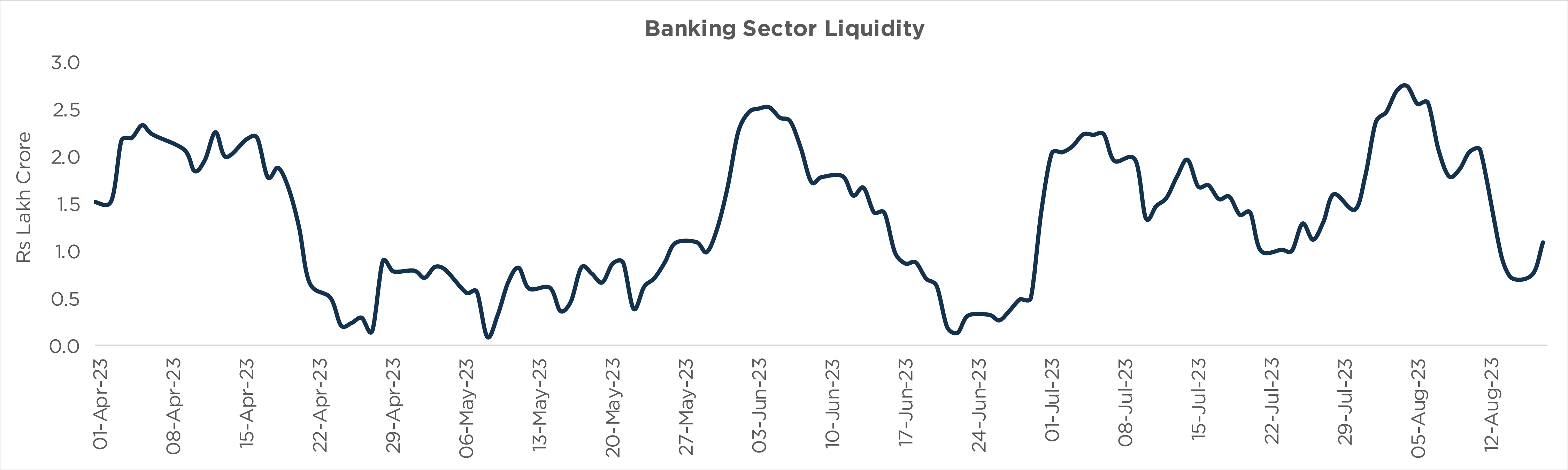


Currency Volatility in CY
(as measured by std. dev. of daily returns, %)

Source: Refinitiv, Data as of 17th August

- Strong foreign flows despite narrowing differential and RBI's FX interventions, have supported the rupee, thereby limiting its volatility.
- Going ahead, narrowing interest rate differentials and rising oil prices can weigh on the rupee. We expect USD/INR to average between 81-83 over the next six months.

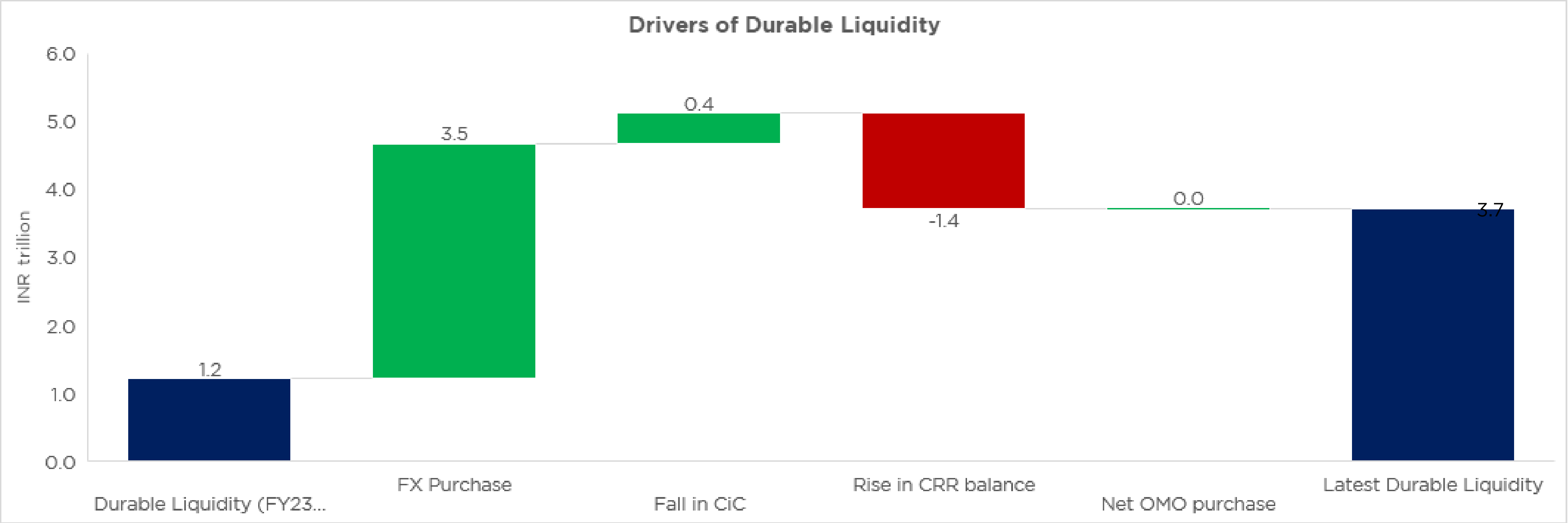
RBI Introduces I-CRR to Absorb Liquidity



Source: RBI, CEIC, CareEdge

- Systemic liquidity averaged below Rs 1 lakh crore in the last week, down from Rs. 2.4 lakh crore at the beginning of the month due to the recent incremental cash reserve ratio (I-CRRR) norm.
- A pickup in government spending, sustained foreign inflows, and the lingering effect of high-valued currency withdrawal had earlier contributed to the accretion of liquidity.
- RBI directed banks to maintain a 10% incremental cash reserve ratio (I-CRRR) on the augmented deposit between 19th May and 18th July to absorb excess liquidity.
- We expect this new measure to absorb liquidity worth ~Rs 1 Lakh crore from the system.

FX Purchase Supports Durable Liquidity



- Surplus BoP and withdrawal of 2000-denominated banknotes led to an increase in durable liquidity.
- Amid string foreign flows, RBI continued to purchase USD from both spot and forward markets to maintain the stability of USD/INR.
- No net OMO purchases were undertaken in the FY24 to date.

CareEdge Economy Outlook

CareEdge RATINGS

Economic Growth

GDP growth projected at **6.5%** for FY24

Inflation

Average inflation projected at **5.6%** for FY24

Current Account Deficit

CAD (as % of GDP) projected at **1.6%** in FY24

Fiscal Deficit

Fiscal deficit (as % of GDP) pegged at **5.9%** in FY24

Interest Rates

10-Year G-Sec Yields to range between **7-7.2%** by end-FY24

Currency

USD/INR projected to be at **81-83** by end of FY24