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Economic Round-up: May 2023

Downward revision to Germany's Q1CY23 GDP (-0.3% versus -0.5% in Q4CY22) has reignited fears of global growth slowdown on account of elevated prices, and aggressive tightening by central banks. Further fuelling these fears is incoming macro data from China, which shows weakening momentum in its manufacturing sector and less than expected pick-up in consumer spending (retail sales, services PMI). In case of US, while labour market still remains tight, consumer confidence has begun to get impacted and inflation expectations continue to remain elevated. This month, BoE and ECB are expected to further hike their respective policy rates, while Fed's decision remains uncertain. On the domestic front, India's growth surprised positively as it rose by 6.1% in Q4FY23 compared with an increase of 4.5% in Q3FY23. In FY23, economy rose by 7.2% (7% as per 1st AE) compared with 9.1% in FY22. Central government has also announced that it has met fiscal deficit target of 6.4% in FY23 and we maintain that it remains on track to lower the deficit to 5.9% in FY24.

Global growth: Fears of slowdown in China (PMI, FAI, trade) has reignited fears of global growth slowdown. In addition, manufacturing activity remains weak across regions (US, UK, Europe), while service sector seems to be the engine of growth so far. In US also, mixed signs are emerging. While inflation expectations are inching up, labour market still remains tight, and housing sector seems to be recovering. However, consumer confidence has taken a beating as mass lay-offs by tech companies is beginning to show its impact. Spending cuts agreed to reach the US debt ceiling deal will also have an impact on growth going forward. Elsewhere, aggressive tightening by ECB has already begun to show the impact on Germany economy which entered a technical recession in Q1.

Global Central Banks: While it is almost certain that BoE and ECB will be hiking rates in their Jun'23 policy meetings, Fed's stance still remains unclear. While some believe that continued strength in labour market will lead to Fed hiking by 25bps in Jun'23, other are of the view that Fed may opt for a pause and await for more macro data points to decide on the next hike/pause decision. Reserve Bank of Australia is also expected to hike rates in Jun'23 as inflation has surprised on the upside in Apr'23. BoJ on the other hand has reiterated to maintain its ultra-loose monetary policy stance, while the IMF has advised it to re-anchor inflation expectations.

Key macro data releases: Latest macro data released shows that **economic growth** has been resilient so far with GDP rising by 7.2% in FY23 and even Q4FY23 GDP (6.1%) surpassed RBI's expectations (5.9%). We maintain our growth forecast of 6-6.5% for FY24, in the wake of slowing global economic conditions.

On the Fiscal front, government managed to meet the fiscal deficit target for FY23 (6.4%), on account of higher tax and non-tax revenue collections. Slippage in expenditure by certain ministries (fertilizers, finance), was offset by cuts in others (agriculture, health, rural development). We remain confident that government will be able to bring down the fiscal deficit to 5.9% in FY24.

On the industrial production side, core sector output (which carry a weightage of 40% IIP) slowed marginally to 3.5% in Apr'23 compared with 3.6% in Mar'23. Out of a total of 8, only 4 industries posted positive growth.

CPI inflation eased to its 18-month low of 4.7% in Apr'23 compared to 5.7% in Mar'23. This was on account of favourable base. CPI food index moderated to 3.8% in Apr'23 from 4.8% in Mar'23. Core CPI (excl. food and fuel) came down to 5.2% in Apr'23 from 5.8% in Mar'23.

Global developments

US debt deal finally sealed

For most part of last month, markets remained concerned about the US debt ceiling deal. Earlier in the month, US Treasury Secretary, Janet Yellen, had warned that US government will run out of cash by 1 Jun 2023 (later revised to 5 Jun), if a decision was not reached to raise federal government's debt ceiling limit. Risks of US default would have been catastrophic for the global economy. However, towards the end of the month, a tentative deal between the Republicans and the Democrats was reached, which has now been passed by the Congress by a majority vote. It will now have to face the test in the Senate, before it can be signed into a law by President Biden.

On the macro front, US economy continues to give mixed signals. While on one hand, labour market still remains strong, on the other hand, consumer confidence and manufacturing sector growth seems to be waning, while inflation expectations still remain high. Non-farm payroll additions in Apr'23 rose by 253k (est.: 180k) from 236k in Mar'23, supported by gains in services sector. Unemployment rate inched down to 3.4% from 3.5% in Mar'23. For the week ending 27 May 2023, the 4-week moving average for initial jobless claims filed fell by 1500 to 1.8mn. ADP employment also rose by 278k in May'23 versus est.: 170k and compared with 291k additions in Apr'23. Retail sales in Apr'23 also came in higher at 0.4% (MoM) compared with (-) 0.7% decline in Mar'23. Core retail sales (ex-auto and gasoline) beat analyst expectations and rose by 0.6% following (-) 0.5% decline in the previous month. More positively, home prices have come down from their peaks and new home sales rose by 4.1% to 683k units in Apr'23 (highest since Mar'22). Now lay-offs in the tech sector is beginning to dent the consumer confidence. Conference board's consumer confidence index decline in May'23 to 102.3 from 103.7 in Apr'23. Worryingly, 6-month outlook for economic conditions ahead (income, labour, business) fell further to 71.5 from 71.7. Higher inflation expectations imply that risks of elevated rates in the US still remain. Tight financial conditions is already hampering the manufacturing sector (PMI at 46.9 in May'23 from 47.1 in Apr'23).

Eurozone's largest economy and 4th largest economy in the world—Germany—entered recession in Q1CY23, as its GDP growth was revised downward from 0.1% (preliminary estimates) to (-) 0.3% compared with (-) 0.5% fall in Q4CY22. This was largely on account of (-) 1.2% drop in household consumption and (-) 4.9% decline in government spending. On the other hand, investments (in machinery & equipment, and construction) and exports contributed positively to GDP growth. Higher prices have been blamed for dent in growth and weakening confidence. ZEW economic sentiment index has fallen for the 3rd consecutive month in May'23 and is down to (-) 10.7 from 4.1 in Apr'23. Ifo business sentiment index also fell, to 91.7 in May'23 from 93.6 in Apr'23. Slowdown in China; and uncertainty around central bank rate decisions (ECB and Fed), is dampening the mood. Prices have begun to come down, with CPI in May'23 at 6.3% versus est.: 6.8% and 7.2% in Apr'23. Dip in inflation in France, Spain and Italy also suggests cooling down on an aggregate level as well. Going forward, as prices come down, it may support currently reeling manufacturing sector. Flash manufacturing PMI for Eurozone dipped to 36-month low of 44.6 in May'23 from 45.8 in Apr'23, dragged by Germany. France's manufacturing sector reported less sharp contraction in activity in May'23. In UK also pace of contraction in manufacturing sectors fastened. In case of services, while activity continues to expand, the pace has slowed in Eurozone (led by France) and UK. Germany witnessed some improvement in May'23.

After resurgence of growth in Q1CY23 (supported by re-opening of the economy and Lunar New Year), economic momentum seems to be dwindling at the start of Q2CY23. Most recently, official manufacturing PMI (covering large firms) fell to a 5-month low of 48.8 in May'23 from 49.2 in Apr'23. In comparison, Caixin manufacturing PMI index, which is based on smaller-to-medium firms, rose in May'23 to 50.9 from 49.5 in Apr'23. This indicates that larger firms are facing more headwinds. Official non-manufacturing PMI is also showing signs of slowdown with index dropping to 54.5 in May'23 from 56.4 last month. Within this, both services (53.8 versus 55.1) and construction (58.2 from 63.9) declined. Amongst services, telecom, IT, and transportation continue to report buoyant growth (index above 60). Construction sector is now noticing the impact of waning fiscal stimulus, which was front-loaded early in the year. This is also visible in easing FAI growth in Jan-Apr'23 (4.7%) versus 5.1% in Q1. Industrial production in Apr'23 rose (5.6%), much less than expected (10.7%) from Mar'23 (3.9%). Retail sales also rose (18.4% versus 10.6% in Mar'23) less than expected (22%). Further, with falling prices, industrial profits of firms in China has also taken a hit as they recorded (-) 18.2% decline in Apr'23 following (-) 19.2% decline in Mar'23. On YTD basis, profits this year (Jan-Apr) are down by (-) 20.6% from (-) 21.4% in Q1.

Global central bank decisions

Following 25bps hike in May'23, there was a consensus that US Fed will opt for a long pause from Jun'23. However, the incoming macro data (rise in inflation expectations and strength in labour market—jobless claims, unemployment rate, job openings) has led to rise in uncertainty around Fed's decision. While there seems increased probability of rate hike in Jun'23, some Fed officials have also made remarks signalling that a pause may be more appropriate to gauge the impact of policy tightening so far.

In case of BoE, post the inflation shocker for Apr'23 (8.7% versus est.: 8.4% by BoE), markets are pricing in at least 2 more rate hikes by the central bank following 25bps hike in May'23. Another 25bps is expected in Jun'23 and then in Aug'23. While most analysts are expecting rates to peak and pause at 5%, some are even estimating a peak of 5.5% in case inflation continues to remain sticky. In Apr'23, core CPI had hit 31-year high of 6.8% compared with 6.2% in the previous month. Food and beverage inflation also remains elevated at 19.1% (19.2% in Mar'23)—highest since Mar'77.

Despite dip in Eurozone inflation in May'23 to 6.1% (est.: 6.3%) from 7% in Apr'23, ECB is still expected to hike rates by another 25bps in Jun'23 and Jul'23. It had raised rates by 25bps in May'23 to 3.75%. Outlook after Jul'23 remains uncertain as the unprecedented amount of tightening by the central bank so far has already pushed Germany economy into a technical recession. Further, as core inflation is also beginning to inch down (5.3% versus 5.6%), hopes of a pause by ECB in the later part of the year have increased.

Other central banks which returned to a rate hike in May'23 included: New Zealand, Australia, and Norway (each by 25bps). While New Zealand's central bank has hinted at a pause going forward, RBA remains more data dependent and Norway is expected to continue hiking rate till it reaches the peak rate of 4% by the end of CY23 (currently at 3.25%). In RBA's case, Australia's retail inflation (CPI) has again inched up to 6.8% in Apr'23, beating median estimate of 6.4% and is also up from 6.3% in Mar'23. Higher prices of housing and fuel is keeping headline print higher. This is expected to put pressure on RBA to hike rates by another 25bps in its Jun'23 policy meeting.

In Japan, even as inflation remains above BoJ's target of 2%, the central bank has vowed to maintain ultra-loose monetary policy for the time being. Core CPI in Japan (ex food but including energy) rose by 3.4% in Apr'23 from 3.1% in Mar'23, while CPI-ex food and fuel-rose by 4.1%—highest since Sep'81. IMF has BoJ to re-anchor inflation expectations if prices continue to breach central bank's target for a longer than anticipated period. It has also advised that it should be done in a step by step process. First the bank should move away from YCC and then policy tightening should be undertaken. BoJ currently expects inflation to fall back around/below 2% mark towards Mar'24.

Special studies

How funding through CPs have evolved?

Commercial Paper (CP) issuances have carved an important space historically and remained a preferred choice for better rated corporates for raising capital in a cost effective way from the market. Further, flexibility in terms of adjusting the maturity of instruments to match expected cash inflows and buyback options, have put them at an advantage at times. Notably, in all these years (except FY18, which is a period of partial rising rate cycle), falling interest rate regime have given a cost advantage for borrowing through this route.

The peak of CP issuances occurred in FY19, supported by stronger appetite from non-financial corporations for working capital needs (RBI Monetary Policy Report – October 2018) and also supported by easy liquidity conditions especially in H2 of the same year (~on an average Rs 84,300 crore).

The moderation in issuances in FY20 and FY21 despite a favourable interest rate regime can be attributed to the Covid-19 induced slowdown. In FY23, RBI's cumulative hike of 250bps in the current cycle had led to fall in issuances, on account of higher borrowing cost. From Rs 20.2 lakh crore, issuances fell to Rs 13.7 lakh crore in FY23. In Apr'23 and May'23 (till 26 May 2023), issuances amount to Rs 1.11 lakh crore and Rs 1.04 lakh crore respectively.

On an outstanding basis, CPs amounted to Rs 3.5 lakh crore in FY23, almost at the same level as seen in FY22. This is on account of rollover of CPs i.e. replacing one CP with another. The outstanding amount does not match with the issuance amount as many of the CPs are redeemed during the period. Comparing the outstanding CPs amount with overall outstanding bank credit, clearly shows that in years where bank credit growth has slowed down, there has been a preference for CPs. In quantum, of course the two sources of funds are not comparable. Years such as FY15, FY17 and FY21 reflect the same. Ratio of outstanding CP to the total sources of fund have gained momentum since FY14-FY19 (normal growth years without any shock). However, in FY23, the ratio dropped on account of higher interest rate regime and normalization in liquidity conditions of the economy.

Are borrowings through CPs are cheaper?

CPs have benefited on account of lower interest rate (6 out of 10 years have been associated with falling interest rate cycle, and one year has been pause). In all the years, bank lending rates have been higher than the CP rates. Though it's a broad form of aggregation as the tenor vary, but this gives an indicative picture of the cost analysis. In 6 out of the 10 period of observation, the spread between CP rates and Bank lending rate have been more than 200bps.

How CP rates have evolved Vis a Vis T-Bill?

CP & T-Bill rate: The impact of current hike cycle of RBI has been sharper in case of T-Bill yields which have witnessed quite a sharp upturn. We look at how CP rates of similar maturity have moved when RBI has cumulatively raised repo by 250bps. The CP rates for all tenors have been higher than corresponding T-Bill yield. Notably, the spread between CP and T-Bill for the 91 days tenor accelerated at the sharpest pace between Aug-Mar'23 (from 58bps in Aug'23, it rose to 122bps in Mar'23), where it peaked. This is on account of sharper pace of increase in CP rates compared to the corresponding maturity T-Bill rates.

Maturity Pattern of CPs:

The changes in the maturity pattern of CPs is interesting. There has been clear shift from 7-30 days paper to 31-90 days paper, on account of liquidity adjustment. From around 67% concentration towards 7-30 days paper as seen in FY14, the ratio was significantly lower at 7.9% in FY23. On the other hand, share of 31-90 days paper went up from 24.7% to 52.1% during the same period. Interestingly, in May'23, the share of 91-180 days paper also rose.

Liquidity and CP rates:

There is a strong degree of co-movement between CP rates and market liquidity. In episodes of liquidity deficit such as H2FY16, CP rates inched up sharply in consonance with rising liquidity deficit. Further in H1FY18, in line with increasing surplus liquidity, CP rates inched down. So for the entire Covid-19 period, when system level liquidity went into record surplus, CP rates fell down sharply. Currently with normalization in liquidity level, some upward pressure on CP rates cannot be ruled out.

RBI Balance Sheet

Highlights of Macro economy:

- Global economic outlook both for CY23 and CY24 looks benign on account of lagged impact of tighter financial conditions, subdued private investment, and geo economic shifts impacting capital flows and persistent elevated inflation.
- The report pointed out that 'the pace of global disinflation, however, remains less than desirable', reflecting some upside risks to global inflation as is still visible in US, UK.
- The RBI is confident on India's macro stability, sound policy environment and strong and healthy balance sheet of banks. Further it has pointed out that demographic dividend, digital revolution and service sector competitiveness will boost India's growth prospects in the medium term.
- Taking into account softer global commodity and food prices, good rabi crop prospects, sustained buoyancy in contact-intensive services, the government's continued thrust on capex, higher capacity utilization in manufacturing, double digit credit growth, receding drag on purchasing power from high inflation and rising optimism among businesses and consumers, real GDP growth for 2023-24 is projected at 6.5% with risks evenly balanced.
- The cumulative increase in policy repo rate by 250 bps last year would steer the disinflationary process, along with supply side measures to address transient demand-supply mismatch due to food and energy shocks.
- The inflation trajectory is expected to move down over 2023-24, with headline inflation edging down to 5.2% from the average level of 6.7% recorded last year.
- Robust balance sheets of corporates and banks, coupled with high capacity utilization, would aid in strengthening the momentum in private investment.
- Traction in construction activity is likely to be sustained as reflected in steady expansion in its proximate indicators: steel consumption and cement production.

- The crowding-in effects of sustained increase in government capex over recent years is expected to spur higher private investment in 2023-24.
- The outlook for services sector remains positive in 2023-24. Real estate and construction have witnessed a revival post-pandemic and are expected to perform well in this year also as both demand for and supply of housing remain buoyant.
- In the external sector, the current account deficit (CAD) is expected to remain moderate, drawing strength from robust services exports and the salubrious impact of moderation in commodity prices of imports. With global uncertainties persisting, foreign portfolio investment (FPI) flows may remain volatile. The favourable domestic growth outlook, lower inflation, and business friendly policy reforms could, however, help sustain buoyant FDI inflows.

Some pertinent issues in today's context:

In the current year, RBI's surplus transfer was more than the budgeted amount of Rs 48,000 crore for banking sector. This along with healthier balance sheet of banks will result in higher dividend pay-out. Hence this will significantly increase the government's non tax revenue providing support on the fiscal front.The ratio of RBI transfers to non-tax revenue has varied over time. At 29% for FY23, this is on par with the levels attained in FY14-15. FY20 was the time when reserves were transferred to the government as per the recommendations made by an expert Committee. In absolute terms surplus transferred in FY23 is lower than the transfer made in FY21.

Gold holding increasing:

The holding of gold by RBI has increased sharply from 566 metric tonnes in June 18 to 795 metric tonnes in Mar'23. This is on account of higher purchases of gold since 2019. Apart from this, inflation also came into play and demand for gold increased as safe haven asset. Such continuous increases will also allow for diversification of holdings of forex reserves.

Bank notes in circulation gained pace:

Post demonetization, there has been more than 2.5 fold increase in currency in circulation. From Rs 13 lakh crore in FY17, the year of demonetization, the value of bank notes in circulation rose to Rs 33 lakh crore. Another important data which has been given in the Annual Report in this context is that the number of counterfeit currency in FY23 stood at 2,25,769 compared to 2,30,971 in FY22 and 2,08,625 in FY21. Thus, gradual reduction is taking place is such activity.

An interesting observation here was that post demonetization there has still been a preference to hold currency in higher denomination. In 2016 for example 86.4% of total was in notes of Rs 500 and Rs 1000. In 2023 it was 87.9%. Besides convenience in holding currency is also a reflection of the diminishing value of currency on account of high cumulative inflation which was around 30% for the 6-years period.

Earnings on FCA improved on account of better returns on forex investments in US Treasury and on account of better return on dollar. This becomes critical given that our forex reserves held by RBI and have been increasing and being invested in various avenues.

Impact of withdrawal of 2000 rupee notes

RBI in its notification dated 19 May 2023 announced gradual withdrawal of 2000 rupee notes from the system; albeit stating that it continues to be a legal tender. Against this backdrop, we have tried to look into the impact on banking system liquidity considering alternative scenarios and also the possible cost-returns analysis.

Key findings:

- Move is clearly to encourage a shift in payment behaviour of the economy.
- Banks will face possible temporary influx of liquidity leading to increase in deposit base.
- This will widen credit deposit gap; and surplus liquidity with banks which can be used either for investment in government securities or lending purposes.
- This will also lead to marginal inching up of interest outflows on deposits for banks. However, there will be corresponding return on investments and the net impact may be balanced out.

Current state of 2000 rupee notes:

In its notification, RBI clearly stated its main decision towards withdrawal of this denomination has been the persistent decline in share of 2000 rupee currency notes in the overall basket. From around 50% in FY17, the share of 2000 rupee notes in value terms have fallen to 3.6% in FY23. Hence RBI's move clearly reflects the shifting pattern of payment system in the economy.

Needless to mention that India's economy underwent revolutionary changes in terms of payment dynamics. In terms of CAGR, digital payment in volume terms have grown at a pace of 8.8% in the past 5 years compared to 4% CAGR in real GDP during the same 5-year span. Negative growth witnessed in FY20 and FY21 as volume of activity in the country went down due to the lockdown

Impact on Banks using scenario analysis

There can be two extreme cases. One where the entire stock of 2000 rupee notes are exchanged for smaller denomination notes; and the other where some 2000 rupee notes gets deposited in bank deposits. For the first case, impact on system level liquidity will be neutral.

However, for the second case, we have charted out three scenarios. In this section, we consider three different scenarios, where we analyze what will happen to bank deposit growth and credit-deposit gap if 25% of total INR 2000 notes are deposited, 50% are deposited and 75% are deposited.

Scenario 1: If 25% of the total INR 2000 notes (Rs 3.62 lakh crore) are deposited then we can expect bank deposits to go up by Rs 90,000 crore.

Scenario 2: If 50% of the total INR 2000 notes (Rs 3.62 lakh crore) are deposited then we can expect bank deposits to go up by Rs 1.8 lakh crore.

Scenario 3: If 75% of the total INR 2000 notes (Rs 3.62 lakh crore) are deposited then we can expect bank deposits to go up by Rs 2.7 lakh crore

Bank deposits as of 31 Mar 2023 were at Rs 180 lakh crore. Assuming 11.5% growth in FY24, deposits were earlier expected to come in at Rs 201 lakh crore. Now, following the withdrawal of Rs 2000 note, and based on our scenario analysis above, deposits can range between Rs 202-204 lakh crore.

Further, for FY24, we have assumed a credit growth of 12-14%. This implies that credit outstanding is expected to rise from Rs 137 lakh crore in FY23 to Rs 155 lakh crore this fiscal year. The gap between incremental credit and incremental deposit, which was earlier assumed to be ~Rs 3 lakh crore, will now increase to ~Rs 4-6 lakh crore.

In any of the three scenarios, banks will be flushed with liquidity which can be then deployed either for lending or for investment purposes. However, this will come at a cost. Assuming average term deposit rate for >1Y deposit at 6.63%, cost for banks for servicing these additional deposits (Rs 0.9-2.7 lakh crore) will go up by Rs 6,000-18,000 crore.

Whether this Rs 3.62 lakh crore be parked in SDF/Gsec by banks?

If say Rs 2.7 lakh crore of deposits is invested at the SDF, average interest cost on part of the RBI due to higher frequency of reverse repo operation on account of surplus liquidity in the system, amounts to Rs 0.17 lakh crore, on the assumption that the entire amount is kept in the SDF window by banks.

If invested in government bonds then the Rs 2.7 lakh crore of deposits could earn around 7% in which case there would be earnings of Rs 0.19 lakh crore.

The net gain could hence will be marginal around Rs 0.02 lakh crore even if the entire amount is not used for lending but invested in government bonds.

But, excess demand in the bond market would lead to increase in price of those securities and lower yields. Hence yields across the board are likely to fall by 5-10 bps depending on the quantum of funds that move into deposits rather than be exchanged for other notes.

The pronounced impact will be on short end of the curve which are more prone to the transitory changes.

Possible Expenditure on part of RBI

In 2021-22, the total volume of currency in number increased by 61,655 lakh. Total cost of printing currency was Rs 4,985 crore. The average cost of printing a currency note was around Rs 8/piece. Hence, if the entire amount of Rs 3.6 lakh crore of Rs 2000 notes was exchanged for say, Rs 500 notes, then the ~181 crore pieces of Rs 2000 notes would work out to ~ 724 crore pieces. The cost would be Rs 5,792 crore.

Sectoral impact

The following sectors/areas would be the ones that would generally be using the 2000 note and could face temporary disruption.

Real estate: Construction activity is to some extent cash-dependent and this move may impact activity in the short run. Often land deals are partly settled in cash.

Agriculture: It is also heavily cash dominated. Apart from large farmers, medium and small farmers may face issues while making payments for inputs and labour.

Transportation: Large part of freight moved through roads also involve significant cash payments as it is in the unorganized sector.

MSME: Small traders who buy raw materials, pay salaries/suppliers using INR 2000 note may get temporarily impacted.

Elections: State and General elections are due towards the end of CY23/early CY24. Elections held in different parts of the country also use cash to meet expenses. As the need remains, conversion to Rs 500 notes would be preferred.

Jewellery: Sales of jewellery in the hinterland are still conducted in cash and there can be disruption in the informal segment.

Forex: There is a grey market for foreign currency which made use of the Rs 2000 note. Here too there would be disruption as buyers-sellers change over to the Rs 500 denomination.

Disruption on account of withdrawal of the Rs 2000 note will be minimal and restricted to specific sectors. Activity here will most likely shift to the Rs 500 note as it is unlikely that the terms of payment may change as it is largely in the informal segment. Banks will have surplus liquidity to begin with which if invested in bonds can give a marginal net return. There can be a tendency of a substantial part of the notes to be exchanges; but this has to be tracked in the next two months when a clearer picture emerges.

Bonanza for the government

The RBI announced a surplus transfer to the government of Rs 87, 416 crore for the year. This will come in very handy and ensure that the government managed it fiscal numbers with relative ease given that there are question marks on the divestment programme.

The Budget had looked at a number of Rs 48,000 crore as dividend from banks and RBI. RBI has overshot this number with the transfer of Rs 87,000 crore. This was enabled by higher earnings on sale of forex during the year, better returns on forex investments in US treasuries (though value of bonds would have fallen which has to be charged to the contingency reserve), revaluation of forex assets and adjustments in reserves as per the Bimal Jalan Committee recommendations. The RBI would have had higher pay-outs due to the higher SDF rates with the system being in surplus all through the year.

As PSBs have also reported very good profits and announced dividend, there will be higher flows of dividends from this source too. Add to this the possible higher dividend payments by the OMCs and the situation appears quite comfortable from a market perspective as this will not lead to higher borrowings.

Have banks gained at the expense of mutual funds

When the government took the decision to no longer provide any tax benefit to debt mutual funds in terms of capital gains, it was largely believed that funds would move back to bank deposits. What exactly did the data show for April 2023?

Data on AUM of mutual funds showed a smart increase. AUM as of April end stood at Rs 41.62 lakh crore as against Rs 39.42 lakh crore in March. This is an increase of Rs 2.20 lakh crore. This was a good month in the equity market too with the Sensex moving from 58,992 to 61,112. Interest rates on deposits were largely stable and for 1 year remained in the range of 6-7.25%. The 10-year yield had come down by around 20 bps, and similar declines were witnessed in the Treasury bill yields. However, there was also an increase in bank deposits during this period though the dates for comparison are different with the two month-end points being March 24th and April 21st.

The overall picture was quite interesting as April had been a good period for savings. Both banks and mutual funds garnered higher funds. Some notable points are as follows:

- Time deposits of banks increased by Rs 3.09 lakh crore while demand deposits declined. The net increase of Rs 2.67 lakh crore was at a time when deposit rates remained largely unchanged. The year-end phenomenon of bulk deposits being raised would have contributed to this increase. However, normally short term deposits mature in the first fortnight of the new financial year and hence this increase is significant as it comes after this adjustment.
    - In 2022, during the same time period overall deposits increased by Rs 1.58 lakh crore with time deposits increasing by Rs 2.36 lakh crore and demand deposits declining by Rs 0.78 lakh crore. This was also the time when the interest rates situation had remained unchanged.
- The mutual funds picture is quite contrary to expectations.
    - The increase in debt funds was higher than that in equity.
    - Within debt funds, around Rs 90,000 crore of the Rs 1.16 lakh crore increase was through liquid (Rs 65,288 crore), money market funds (Rs 14,316 crore) and ultra-short duration funds (Rs 11,173 crore).
    - The fact that there has been a preference for very short terms can be a useful indicator for banks on where to focus for garnering funds.
    - The increase from equity funds was lower at Rs 67,469 crore. Within equity funds, large, medium and small cap funds each had a share of around 13% while flexi cap had share of 16%. Therefore there was not much concentration compared with debt funds.
    - Surprisingly the increase in hybrid funds, which was expected to be preferred on account of the change in tax laws was quite marginal.

Hence based on one month data it did look like that both banks and mutual funds have witnessed an increase in flow of savings. It is not clear whether this has come due to a reduction in consumption, as the GST collections for April have come in at an all-time high of Rs 1.87 lakh crore. The impressionistic view is that both financial savings and consumption were up in April. It would however need to be seen if this position is maintained through the year. The preference for debt over equity funds does come as a surprise given the change in tax laws as well as the performance of the equity market as depicted by the movements in the Sensex.

Gains from Russian Oil

In 2022-23, India imported US$ 162.1bn of crude oil. This involved physical import of 236.6mn tonnes of crude oil. The price of crude oil was volatile during the year on account of the Ukraine war and ranged from US$ 75-130/barrel during the course of the year. This was the time that India struck deals with Russia to import oil at more favourable terms which has proved to be beneficial for us. The foregoing analysis looked at the cost advantage that was to be had by diverting our sourcing plans more towards Russia.

Looking at the shares of the top ten countries from where India imported crude oil in the last 2 years, it can be seen that the share of Russia has increased from 2% to 19.3%. This has come at the expense of a decline in share of Iraq, which has been the largest supplier, followed by Saudi Arabia.

What was the price advantage?

Oil came in at the lowest cost in 2022-23 from Russia. The average price of procurement ranged from US$ 615/tonne from Russia to US$ 790/tonnes from Nigeria. Oil from Iraq, which is the largest supplier averaged US$ 636/tonne and was 3.5% higher than the Russian price. The average cost of procurement of crude for India was US$ 685/tonne with 4 countries supplying at less than this average – Brazil, Mexico and Iraq besides Russia. If Russia is excluded from the basket, the average cost for India would work out to US$ 704/tonnes. The importance of the oil deal with Russia can be gauged from this average price differential. The overall savings on account of Russia increasing its share to 19.3% has led to savings of around US$ 5 billion equivalent (data on the currency used for trade with Russia is not available).

The broader issue for India is the 'what happens when the war ends'. Presently the benefit from Russia has been engineered by the ban put by the west on Russia for virtually all trade. Russia has not been the cheapest source of oil in the past. While there will be attempts to renegotiate contracts with Russian companies at favourable prices, given the supply constraints for all oil producing countries, the same may not be possible all the time. In the past the price from Russia tended to be higher than the average price that India was paying and it was mainly due to the unusual conditions that this benefit was obtained.

With OPEC unlikely to increase output during the year, crude oil price will be driven by demand conditions. A mild slowdown in the west, which is what is being expected today would mean that there can be an increase in demand for oil. As long as this demand comes from USA and is satisfied internally there would not be any untoward pressure on overall demand. The China factor however has potential to exert upward pressure on prices. There are also limits to which India can import from Russia at a lower price and the discounts procured in 2022 would tend to decline as the latter seeks to repair its economy. While share of imports from Russia has increased to 19.3% it is unlikely to go significantly higher in the coming years. The gains would accrue in case there are rupee payments made which would reduce the pressure on the forex market.

At the consumer level it has been seen that prices are relatively unaffected by the movements in global prices and the parties that get involved are the governments and OMCs both when prices go up or down. Hence the inflationary impact has been muted ever since the retail prices of petrol and diesel were frozen.

BoB Essential Commodities Index (BoB-ECI)

Inflation indices in India are presented on a monthly basis at both the wholesale and retail levels. The 12th of every month normally has the CPI release where we get an idea of how retail inflation has played out. BoB Essential Commodities Index (BoB-ECI) looks at a sub-set of the CPI and presents how their cumulative prices have moved for the basket for the month. It is in a way a leading indicator of the food component of the CPI.

BoB-ECI is a weighted average composite Index of commodities considered 'essential' by the government and are part of the CPI. Department of Consumer Affairs publishes prices of 20 essential commodities which are included in the index. To maintain comparability with the CPI the same base year is chosen and the BoB-ECI calculated.

In Apr'23, BoB Essential Commodity Index has moderated to 2.8% in Apr'23 from 3.5% in Mar'23, on YoY basis. The H1FY24, CPI prints would get comfort from favourable elevated base.

Price picture using BoB Essential Commodity Index:

- Department of Consumer Affairs publishes data on essential commodities on a daily basis. This includes data on retail, wholesale prices, spot and future prices. The data is collected from 340 market centres spread across the country.
- In an attempt to capture the price scenario, we have constructed the BoB Essential Commodity Index. This Index is a weighted average index of 20 commodities tracked by Department of Consumer Affairs, with a weight of 22.8% in overall CPI basket. The base has been in alignment with CPI (2012=100). It captures 58.3% weight in the overall food basket of the CPI index and hence can be used as a leading indicator of prices.
- In our administered 135 period of study since Jan'12 (on YoY basis), there has not been much divergence between the BoB-ECI and Consumer Food Price Index and directionally both exhibit the same trend. Our back testing results show, only in 33 period out of 135, the difference between the two series has been more than 2% points.
- The top 10 items (in terms of weight in the CPI basket) of the BoB-ECI include Milk, Rice, Atta, Mustard oil (Packed), Sugar, Tea loose, Potato, Tur/Arhar dal, Soya oil (Packed), Sunflower oil (Packed).
- On YoY basis, the BoB-ECI moderated to 2.8% in Apr'23 from 3.5% in Mar'23. From a peak of 8.5% in Oct'22 in FY23, BoB-ECI has considerably dropped to 2.8% in Apr'23 and for the 7-days in May'23, it has fallen further to 1.3%.
- On sequential basis, BoB-ECI has fallen by 0.2% in Apr'23 compared to 1.2% decline in Mar'23. Notably, the pace of decline in Apr'23 has moderated due to pick up in retail prices of items such as onion, salt (pack), sugar, moong dal etc.

How subcomponents of Essential Commodities moved?

- The YoY picture shows that, for items such as milk whose weight in CPI basket is as high as 6.4% has been fairly stubborn. Since Nov'22, the price change has been in double digits. This is on account of reports of rising fodder cost and lower dairy yield.
- Within cereals, price of rice has been high in the past few months. This has been in line with increase in international price of rice, as seen in the World Bank data. However, wheat prices got comfort from better Rabi sowing.
- Edible oil is also likely to get comfort from falling prices of Mustard oil, Soya oil and Sunflower oil. Within vegetables, tomato and potatoes would keep price in check. However, some hint of reversal in onion prices are likely to be closely watched.
- Pulses are likely to witness some upward momentum due to increase in prices of Urad and Moong.

So where is CPI print headed?

The Apr'23 CPI would get comfort from a favourable base of around 84bps (CPI print in Apr'22 was 7.8% against 7% in Mar'23). Thus, we expect the headline number to be around 4.6% in Apr'23. Despite this, the sequential picture of CPI might reflect some upside risk emanating from 1) risks to vegetable and fruits inflation due to early onset of summer 2) volatility in oil and gold prices and 3) fairly robust domestic macros.

Global Commodity Price outlook

The World Bank released its report on the outlook on commodity prices for 2023. The general drift was that prices will be moving downwards, which is good news for consumers. There are as usual risk factors that had been highlighted by the Bank – which presently may not be a major cause of concern though central banks across the world would be monitoring closely before thinking of reversing their stance.

Global commodity prices fell 14% in the first quarter of 2023, and by the end of March, were roughly 30% below their historic peak in June 2022. The surge in prices after Russia's invasion of Ukraine has largely been unwound due to a combination of:

- Slowing economic activity
- Favourable winter weather, and
- Global reallocation of commodity trade flows

For the remainder of this year, commodity prices are forecasted to remain broadly unchanged. However, prices are still expected to remain above pre-pandemic levels, which will continue to weigh on affordability and food security.

Upside risks to prices include

- Possible disruptions in the supply of energy and metals (in part due to trade restrictions) is a major risk to these forecasts. Supply could disappoint both in Russia, especially if sanctions disrupt oil exports more than anticipated, and OPEC+ where supply remains below target—with many countries at or near full capacity. Tighter credit conditions may impede the ability of oil or coal companies to increase supply elsewhere. Policies to hasten the energy transition may discourage fossil fuel production, while also increasing demand for metals, particularly copper, nickel, and lithium. Fossil fuel energy producers may prefer to use profits to strengthen balance sheets and reward shareholders, rather than investing in expanding production. This would lead to higher prices of carbon-intensive energy commodities, but also metals and minerals.

- Global supplies of grain and energy (particularly coal and natural gas) could change course unexpectedly if geopolitical tensions intensify. In the case of energy, European natural gas stocks are high but may not be sufficient to cover consumption in the 2023-24 winter months. Disruptions in trade routes—particularly for grains around the Black Sea and Ukraine—amid sanctions and counter-measures could raise grain prices. Against the backdrop of already elevated food prices, this could deepen food insecurity in many EMDEs.

- Recovery in China may be tilted toward commodity intensive sectors. This would lead to higher prices for energy and metals because of larger demand from industry. The real estate sector in China may begin to strengthen sooner than assumed, raising import demand and prices for base metals. This could result in upward pressure on prices of aluminium, copper, lithium, and nickel, which are anticipated to experience a surge in global demand over the medium term because of their usage in the manufacturing of electric vehicle batteries.

- The occurrence of adverse weather events that affect crops in major global food-producing regions could result in an increase in food prices. In addition, if an El Niño event happens, it could lead to higher temperatures and heavy rainfall later in 2023.

The main downside risk is if prices of industrial commodities—energy and metals commodities—retreat if global activity ends up weaker than expected.

The decline in energy prices in the first quarter of 2023 is expected to fade and be followed by stable prices over the remainder of 2023 and a slight uptick in 2024, as markets are expected to tighten amid supply pressures. Non-energy commodity prices, in contrast, will decline by about 10% in 2023 and almost 3% in 2024 as global demand is proving to be weak.

Energy products

The energy price index is expected to fall by 26% in 2023 (much of that decline has already taken place) and remain broadly unchanged (up 0.1%) in 2024. Brent crude oil prices are forecast to average US$ 84 per barrel in 2023. Weaker global demand has already caused them to drop 15% below the 2022 average, and they are projected to remain at that level through the end of 2024. Natural gas prices in Europe have fallen precipitously, with a 53% decline expected in 2023, but will remain almost three times as high as the average levels seen in 2015-19. Europe still faces challenges to ensure adequate supply next winter.

Oil consumption is expected to rise by 2% in 2023 to a new all-time high of 101.9 mb/d, according to the International Energy Agency. Recovery in China will account for more than half of the expected increase in global oil demand. Other Asian countries account for most of the rest of anticipated global oil demand growth. Outside of Asia, oil demand growth is expected to moderate in 2023. This reflects sluggish industrial activity and the continuing transition to a low carbon-emissions economy.

Natural gas prices are forecast to be significantly lower in 2023. Following a record-high annual increase of 150% in 2022, the European benchmark price is expected to fall by 53% from its 2022 average on lower demand, above average inventories, and improved access to supply. The U.S. benchmark price will decline by 58% in 2023, mainly because of increased domestic production.

In 2024, prices in Europe are expected to fall 11% from 2023, assuming Europe embarks on investments in LNG importing facilities. Nevertheless, price levels are expected to remain elevated over the forecast period because Europe still faces challenges in ensuring adequate supply next winter, including from Asian competition for LNG supplies.

Coal prices are forecast to fall 42% in 2023 and 23% in 2024. The anticipated increase in demand from China is likely to be offset by weaker demand elsewhere, as utilities switch back to natural gas. Exports from major producers (particularly Australia, and Indonesia) are anticipated to rise.

Fertilizer prices are projected to fall by 37% in 2023 in tandem with expected declines in the prices of natural gas and coal, but in real terms remain near the high levels during the 2008-09 food crisis. The forecast assumes that Russia will continue to redirect most exports towards Brazil and India. Still, ammonia prices will continue to be affected by gas market dynamics and trade restrictions

Agricultural prices are projected to decline 7% in 2023 and ease further in 2024. Food prices are expected to fall by 8% in 2023 and 3% in 2024, assuming that grain and oilseed exports from the Black Sea region will remain stable. Nevertheless, real food prices in 2023 will remain at their second highest levels since 1975—exceeded only by 2022.

In 2023, wheat prices are expected to be 17% lower and maize prices 15% lower than in 2022, amid weak global demand (aside from China, which may see a pickup in demand for maize in animal feed). At the same time, falling crude oil prices should reduce demand for maize in ethanol production.

Rice prices on average are expected to be 17% higher in 2023, with much of the increase already having taken place. Rice prices are expected to decline in 2024, as Pakistan's exports recover and high rice prices in 2023 encourage production elsewhere.

Global grain supplies over the forecast period are expected to rebound from the supply contraction in 2022. Brazil is set for a record breaking grain harvest in 2023 as a result of favourable weather. Similarly, better-than-expected grain harvests in Australia, Canada, Kazakhstan, and Russia in the 2022 production season are likely to lead to higher stock-to-use ratios for 2023. In addition, planting intentions surveys from the United States indicate sizable increases in maize and wheat acreage, which may put additional downward pressure on 2023 prices.

Prices for agricultural raw materials, which include cotton and rubber, will decline in 2023, reflecting sluggish global industrial demand growth, and rebound in 2024 as China's demand picks up. Although cotton production in Australia, Côte d'Ivoire, Mali, and Pakistan is expected to decline, this will be offset by increases in China and India, resulting in little overall change in global cotton production. Cotton prices are projected to decline by more than 23% in 2023 but are expected to increase slightly in 2024 due to reduced plantings in key producing countries like the United States.

Global production of oil seeds, oil meals, and vegetable oils is expected to be higher in 2022-23 than in the previous season because of favourable planting conditions in countries that are major producers or crushers of oil seeds. The oils and meals price index is expected to decline by 14% in 2023 and 2% in 2024. The forecast assumes that there are no further disruptions from the war in Ukraine, while good harvests in major grain producing countries—such as Australia, Canada, Russia, and the United States—contribute to lower prices. More specifically, soya coconut, palm and groundnut oil prices are to come down in 2023 thus providing relief relative to last year.

Metals and minerals prices, which briefly increased in January 2023, are expected to fall by 8% in 2023 relative to last year and a further 3% in 2024. Global demand in manufacturing is expected to remain weak, and China's recovery is expected to be heavily services-oriented. Strong supply growth is projected over the forecast horizon, supported by a recovery from production outages and new mines coming on stream for key metals (copper, nickel, and zinc).

Precious metals prices are expected to increase by 6% in 2023 as safe-haven demand rises amid elevated uncertainty with respect to future growth prospects, ongoing concerns about inflation, and financial stress in the first quarter

Gold prices are expected to average $1,900 per troy ounce in 2023—6% higher than in 2022. In 2024, gold prices are projected to decrease by 8% as the global economy begins to recover gradually and inflationary pressures recede. Physical demand is expected to support gold prices, though that demand remains price sensitive. Decisions from central banks on how much gold to hold will also be a key factor, with a possible return to 2021 levels of weaker gold demand exerting downward pressure on prices. Over the longer run, the path of inflation and interest rates will be the key factors driving gold prices. Short-run price volatility is likely to continue, in view of elevated geopolitical and economic uncertainty.

From the Indian standpoint, lower commodity prices in 2023 is good news as this will put a cap on imported inflation. Major commodities that have an influence on inflation are crude, coal, edible oils, fertilizers and metals. Lower metal prices will be a booster for the construction and EV industries as input costs will be under check. Also lower global prices of grains will lower the attractiveness of exports to a considerable extent which is good for domestic supplies. Monsoon and possible impact of El Niño on kharif crop would be the prime concerns today.

Data Releases

Currency outlook: Further downside for INR likely

INR depreciated in May'23 amidst renewed dollar strength. Safe-haven demand brought on by uncertainty over US debt ceiling buoyed the dollar. However, with the finalization and subsequent approval of the debt-deal market sentiments have settled down. Further denting the dollar's rise were dovish comments from Fed officials which hinted at a pause in Jun'23 meeting. As a result, INR has appreciated by 0.4% as DXY retreated. We believe that range-bound oil prices, FPI inflows as well as lower trade deficit will continue to support INR in the near-term, and any pressure on INR will be only short-lived. Furthermore, RBI has shored up enough forex reserves since the start of the year to help it manage any excess volatility in the exchange rate, if the need shall arise.

Bond Market Round-up

UK and US 10Y yields' noticed quite a sharp upturn in May'23. In UK, more than expected public borrowing, favourable growth indicators and inflationary concerns resulted in inching up of its yield. In the US, higher than expected PCE index, tighter labour market conditions and uncertainty surrounding US debt limit deal, kept yields elevated. Now with the passage of the deal in the House, some comfort on global yields might be visible. India's 10Y yield on the other hand was comforted due to softening of headline CPI print and comfortable liquidity conditions. RBI's announcement of withdrawal of 2000 rupee notes also raised hopes of a favourable durable liquidity number in the near term. Post the announcement (19 May'23), reserve money balances have fallen and bank deposits increased. Our analysis suggests that If 50% of the total INR 2000 notes (Rs 3.62 lakh crore) are deposited then we can expect bank deposits to go up by Rs 1.8 lakh crore. This will further put downward pressure on yields in the near term. We expect India's 10Y yield to remain in the range of 6.95-7.05% in the current month. Any cautionary call by RBI against inflation can however result in some volatility.

GDP growth in FY23: Positive surprise

Indian economy rose by 7.2% in FY23 after expanding by 9.1% FY22. Higher than anticipated GDP was on the back of strong growth led by agriculture (4% against 3.5%) and trade, transport sector (14% from 13.8% in FY22). Growth also surprised positively in Q4FY23 as it rose by 6.1% compared with an increase of 4.5% in Q3FY23. The improvement was led by expansion across sectors such as agriculture clocking 5.5% growth (4.7% in Q3) despite unseasonal rainfall in Mar'23. Mining and quarrying growth edged up by 4.3% (4.1% in Q3) and manufacturing sector growth improved by 4.5% after contracting by (-) 1.4% in Q3FY23. Construction sector registered double digit growth of 10.4% against 8.3% in Q3. Even sectors such as financials services and public administration recorded a much higher growth of 7.1% and 3.1% respectively in Q4FY23. However, some moderation in services activity was noticed with growth decelerating to 6.9% compared with a growth of 8.2%.

Amidst the risk of global slowdown, stubborn elevated global inflation print, rate hike cycle, we expect India's economy to clock 6-6.5% growth in FY24 with possible recovery in capex cycle and resilience shown by strong domestic fundamentals. Adverse impact of El Nino, untimely departure of monsoon and spatial distribution of rainfall will pose significant downside risk to these projections. Moreover weaker exports due to global slowdown will add to the downside risks.

Core industries

Growth in India's core sector output (which carry a weightage of 40% IIP) slowed marginally to 3.5% in Apr'23 compared with 3.6% in Mar'23. Out of a total of 8, only 4 industries posted positive growth. Following observations can be made: Fertilizer output increased sharply by 23.5% in Apr'23, building on a gain of 9.7% in Mar'23, amidst increased demand ahead of key cropping season; Infrastructure linked industry such as steel and cement noted an improvement in Apr'23 amidst increased demand. While steel output increased by 12.1% in Apr'23 compared with an increase of 8.8% in Mar'23, cement output recovered to 11.6% after a drop of 0.6% in Mar'23; Coal output slowed down to 9% in Apr'23, slowing from an increase of 12.2% in Mar'23 due to base effect (+30.1% in Apr'22). With the government's steadfast commitment on reducing dependence on imports, coal production is likely to improve in the coming months; Electricity production declined for the second straight month and fell by 1.4% in Apr'23 versus a decline of 1.6% in Mar'23. This can be explained by base effect. Improvement in industrial activity and high seasonal demand will push electricity output higher in the coming months; Growth in crude oil, natural gas and refinery products contracted by 3.5%, 2.8% and 1.5% respectively in Apr'23; Based on the above as well as the weakness seen in merchandise exports in Apr'23, we expect IIP growth in the range of 2-3% in Apr'23.

Fiscal

Centre's fiscal position in FY23 came in line with government's revised projections for FY23. Better than expected growth in nominal GDP (16.1% as per provisional estimate for FY23 versus 15.4% as per 1st AE for FY23), pick up in revenue collections, helped government achieve this target. Centre's overall receipts rose to Rs 24.6 lakh crore in FY23 compared with government's revised estimates (RE) of Rs 24.3 lakh crore. Within this, revenue receipts for FY23 have come in at Rs 23.8 lakh crore, compared with RE of Rs 23.5 lakh crore, implying an excess of ~35,000 crore. Both tax and non-tax receipts posted better than projected growth. With the help of higher revenue growth, government was able to meet the spending targets and still lower the fiscal deficit. Within this, while revenue expenditure target fell short of Rs 6,946 crore, capex overshot by Rs 8,551. This implied overall slippage of Rs 1,605 crore. Amongst the subsidies, savings from food (Rs 14,392 crore) and petroleum (Rs 2,354 crore), were offset by higher payments on account of fertilizer subsidy (Rs 26,119 crore). As a result, subsidy account saw a slippage of Rs 9,374 crore. For FY24, we continue to expect fiscal deficit ratio of 5.9%, even as downside risks to revenue growth persist (easing inflation and slowing economic conditions.

CPI inflation dips further

CPI inflation eased to its 18-month low of 4.7% in Apr'23 compared to 5.7% in Mar'23 and broadly in line with our estimate of 4.6%. This was on account of favourable base (7.8% in Apr'22 from 7% in Mar'22). CPI food index moderated to 3.8% in Apr'23 from 4.8% in Mar'23, on YoY basis. Amongst major food items, index for oils and fats fell further, while that for cereals, eggs, milk, fruits, and spices eased. On the other hand, price index for pulses, and sugar inched up. Pace of contraction in meats and fish and vegetables slowed. On a MoM basis, CPI food index inched up. Barring vegetables, price pressures were broad-based, including items like meat and fish, fruits, pulses, cereals, eggs, oils & fats, and sugar. Going forward we can expect food inflation to ease, owing to normal monsoon, dip in commodity prices and normalisation of supply chains.

Core CPI (excl. food and fuel) came down to 5.2% in Apr'23 from 5.8% in Mar'23. Barring higher inflation seen in case of pan and tobacco, education and personal care effects, amongst other sub-components moderation was broad-based. Significant amount of support was provided by easing price index for transport and communication, followed by clothing & footwear, household goods and services and housing. However, on MoM basis again there are mixed signs. While on one hand components like housing, pan/tobacco, education, personal care and effect and transport inched up in Apr'23, items like household goods and services and health showed downward movement.

The latest CPI print was helped largely by a favourable base. This support will remain through the entire H1FY24. However there might be other factors that may pose upside risks to inflation. Milk prices may get impact by demand-supply concerns and fodder prices. Vegetable index may put upward pressure in H1. Further, actual amount of rainfall in the coming months will decide whether food inflation will remain in check or not. On the external front, weak global activity is likely to keep oil prices in check, thus supporting our fuel inflation. International commodity prices are expected to remain low. However, volatility in dollar can impact prices of gold and thus the personal care and effects item in core. We expect RBI to remain in wait and watch mode at least for the next few months. Deviation in inflation trajectory will be key in determining RBI's 'pivot'.

WPI cools down further

Headline WPI fell more than expected in Apr'23. It was down by (-) 0.9% versus our estimate of (-) 0.6% and 1.3% in Mar'23. This is the first time it has entered deflationary territory since Jul'20 (-0.2%) and is currently at its 34-month low (-1.8% in Jun'20). Food inflation also cooled down significantly from 2.3% in Mar'23 to 0.2% in Apr'23. Within food, deflation in price index for milk, eggs, meat & fish, and moderation in vegetable inflation helped drag the overall index down. On the other hand, upward price pressures were visible in case of food grains, particularly pulses. Cereal price index fell less sharply. Increase in paddy prices and less sharp decline in wheat prices was in line with trend in international commodity prices. As indicated by World Bank's pink sheet, paddy prices have risen by 15.4% in Apr'23 from 12.8% in Mar'23, while wheat prices continue to decline, albeit slowly.

Fuel and power inflation in Apr'23 came down drastically to 0.9% from 9% in Mar'23, mainly owing to favourable base (38.8% in Apr'22 versus 31.8% in Mar'22). In Apr'23, mineral oil index entered deflation (-4.9%) for the first time since Jan'21 (-6.8%), declining from 6% in Mar'23. This was again on account of base effect (63% in Apr'22 versus 50% in Mar'22). Within mineral oil, barring Bitumen, all other sub-components declined even more sharply in Apr'23. Even coal (3.2% versus 3.4%) and electricity (20% versus 22.7%) price index showed moderation. Going forward, as US and China's economy are showing some signs of slowdown, risks to global demand still persists. As a result, even oil prices have come under strain. This along with favourable base, will keep fuel inflation in check even next month.

Core inflation remained in deflation for the 2nd consecutive month in Apr'23 as it fell to (-) 1.8% from (-) 0.3% in Mar'23. Manufactured products inflation also fell further to (-) 2.4%—lowest since Oct'15, and down from (-) 0.8% in Mar'23. Of the 22 commodity sub-indices, 18 indices rose at a slower pace in Apr'23 than Mar'23 led by basic metals, fabricated metals, paper & products, and chemicals. Within basic metals, faster deceleration was visible in price index for Zinc, Copper, and Aluminium. On the other hand, price index for lead declined at a slower pace. On international level, as reflected in World Bank's pink sheet, prices of zinc fell the most, followed by prices of aluminium. Decline in prices of copper and lead remained broadly steady.

IIP growth slows

IIP growth moderates: IIP growth came in below our expectations (3.5%) at 1.1% in Mar'23 compared with a growth of 5.6% in Feb'23. Electricity output contracted (-1.6%) for the first time since Sep'20 (-4.4%) and was down from 8.2% in Feb'23. Manufacturing output moderated to 5-month low of 0.5% in Mar'23 from 5.3% in Feb'23. Within manufacturing, 10 of the subcomponents (out of 23) have registered a contraction in output with pharma (-2.5% versus 22.9), computer, electronics (-28.7% versus -12.2%), wearing apparel (-30.7% vs -16.8%) and food products (-5.8% versus 4.2%) dropping the most. Surprisingly, mining output was the only bright spot registering an improvement in Mar'23 (6.8% vs 4.6%).

For FY23, IIP growth has slowed down to 5.1% against a growth of 11.4% in FY23. Mining and manufacturing have also recorded much slower growth at 5.8% (12.2% last year) and 4.5% (11.8% in FY22) respectively in FY23. Electricity output has improved to an 8-year high of 8.9% in FY23 against a growth of 7.9% in the previous year.

Consumer non-durables a drag: Within use-based too, broad based moderation continued across all sectors. Output of consumer non-durables contracted in Mar'23 (-3.1%) after returning to growth in Feb'23 (12.1%). Consumer durables output declined at a much faster pace to (-) 8.4% from (-) 4.1% in Feb'23. Amongst others, sharp moderation was registered under primary goods (3.3% versus 6.9%), infrastructure and construction goods (5.4% versus 8.4%) and capital goods (8.1% versus 10.5%). A marginal glimmer of hope was offered by intermediate goods wherein the output improved by 1% against a growth of 0.7%. For FY23, consumer durable (0.5% versus 12.5%) and intermediate goods (3.7% versus 15.4%) disappointed the most.

The global environment continue to lace with uncertainty, spill overs of the same on the domestic economy is largely expected (impact on exports). However, with resilient domestic demand (robust manufacturing PMI, high demand for electricity in coming months, capex revival) and favourable base effect will play in favour of the manufacturing sector in FY24.

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