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IMF World Economic Outlook

IMF flags risks to recovery

The International Monetary Fund (IMF) in its recent report has flagged risks to the global growth recovery. Recognizing the impact of steep monetary policy tightening as well as signs of stress in the global banking sector, growth forecasts for major economies have been trimmed. For India, growth has been projected at 5.9% for FY24, significantly lower than RBI's forecast of 6.5%. We maintain our GDP estimate in the range of 6%-6.5%; however risks remain on both upside and downside and will revisit our forecasts based on incoming data.

Growth projections

In the latest World Economic Outlook report, IMF has projected global GDP growth to decelerate to 2.8% in CY23 from 3.4% in CY22. It notes that while growth had shown signs of recovering in early 2023, developments pertaining to financial sector instability in major economies along with monetary policy tightening by global central banks is pushing the World towards a "hard landing". Notably, Advanced Economies (AEs) have been the most severely impacted. Growth in AEs is expected to slow down precipitously to 1.3% in CY23 from 2.7% in CY22. Within this group, UK and Germany are likely to experience a recession in CY23, with growth expected to contract by 0.3% and 0.1% respectively. For Euro Area as a whole, GDP is expected to rise by only 0.8%, after increasing by 3.5% in CY22. Even in US, growth will be lower at 1.6% compared with a 2.1% increase in CY22. Japan is the only major economy which may witness an expansion in GDP growth in CY23.

Table 1: Global growth expected to moderate in CY23

Country	2022	2023E	2024E
World	**3.4**	**2.8**	**3.0**
Advanced economies (AEs)	**2.7**	**1.3**	**1.4**
Euro area	3.5	0.8	1.4
--France	2.6	0.7	1.3
--Germany	1.8	(0.1)	1.1
Japan	1.1	1.3	1.0
UK	4.0	(0.3)	1.0
US	2.1	1.6	1.1
Emerging market and developing economies (EMDEs)	**4.0**	**3.9**	**4.2**
Brazil	2.9	0.9	1.5
China	3.0	5.2	4.5
India	6.8	5.9	6.3
Russia	(2.1)	0.7	1.3
South Africa	2.0	0.1	1.8

Source: IMF World Economic Outlook Database April 2023, Bank of Baroda Research | For India 2023 refers to FY23 and 2024 refers to FY25

Growth in Emerging Market and Developing Economies (EMDEs) is expected at 3.9% in CY23, marginally lower than 4% in CY22. Within this group, growth in China is expected to rebound sharply to 5.2% in 2023 from 3% in 2022 led by a removal of Covid-19 restrictions. This is offset to an extent by a slowdown in growth in India, Brazil and South Africa. In Russia, growth is expected to rebound to 0.7% after a sharp contraction of 2.1% in the year before.

Risks tilted to the downside

IMF notes that risks to the outlook remain heavily tilted to the downside with the short and medium-term outlook remaining highly uncertain. Amongst these, tightening financial conditions due to higher real interest rates remains a key challenge. Lower lending in major AEs will impinge on investment demand and household expectations, which in turn will result in lower global demand and further moderation in commodity prices. EMDEs will be vulnerable to accelerated capital outflows, dollar appreciation and ballooning of external debt. In such a severe stress scenario, global GDP growth is expected to fall below 2%-a phenomenon which has happened only 5 times since 1970. Debt servicing concerns may also come to the forefront, amidst elevated levels of household and corporate debt and higher rates.

Another possible fissure in the global growth outlook can come from elevated core inflation. The report notes that while inflation in major economies has moderated, the pace has been much slower than anticipated. From an average of 8.7%, global inflation is expected to moderate to 7% in 2023. Furthermore, while lower food and energy prices have led to a softening in headline inflation rate, core inflation continues to remain sticky. Tight labour market conditions in several countries also raises the possibility of a wage price spiral, reversing the gains made against inflation so far.

Table 2: Global inflation still elevated

Country	2022	2023E	2024E
World	**8.7**	**7.0**	**4.9**
Advanced economies (AEs)	**7.3**	**4.7**	**2.6**
Euro area	8.4	5.3	2.9
--France	5.9	5.0	2.5
--Germany	8.7	6.2	3.1
Japan	2.5	2.7	2.2
UK	9.1	6.8	3.0
US	8.0	4.5	2.3
Emerging market and developing economies (EMDEs)	**9.8**	**8.6**	**6.5**
Brazil	9.3	5.0	4.8
China	1.9	2.0	2.2
India	6.7	4.9	4.4
Russia	13.8	7.0	4.6
South Africa	6.9	5.8	4.8

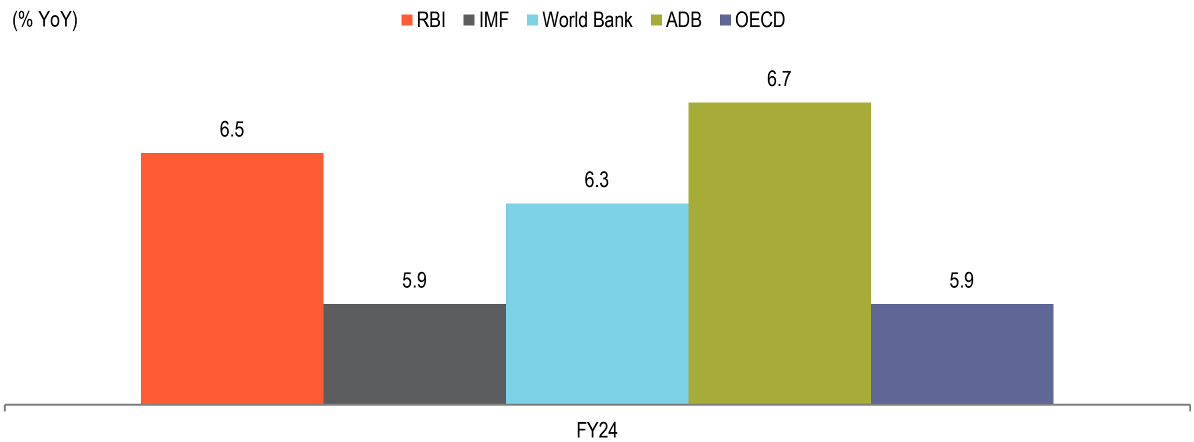
Source: IMF World Economic Outlook Database April 2023, Bank of Baroda Research

With growth in China showing mixed trends so far, risks on this front also remain tilted to the downside with signs of stress are still visible in the property sector. Uneven or lower than expected growth outcomes in China will have a dampening impact on global outlook. Apart from these, debt distress in several low-income and EMDEs as well as escalation of Russia-Ukraine war also remain key risks to the outlook.

What about India?

IMF has projected a growth rate of 5.9% and 6.3% for India in FY24 and FY25 respectively. Notably, this is lower than RBI's forecast. Despite this, India is likely to remain the fastest growing major economy. Interestingly, growth forecast by major international agencies have varied and ranged from 5.9% to 6.7%.

Figure 1: India's growth projections as per RBI and major international agencies



Source: IMF, World Bank, ADB, OECD and RBI, Bank of Baroda Research

What do we think?

We continue to foresee India's GDP growth in the range of 6%-6.5% for FY24. With no new data available for FY24, we do not see the merit in changing the forecasts presently. We would revisit the same based on the incoming data. However, there are some factors which will impact the trajectory of growth going ahead. These are:

Downside risks:

- **Lower than expected agricultural growth:** Monsoon rains are important for agricultural production. While the IMD has predicted a normal South-West monsoon at 96% of LPA. However, there are concerns with respect to evolving El-nino conditions, which may result in deficient rainfall. This will impact kharif production which accounts for ~50% of total crop production in India. A slowdown in agriculture sector will also weigh on rural consumption and growth.
- **Inflation may surprise to the upside:** Lower agricultural production will also push food inflation higher. This will also have a negative impact on consumption demand.

Upside risks:

- **Fiscal position comfortable:** Sound and prudent fiscal policies have ensured that the Government has been effectively able to manage its Budget without compromising on developmental expenditure. Steps have been taken to reduce expenditure subsidies etc., even as capital expenditure has been scaled to a historic high. This has been achieved while meeting the government's overarching objective to bring down fiscal deficit to sustainable levels.
- **External sector position has improved:** While merchandise exports have been lackluster, the drag has been mitigated due to lower imports as well as buoyant services exports. India's services exports have increased to a historic high despite rising global headwinds. Remittances too have remained strong as growth in Gulf countries has benefitted from higher oil prices. As a result, we have seen a gradual improvement in India's BoP position. We expect CAD to moderate to below 2% of GDP in FY24.

Bigger picture, still uncertain:

- **Investment sentiment still cautious:** Despite efforts by the government, investment demand has continues to remain nascent. Private sector capex has remained muted. Furthermore, credit to industry has remained muted even as overall credit demand has picked up pace. Capacity utilization rates have been improving and new projects announcements rose to a record high in Mar'23. We might have to wait to see if this translates into higher investments.

- **Consumption demand:** Consumption has been the major driver of India's growth. Based on the evolving domestic and global macro backdrop, consumption demand story will play out. While rural demand will be contingent on monsoon rains, urban consumption will depend on inflation outcome.

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