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Sonal Badhan
Economist

Economic Round-up: April 2023

GDP data for Q1CY23 shows that while major economies have avoided a recession (most feared in case of Europe), slowdown in activity still continues. Growth in US has slowed down significantly while Germany is staring at stagflation. Risks on the other hand remain as major central banks continue to tighten their monetary policies further. Prices, while showing moderation, remain sticky at elevated levels (US, Europe). US Fed and ECB are expected to announce another round of rate hike (+25bps) this week. Investors will keenly await signals conveying future guidance. Analysts expect Fed to pause from Jun'23 onwards. BoE may also pause from this month or June. Further, news of one more bank failure in the US (First Republic Bank), has again reignited fears of growth in the wake of tight liquidity conditions. Course of rate actions by major central banks will decide the fate of economic growth in Q2.

Global growth: Economic activity is showing signs of slowdown in the US (Q1GDP, manufacturing production, retail sales, non-farm payrolls), and is giving mixed signals in China (FAI, manufacturing PMI is down, while home sales, exports, credit is up). In Eurozone, while the economic group managed to skirt recession in Q1, supported by dip in wholesale energy prices and fiscal stimulus, weakness in manufacturing persists at the beginning of Q2 (Apr'23). Inflation also remains sticky at elevated levels so far. Risks of stagflation in Germany also remain.

Global Central Banks: Even as turmoil in financial market continues (First Republic Bank in the US), US Fed and ECB are set to hike their respective policy rates by 25bps this week. BoJ has kept its policy stance (accommodative) unchanged for now but has tweaked its forward guidance. This lays the ground work for studying the possibility of gradual roll back of its massive monetary stimulus program (likely from this yearend). BoE decision in May'23 will either be a final 25bps hike or a pause, as inflation is expected to cool off significantly in the coming months. On the contrary, PBOC has reiterated its support to maintain loose monetary policy in order to support growth. While rates were left unchanged in the meeting last month, analysts expect a cut in rates and increase in liquidity if economy is unable to pick up along the expected lines.

Key macro data releases: On the industrial production side, core sector growth moderated to 3.6% on YoY basis in Mar'23 as against 7.2% in Feb'23. Major deceleration in growth was observed for sectors such as cement and electricity. Even fertilizer noticed quite a drop in growth. In FY23, core sector growth moderated to 7.6% from 10.4% in FY22. While growth in sectors such as coal, electricity and fertilizers held strong, sectors such as natural gas, steel and cement showed moderation.

CPI inflation eased to its lowest since Dec'22 to 5.7% in Mar'23 compared to 6.4% in Feb'23 and against our estimate of 5.8%. This was on account of favourable base (7% in Mar'22 from 6.1% in Feb'22). For FY23, headline CPI averaged to 6.7% against RBI's estimate of 6.5%. CPI food index moderated to 4.8% in Mar'23 from 6% in Feb'23, on YoY basis. Core CPI (excl. food and fuel) came down to 5.8% in Mar'23 from 6.1% in Feb'23. The entire H1FY24 would get comfort from statistical base. However, beyond that, inflationary pressures on some front remains worrisome. This includes rising milk prices due to demand-supply mismatches and rising fodder prices.

Global developments

Financial markets continue to rock the boat

Following the shockwaves felt after bank failures of SVB and Signature Bank (US), and troubles in Credit Suisse Bank (Switzerland), recently First Republic Bank in the US also sounded alarm. Failure of First Republic Bank is one of the biggest bank shutdowns in the US. Through a government brokered deal it has now been acquired by JP Morgan Chase, which will take over US$ 173bn of loans, US$ 30bn worth securities, and US$ 92bn in deposits. The acquiring bank and FDIC will share losses and recoveries on account of single-family and commercial loans.

These shocks along with continued rate hikes by Fed are showing mixed impact on real economy. While on one hand Q1CY23 GDP growth slowed to 1.1% (est.: 2%) from 2.6% in Q4CY22, on the other hand, price pressures still remain indicating strength in domestic demand. Dip in inventories and drop in private investment dragged the Q1 GDP down. But, PCE price index for Q1 rose to 4.2% (est.: 3.7%), and core PCE price index was up by 4.9% from 4.4% earlier. Retail sales have however begun to decline from Mar'23 onwards (-1% MoM versus est.: -0.4% and -0.2% in Feb'23). Slowing demand for goods also impacted factory production (-0.5% MoM in Mar'23 versus +0.6% in Feb'23). Even in Apr'23, manufacturing activity continued to contract, as shown by ISM manufacturing index, albeit at a slower pace (47.1 versus 46.3 in Mar'23). In Mar'23, non-farm payrolls rose by 236k (est.: 238k), easing from 326k additions in Feb'23. However unemployment rate inched down to 3.5% (est.: 3.6%) from 3.6%. Housing market was showing signs of improvement with new home sales rising by 9.6% (est.: +1.1%) in Mar'23 following (-) 3.9% in Feb'23. Existing home sales, which have the major share in overall home sales, had picked up pace in Feb'23, but again fell in Mar'23 following reversal in mortgage rates.

GDP growth (QoQ) data for Eurozone shows that region has managed to skirt recession by a narrow margin, as it posted 0.1% growth in Q1CY23 versus est.: 0.2%, but up from 0% in Q4CY22. Major economies within the group avoided recession. Decline in energy prices, fiscal stimulus provided by individual government and warmer than expected winters, helped avoid recession. Germany reported flat growth (0%) in Q1 (est.: 0.2%) after declining by (-) 0.5% in Q4. Drop in government and household consumption was countered by increase in exports and private investment. Latest PMI data shows that manufacturing activity remains weak in at the start of Q2 (Apr'23), with PMI for Eurozone at 45.8—35 month low versus 47.3 in Mar'23. Germany was the second weakest performer with index down to 44.5 in Apr'23 from 44.7m in Mar'23. Even in France, conditions remain subdued with index at 45.6 from 47.3 in the previous month. Inflationary pressures are seeing cooling down as supply chains improve. However, stickiness in inflation and that too at elevated levels (CPI at 7% in Apr'23 from 6.9% in Mar'23) remains a key risk to growth and will also keep pressure on ECB to continue hiking rates. In Germany, economy is showing resilience in Q2 as well with the Ifo index improving for the 7th consecutive month in Apr'23 (93.6 from 93.2) supported by drop in wholesale energy prices and reopening of China's economy. However, risks to recession/stagflation may emerge from high retail energy prices, continued rate hikes by the ECB.

Following the reopening of economy (post Covid-19), China's Q1CY23 GDP growth expanded by 4.5% (est.: 4%), up from 3% growth achieved in CY22. Domestic consumption rebounded as retail sales rose by 5.8% in Q1 and by 10.6% in Mar'23 alone (highest growth since Jun'21). Industrial production too improved in Mar'23 and rose by 3.9%, up from 2.4% during Jan-Feb'23 period. However, FAI growth eased to 5.1% in Q1, from 5.5% during Jan-Feb'23 period. This was largely driven by construction sector and private investment. Industrial profits continued to decline in Q1 as well (-21.4%), although the pace of contraction has slowed (-22.9%). Despite showing improvement in Q1, manufacturing activity in Apr'23 has slowed unexpectedly (official PMI at 49.2 from

51.9 in Mar'23). Weakness in global demand dragged the new export orders index down to 47.6 from 50.4 in Mar'23. Investments and employment also reported to be under stress. However, growth in home sales, home prices and overall credit still remains strong.

Global central bank decisions

Despite the market turmoil caused by bank failures (SVB and Signature Bank) in in Mar'23, Fed continued to increase its policy rate by 25bps. In its upcoming meeting in May'23 (decision due later tomorrow), the central bank is expected to continue its rate hike spree (+25bps) and provide future guidance for rates (pause from Jun'23 or later). Mixed macro-economic data points (ISM manufacturing PMI, build-up in price pressures) signalling less than anticipated slowdown in prices and economic activity, will be the key driver for this. Developments around recent bank failure of First Republic Bank is also likely to play on Fed's future guidance.

In case of BoE, there is a 50-50 chance of a final rate hike in May'23. In its last meeting, the central bank had raised rates by 25bps, taking the cumulative hike to 400bps (since Dec'22). This is mainly owing to stubbornly elevated inflation in the UK so far. However, going ahead, BoE expects inflation to cool down significantly. Thus, one final rate hike of 25bps is expected in the May'23 meeting, and then a pause or the pause may begin from May'23 itself.

Noticing weakness in the economy, ECB is also expected to slow down its pace of rate hikes. In its May'23 meeting, the bank is expected to hike rates by 25bps, compared with 50bps hike announced in Mar'23. Cumulatively, ECB has also raised by 350bps. This week's rate decision will also provide guidance as to how long will the rate hike cycle carry on. In view of stickiness in core inflation and that too at elevated levels, ECB's chief economist Lane recently signalled that ECB should continue hiking rates "in a timely manner" to bring inflation down within the targeted range.

Reserve Bank of Australia today returned to its rate hike cycle by announcing 25bps increase in cash rate target (to 3.85%), following a pause in Apr'23. Driver of this decision has been cited as elevated level of inflation print (~7%). The central bank admits that it will take years to bring inflation down to the targeted range and it will settle around 4.5% in CY23 before falling to 3% by mid-2025. In its Apr'23 meeting that bank had clarified that a pause did not imply end of rate tightening cycle.

In case of Asia, both Japan and China continue to maintain loose monetary policies. BoJ in its Apr'23 policy decision reaffirmed to maintain ultra-loose monetary policy and did not change to its Yield Curve Control (YCC) policy. The only tweak made was from its forward guidance where statement indicating that policy rates will be maintained at "current or lower levels" was removed. Continuous rise in core inflation is leading to expectations that BoJ will have to gradually phase out its monetary stimulus program from later this year. Divergence in monetary policies of Japan other major central banks (US, UK, ECB) has also led to Yen falling to near 15-year low at the beginning of this week. PBOC in Apr'23 reiterated that it will continue to provide support to the economy, as it is still recovering from the effects of Covid-19, and consequently left its rates unchanged.

Special studies

Banks regained space in 2022-23

It is often argued that bank deposits face competition from mutual funds especially at the retail end. This was one of the reasons that it was felt that the then existing tax benefits accorded to debt mutual funds, which are considered to be close substitutes, made bank deposits less attractive. In the last few years it was observed that mutual funds had gained in strength against bank deposits, though arguably the risk factor in mutual funds is higher. This could also mean that households have become less risk-averse especially at a time when the repo rate was held at a low of 4% by the RBI. However, in FY23 it was observed that funds flowed back to the banking sector and mutual funds witnessed slower growth.

Growth in AUM of mutual funds tended to exceed that of deposits in all years except 2019-20 before 2022-23. The base effect did help to push up the growth rate for AUM of mutual funds. This was also associated with a certain degree of robustness in stock markets (for equity based investment) and higher effective returns on debt schemes.

In absolute terms AUM of mutual funds increased from Rs 10.8 lakh crore in FY15 to Rs 39.42 lakh crore in FY23, which is a CAGR of 17.51% or 3.64 times. Outstanding deposits with the banking system increased during this period by CAGR of 9.8% from Rs 85.33 lakh crore to Rs 180.4 lakh crore which is 2.1 times.

The consequence of faster growth in the AUM of mutual funds relative to deposits also meant that the share of mutual funds in the sum of mutual funds and deposits increased and that of deposits came down. Deposits share came down from 88.3% to 84.1% in FY19 and then rose appreciably in FY20 to 85.9% before declining in the next two years to 81.4%.

There has however been a turnaround in FY23 which can be attributed to both the relatively somber performance of the market as well as rising interest rate scene. The share of banks rose to 82.1%.

The lower growth in AUM in FY23 of 4.9% compared with 9.6% in deposits can be seen mainly in the income oriented schemes. As banks kept increasing their deposit rates there was a tendency for households to prefer the safe haven of deposits. However, growth in AUM under equity schemes was higher indicating also the increase in risk taking culture. Interestingly the growth in AUM under hybrid schemes was flat. This does indicate that those inclined towards markets preferred to go for pure equity rather than take a more nuanced hedge bet on hybrid schemes which have a debt component.

The outlook for 2023-24 will be tilted in favour of bank deposits. This is notwithstanding the fact that the present interest rate cycle of rising repo rate may have ended as the RBI is expected to take a long pause before evaluating options. Bank deposit rates may not go up in a concerted manner and would be based more on the asset-liability management requirements. However, with the tax benefit on debt mutual funds being withdrawn, the returns on debt schemes would be less attractive than before. Interest in the equity segment would however be driven a lot by how the stock market performs. This would remain buoyant provided business is able to register better financial performance.

Understanding Yield Differentials

When the 364-days T-Bill yield equalled that on the 10-year bond sometime back, there was interest generated in the market as to what could have caused this convergence. In fact, the difference between 1 year and 10 years has varied over time. A view can be that the 1 year yield is linked more the state of liquidity in the market and moves in accordance with the same. The 10-year yield takes a more nuanced long term view which is influenced more by what the RBI could be doing. Hence, expectations of no further rate hike which can be a prolonged pause or a 'pivot' can lead to a decline in such yields under ceteris Paribas conditions. Also actions such as switches in tenure of bonds or even bond auctions for longer tenures can affect such yields.

In this analysis the last 5 years are looked at and the differences noted. Weighted average yields for weeks on residual maturity of 1 and 10 years have been juxtaposed to study the relationship.

There has been some kind of a pattern in the movement of the yield-differential over time. It tended to be less than 1 up to 2020. This was the time when the repo rate was also on the rise and had moved on an average basis from 6.1% in H1-2018 to 6.5% in H2-2018 before declining to 5.3% in H2-2019.

Once Covid-19 set in and the repo rate was lowered to 4%, which was retained for the next 18 months or so, the differential increased sharply to a range of 1.51-2.16%. This was more due to the lower tenure yields coming down sharply as the 10-year bond hovered around the 5.80-6.80% band. There was also surplus liquidity in the system which kept these yields depressed.

Subsequently as the RBI started raising the repo rate, the 10-year yield crossed the 7% mark and hovered in the range of 7.20-7.50%. The average differential came down to 0.69% in H2-2022 and further to 0.28% in H1-2023 (up to April). Here while the 10-year yield remained range bound, the 1 year yields rose due to the withdrawal of accommodation stance of the RBI which meant that surplus liquidity was drawn out.

A conclusion that can be drawn is that when the repo rate is at a higher level which pushes up the 10-year yield, though not proportionately, the difference with the 1 year yield reduces. It is low repo rates which tend to push down the 1-year yield further relative to 10-years that widens the differential.

Given that the RBI has worked towards withdrawal of accommodation and that liquidity has come down to stable levels, there should be less volatility in short-term yields. The 10-year yield has come down on expectations that the current rate cycle has already witnessed its peak and the direction will be downwards at the appropriate time. The government's gross borrowing programme of Rs 15.43 lakh crore (Rs 11.02 lakh crore of net borrowings) should not pose any threat to bond yields. Bank credit growth may also be expected to slow down from FY23 thus offering more funds for G-sec absorption as growth in deposits picks up at a higher rate. The differential would be range-bound at 0.50-0.65% under these assumptions.

Are Macroeconomic variables and Stock Indices related?

The performance of Indian stock market (Nifty) in FY23 when compared with last year has not been up to mark. There are varied macroeconomic factors responsible for this dip, with inflation and central bank action dominating the sentiment. Add to this the uncertainty faced due to Russia-Ukraine conflict, kept the investors on the edge. The outflow from overseas funds also contributed to this dip. Supply constraints and other domestic factors added to the sombre performance of market.

Amidst these developments in global economy, there were also impending fears of recession for some of the global economies. Indian economy too witnessed some spill over effects from global economic developments coupled with their own set of unique challenges. The effect of the same was visible on a range of macroeconomic variables as well as on the financial health of the companies. This study attempts to see if there is any relation between the performance of the market indices and the macro-variables.

How has Nifty performed in FY23 vis- a-vis other global indices?

Nifty index declined by 0.6% in FY23 after gaining by 18.9% in FY22. Despite some moderation, in comparison to other global markets, India has relatively performed better, especially with respect to countries like Singapore, Hong Kong, Korea and even US. However, global indices such as France, Germany and UK have outperformed Indian indices.

Sub-Indices of Nifty Index

Even as Nifty has registered some moderation compared with last year, some of the sector indices showed improvement. This study attempts to link macroeconomic metrics like GDP, IIP growth, core sector growth with these stock indices.

<u>The outperformers:</u>

Auto Index: The index has given a strong return of over 16% for FY23. The sector (automobile and ancillaries) has done well in terms of financial performance for last 2-quarters. The vehicle retail sales data from FADA have noted a robust growth of 20.9% for FY23.

Banking Index: Double digit growth of 11.6% for FY23 has been registered for banking index. The sector has seen a robust credit growth in FY23 at 15% against a growth of 8.6% in FY22

PSU Bank: Within banking sector, the PSU Index has given a solid performance and has generated a return of 36.3% for FY23, compared with last year making these most lucrative investment against their private counterparts.

Consumption Index: In comparison to Nifty, the consumption index has performed better with a growth of 4.9% recorded for FY23. On expenditure side, for GDP calculation, PFCE is expected to grow by 7.2% (constant) in FY23.

FMCG Index: The FMCG index has witnessed a strong return of over 26.5% in FY23 compared with last year. The performance of industries within the sector has registered a steady bottom line growth for the last 2-quarters (Sep'23 and Dec'23).

Infrastructure Index: Marginal growth of 1.4% was registered by infrastructure index in FY23. As per the eight core sector classification output of steel and cement for the period of Apr-Feb'23 has improved by 7.5% and 9.7% respectively though lower when compared with FY22. Net profit for these industries was under pressure in the second and third quarters of the year.

Underperformers:

6 of the sectoral indices were underperformers registering negative growth over the year. Their performance also tended to get linked with the performance of the industries as well as the underlying developments that affected their prospects.

Energy: In comparison to Nifty, energy index witnessed negative growth of 11.7% in FY23. In the beginning of FY23, the heatwave conditions in the country was aggravated due to increased demand by both domestic and industrial sector, amidst coal shortage. India meets over 70% of its power demand through the thermal power route with coal being the major source.

Owing to the Ukraine-Russia conflict, global commodity prices had heated up during this period too. In addition, financial performance of power companies (especially DISCOMs) was under pressure with profits coming down in Q1FY23. There were other logistic issues (including transportation) too at play that had an impact on this sector, making this not only a demand challenge but also a supply one.

IT: IT index has underperformed for FY23, declining by 21% in FY23. The year has witnessed uncertainty and fears of global economic slowdown even the recession warnings were given for some European economies. These fears were unfounded as witnessed by the surge in export of services for the country on account of this sector.

Media: The media index registered a sharp contraction of 28.6% (negative return) for FY23 compared with last year. The bottom line growth too underwent negative growth for both Q2FY23 and Q3FY23.

Metals: Double digit negative return of 14.4% was seen for the metal index. The uncertainty of global markets had pushed global commodity prices higher. The industry had to bear the pressure of rising cost and the same was reflected with the financial performance of firms especially in the last 2 quarters witnessing their bottom line suffering as a result. Additionally, output of basic metals has moderated to 7.4% from 19.8% in FY22 (Apr-Feb). For fabricated metals, the output growth has contracted to 1.3% (Apr-Feb) from 12.7% last year.

Pharma: The Pharma index recorded negative return of 11.5% for FY23 on a YoY basis. Growth for pharma sector slipped in to negative territory in FY23 compared with positive growth registered in FY22 (Apr-Feb). Profits in Q3FY23 declined after increasing in the previous quarter (Q2FY23).

Realty: The real estate index for FY23 registered a negative growth of 16.4% for FY23. Infrastructure construction goods output slowed down to 8.1% in FY23 compared with double digit growth of 20.3% in FY22 (Apr-Feb).

Update on India and US rates

India and US 10Y yield differential is seen inching up since March'23. This is on account of faster pace of decline in US 10Y yield compared to India's 10Y yield, which is less elastic. Several factors have been at play.

- There has been synchronized drop in US CPI since Jan'23 both on sequential and YoY basis. The PCE and core PCE index (closely tracked by Fed for inflation) have showed continuous moderation. Producer prices have fallen on sequential and YoY basis.
- The average hourly earnings have also fallen on a sequential basis, non-farm payroll numbers have also fallen since Jan'23, signalling some degree of slowdown in the economy.
- Slowdown in industrial production (both sequential and YoY), ISM manufacturing index also indicates that US economy is losing some stem.
- Fed's Beige Book also highlighted that signs of stress are visible in manufacturing activity and lending volumes.
- Market is pricing in a 25bps in the next policy and a pause either from Jun'23 or afterwards. Further slowing of the economy may even call for an easing policy space towards next year.
- The policy rate differential between India and US has fallen on the other hand. This is because of faster pace of increase in policy rate of US (+50bps increase in the past three months) compared to India (+25bps increase in the past three months).

So how interest rate and policy rate differential between India and US is would pan out?

Inflation dynamics: Currently the inflation differential between India and US is rising, due to faster pace of falling US inflation rate. Going forward, this would be the guiding trajectory. For India, we expect some degree of moderation in CPI rate at around 5.5-5% range in the coming fiscal, where US CPI is likely to settle around 2.5%, which would translate to around 250-300bps inflation differential between India and US. In fact, the faster pace of decrease in US inflation (due to slowdown in the economy) compared to India's inflation (shocks to food inflation and considerably buoyant demand conditions), would keep the differential elevated.

Growth dynamics: On growth front, India's high frequency indicators are favourable. On the other hand, macro indicators in the US are showing some softening on account of the impact of past policy transmission, as Fed rate hike cycle is steeper compared to India's. In India, the lag impact of past policy transmission is likely to materialize from Q1FY24 onwards. However, the catch up to slowdown will be slower. Hence this is likely to keep growth differential between India and US higher which will in fact keep policy rate differential between India and US at an elevated level.

Update on investment scenario and its funding

Investment picture in FY23 was fuzzy. Different dimensions emerged from the CMIE capex data. While new project announcements reached an all-time high in FY23, the picture was not even across sectors. Most of these announcements were in the services sector (transport services). Manufacturing showed only modest pickup with major capital creating sectors such as machinery, metals on the other hand noting considerable drop in announcements in FY23 compared to FY22. Apart from new announcements, even revival rate of projects

dropped to lower levels. The gestation period of projects also increased, reflective of increased economic cost of capital and also delayed completion of projects

On the funding side as well, the story is mixed. Bank credit, the primary source of funding shows that credit off take to industry has been far below the normal pace of credit accretion in FYTD23. Notably, 8 out of the 19 sub-industries which are monitored by RBI, showed credit growth even below 4.3%, which is industry level pace of credit accretion in FYTD23 (April-Feb). Funding through the corporate debt market has also remained skewed. Funds raised from primary market again remained inclined towards services sector, with manufacturing share dropping sharply in the equity segment. Funding through the ECB route has been impacted due to higher capital cost in a rising interest rate regime. But the purpose wise proposals show some degree of respite as here the share of new projects and import of capital goods have increased, which indicated some improved sentiments with regard to investment climate.

Investment in FY23 showed mixed picture:

CMIE data reflected some buoyancy on investment front as new project announcements picked up considerably, reaching an all-time high of Rs 29 lakh crore in FY23 compared to Rs 22 lakh crore in FY22. Basically, this indicator expresses the intentions of business enterprises; albeit all the announcement may not necessarily translate into actual investment. The major pickup is attributable to services sector (other than financial), where new announcements picked up to Rs 10.3 lakh crore in FY23 compared to Rs 5.2 lakh crore in FY22. Within services, the sharp increase happened for transportation sector where new announcements rose to Rs 8.8 lakh crore in FY23 compared to Rs 3.9 lakh crore in FY22. The announcements made by the airlines industry were major contributors here.

Manufacturing and electricity sector also witnessed improvements. However, within manufacturing, the increase is not broad based. Except chemical and products (where new announcements picked up to Rs 7.3 lakh crore in FY23 from Rs 3 lakh crore in FY22), all sub sectors noted drop in announcements. In fact, for capital creating segments such as machinery and metals and products, considerable drop in announcements have been noticed.

Two pain points:

- The revival rate of projects has gone down significantly in FY23. This is indeed worrisome because it indicates that revival of implementation stalled projects has increased. ‘Implementation stalled projects’ are those that have gone beyond the stage of a mere announcement and stalled post implementation. Hence increase in the quantum of those projects incurs higher economic cost of capital.

- Rate of gestation of projects have also increased in FY23, which are reflective of the fact that projects are getting delayed.

How sources of funding for investment fared?

Credit to industry still a laggard: Despite a double digit pickup in overall credit, credit to industry has remained low. In FYTD23 (Mar-Feb’23), credit growth to industry was just 4.3%, far below overall credit growth of 13% noted during the same period. Notably, 8 out of the 19 sub-industries showed credit growth of less than 4.3%, which is industry level growth.

Corporate Debt: Capital raising through the private placement route has remained buoyant. It picked up from Rs 5.9 lakh crore in FY22 to Rs 6.6 lakh crore in FYTD23 (Apr-Feb), whereas capital raising through the public issue route has dropped in FYTD23 to Rs 8,726 crore in FY22 from Rs 11,589 crore in FY22. Even out of this Rs 8,726 crore, major capital raising has been by NBFCs or HFCs. Only infra company raising capital was National Highways Infra Trust with a final issue size of Rs 1,500 crore.

CMIE data on debt raised in the market in FY23 places the total for the year at Rs 7.68 lakh crore. Of this amount the largest shares were financial services at 73% followed by telecom with 9%. Power and refineries had shares of around 3% each. Therefore, there was no major push from the non-financial services side on investment.

Equity markets: If we look closely at the share of industries with respect to funds raised in the primary market in equity segment, it clearly reflects that most of the space is dominated by services sector (other than financial). Manufacturing sector has a relatively low share. In fact through the equity route, the share of manufacturing has considerably come down in FY23. Out of Rs 1.39 lakh crore raised in FY23 through the equity route by all industries, share of manufacturing is just 17% from 22.7% seen in FY22. On the other hand, services sector (other than financial) has a share of 49%.

Foreign funding: Through ECB: Borrowing through the ECB route (both automatic and approval route) has been lower at US$ 22.5bn in FYTD23 compared to US$ 38.5bn in FY22. Higher borrowing cost in the rising interest rate regime, attributed to the same. If we look at the approvals purpose wise, an interesting thing which comes out is that the share of new projects in total approvals have picked up to 12.7% in FYTD23 from 6.6% in FY22, which signals some extent of investment intentions in the economy. Even share of import of capital goods rose to 10.4% in FYTD23 from 5% in FY22.

FDI inflow: Due to uncertain global macros on the back of tightening financial conditions, FDI inflows in FYTD23 have dropped to US$ 42bn in FYTD23 compared to US$ 50bn seen in the same period of previous year. Sector wise, service sector continues to dominate the FDI space as well. In fact for industrial activities such as infrastructure, automobile and metallurgy, the share of FDI inflow has fallen in FYTD23.

IMF WEO: IMF flags risks to recovery

The International Monetary Fund (IMF) in its recent report flagged risks to 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 (WEO) 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.

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 noted that risks to 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.

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%.

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 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.

Banking scene in 2022-23

The year gone by was quite interesting for the banking sector with the RBI changing course on interest rates and invoking successive repo rate hikes in a bit to quell inflation which remained above the RBI tolerance limits for 9 months of the year. As India remained the fastest growing economy in the year there was a steady demand for credit. This had to be matched with deposit growth which was lagging. This led to banks also increasing their deposit rates. The foregoing analysis looked at how various banking indicators fared during the year.

How did the size of the cake grow?

The overall size of deposits (as of 24th March 2023) was around Rs 180 lakh crore and credit Rs 137 lakh crore yielding a credit deposit ratio of 75.8%. Growth in deposits at 9.6% was higher than that of last year which was 8.9%. The increase in interest rates by banks to mop up deposits helped in this effort. Going forward, there would be some advantage for deposits to grow at a higher rate with the government withdrawing the capital gains tax benefit on debt mutual funds. With a level playing field being established, at the margin bank deposits would be preferred.

Bank credit growth however was much higher at 14.5% compared with 6% last year. In incremental terms growth was Rs 17.84 lakh crore compared with an increase of Rs 15.78 lakh crore in deposits. This was in contrast to

2021-22 where incremental deposits were higher than that in credit. Clearly banks used their own funds for funding credit.

How did interest rates move?

All movements in interest rates got linked to the repo rate which was hiked by 250bps before a pause that was taken in April 2023. The overnight reverse repo rate which became the benchmark for the call money market has now become less relevant and remained unchanged at 3.35%. The introduction of the SDF now meant that it has now become the benchmark and has been kept at 25bps lower than the repo rate. The repo rate has also become the standard for the term reverse repo (VRRR) with the cut-offs being normally at 6.49%.

While all rates tended to move up, the extent of increase was lowest for the 10-years bond. In case of treasury bills, their yields were driven mainly by liquidity conditions and by the end of the year, there was convergence in yield on 364 days T-Bill and 10-years government bond.

Transmission of repo rate hikes can be best understood by how the average interest rates behaved in terms of banks passing on the rate hike. The 250bps hike in repo rate led to 161bps hike in weighted average lending rate on fresh loans. In terms of weighted average lending rate on outstanding loans the increase was 93bps. On the deposits side the weighted average domestic term deposit rate increased by 100bps in response to the repo rate hike.

Data on proportion of loans reckoned on an external benchmark shows that in case of PSBs only 35% were under the EBLR as of Dec'22 while it was double for private banks. The same held for foreign banks too. For all banks put together the proportion under EBLR was around 48%. The composition of the loan basket largely drives this ratio as personal loans and SME credit tend to be benchmarked against such a benchmark unlike corporate loans which are linked with the MCLR.

Looking ahead

It does look like that the RBI will take a deep breath for a longer period of time and hence we may have reached the end of this cycle of peak interest rates. In FY24 growth in deposits should be higher while that in credit marginally lower which should assuage the liquidity situation. Therefore the picture should be steady going ahead with rates probably tending to move downwards than upwards given that inflation projections for FY24 are in the 5-5.5% band. The monsoon impact will be critical before there is any rate action which means that a status quo can be expected in the first half of this year.

Data Releases

Currency outlook: Further downside for INR likely

Global economy was once again beginning to stare at the possibility of economic slowdown as fears re-emerged over the possibility of economic recession in US owing to another banking crisis. US officials are already in talks of providing a possible FDIC receivership to First Republic. A lot is at stake for Fed now, as it considers the next rate action given the stubbornly high inflation, elevated wage growth, credit crunch scenario and uncertainty in global growth. Amidst these developments, DXY weakened by 0.4% in last fortnight. Rupee has relatively performed better than the Asian peers and is expected to trade in the range of 81.5-82.25/$ in the next fortnight.

Bond Market Round-up

Global bond yields traded mixed in Apr'23 influenced by varied macros. In the US, while labour market and consumption demand remained buoyant, burgeoning budget deficit and contraction in manufacturing activity posed concerns. However, market is pricing in a 25bps rate hike by Fed in the coming policy with expectations of prolonged pause post that as the OIS papers reflect the same. This comforted US sovereign 10Y yield to some extent in Apr'23. On the other hand, 10Y yields in UK and Germany inched up as the rhetoric of inflation posed concerns. India's 10Y yield have exhibited quite a bit of downswing in Apr'23, falling by 19bps. This was post RBI's surprise move of a pause, defying market expectations of another 25bps hike. Further a lower than expected inflation reading in consonance with favourable oil price and improved appetite for sovereign securities, supported yields in the domestic market. Interestingly, yields across all tenor fell in Apr'23; even the short end curve exhibiting quite a bit of correction, which was not observed in the past two months. Thus the entire yield curve of India shifted downward. Liquidity remained in surplus to the tune of Rs 1.6 lakh crore, supported by RBI's fine tuning through SDF. We expect India's 10Y yield to trade with a downward bias in the range of 7.10-7.15% in May'23. Comfort would come from softening of CPI data in Apr'23, as major high frequency domestic price data are reflecting the same.

Core industries

Core sector growth moderated to 3.6% on YoY basis in Mar'23 as against 7.2% in Feb'23. Major deceleration in growth was observed for sectors such as cement (-0.8% in Mar'23 against 7.4% in Feb'23 and electricity at -1.8% against 8.2%). Even fertilizer noticed quite a drop in growth to 9.7% from 22.7%. In FY23, core sector growth moderated to 7.6% from 10.4% in FY22. While growth in sectors such as coal, electricity and fertilizers held strong, sectors such as natural gas, steel and cement showed moderation.

CPI inflation moderates

CPI inflation eased to its lowest since Dec'22 to 5.7% in Mar'23 compared to 6.4% in Feb'23 and against our estimate of 5.8%. This was on account of favourable base (7% in Mar'22 from 6.1% in Feb'22). For FY23, headline CPI averaged to 6.7% against RBI's estimate of 6.5%. CPI food index moderated to 4.8% in Mar'23 from 6% in Feb'23, on YoY basis. Amongst major food items, oils and fats, meat and fish, spices and cereals, showed moderation. In FY23, food inflation rose to 6.6% from 3.8% in FY22. Going forward we expect, food inflation to soften on account of normal monsoon, falling commodity prices and progressive normalization of supply chains.

Core CPI (excl. food and fuel) came down to 5.8% in Mar'23 from 6.1% in Feb'23. Major comfort came from moderation in personal care and effects (8.3% from 9.4%). This is despite ~3.3% increase in international gold prices in Mar'23 on MoM basis. Apart from this, recreation and amusement (4.3% from 4.9%), transport and communication (4% from 4.5%) and household goods and services (7% from 7.4%) also comforted core.

CPI print in Mar'23 was comforted by a favourable base. Even the entire H1FY24 would get comfort from statistical base. However, beyond that, inflationary pressures on some front remains worrisome. This includes rising milk prices due to demand-supply mismatches and rising fodder prices. Uncertainty also looms with regard to vegetable index which have the seasonal nature of an upsurge in H1. Apart from this, crude oil which is currently comforting might reverse their trajectory once recovery in China space out post the stimulus measures. Another stickiness in core might emanate from volatility in gold prices, which is contingent on the movement in dollar. Weather vagaries is another factor, though at present we are incorporating a normal monsoon in our forecast, any deviation whether spatial or from the number predicted by IMD will have an impact on cereal inflation, which is showing some degree of comfort currently.

WPI cools down further

Headline WPI eased sharply lower to 1.3% in Mar'23 (BoB est.: 2.4%), from 3.9% in Feb'23. This is the 10th consecutive month of moderation and has fallen significantly from the peak of 16.6% in May'22. Food inflation cooled down less slowly and was at 2.3% in Mar'23, compared with 2.8% in Feb'23. Within food, inflation index for grains, fruits, milk, spices moderated, while that of vegetables contracted less sharply and of protein based items was steady. Food grain inflation index eased to 8.2% from 11.8% in Feb'23, mainly led by cereal index (9.5% versus 13.9%). On the other hand, price index for pulses showed signs of pressure (3% versus 2.6%). Within cereals, decline in paddy and wheat prices was in line with trend in international commodity prices.

Fuel and power inflation in Mar'23 dipped to 9%—lowest since Feb'21, and down from 14.8% in Feb'23. This was on account of drag in mineral oil index, which eased to 6% from 15.8%. On the other hand, coal price index remained unchanged from the previous month at 3.4%, while electricity prices index rose to 22.7% from 19.7%. Movement in mineral oil index is in line with trend in international crude oil prices, which have fallen by (-) 29.6% in Mar'23 following (-) 11.2% decline in Feb'23. Domestically, within mineral oils, prices of ATF, Kerosene, Naphtha and HSD fell the most. Going forward, as risks to recession still linger, oil prices are further down by 18% in Apr'23 so far (MTD). This is likely to further ease pressure on fuel inflation next month. However, if global demand (led by US and China) does not slow as much as anticipated, then we could see build-up in prices.

Core inflation entered deflation for the first since Jul'20 as it fell to (-) 0.3% in Mar'23 from 2.1% in Feb'23. Manufactured products inflation also fell considerably to (-) 0.8%—lowest since Dec'19, and down from 1.9% in Feb'23. Of the 22 commodity sub-indices, 19 indices rose at a slower pace in Mar'23 than Feb'23 led by basic metals, paper & products, other manufacturing, food, and chemicals. Within basic metals, faster deceleration was visible in price index for Zinc, Aluminum and lead. On the other hand, price index for copper slower contraction. On international level, as reflected in World Bank's pink sheet, prices of zinc fell the most, followed by prices of aluminum, copper and lead.

IIP growth stable

IIP growth came in above our expectation (4.5%) at 5.6% in Feb'23, compared to 5.5% in Jan'23, on YoY basis. There was a comforting base (1.2% in Feb'22 from 2% in Jan'22) for this macro data as well. Manufacturing index showed growth of 5.3% from 4%. Within manufacturing, increase was visible in production of tobacco, textiles, wearing apparel, chemical and chemical products, pharma, computer, electronic and optical products and transport equipment. On the other hand, mining and electricity growth moderated to 4.6% and 8.2% respectively, from 8.8% and 12.7% in Jan'23.

Use based data: Capital goods production was broadly stable at 10.5% in Feb'23 from 10.7% in Mar'23. Even consumer durables production showed a slower pace of decline of -4% from -8.2% in Jan'23. The FMCG segment noted double digit growth of 12.1% from 6.3%. Primary and infrastructure goods disappointed with growth of 6.8% and -0.3% respectively in Feb'23 from 9.6% and 0.5% in Jan'23.

On a sequential basis, industrial production remained disappointed with all broad segments such as manufacturing, mining and electricity production noting considerable decline. The sharpest fall is visible in electricity production. In use based as well, there is sharp decline seen on a sequential basis, especially for primary goods, intermediate, infra and FMCG goods.

Going forward, uncertainty remains on the IIP picture, as gloomy uncertain external environment is likely to be a drag on exports.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com