3 November 2023

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Economic Round-up: October 2023

Divergent economic trends amongst major economies have come at the forefront. While in the US economy is showing signs of resilience (better than expected Q3 GDP, tightness in labour market, strength in domestic consumption), gloomy economic scenario persists in the Eurozone and China is again witnessing signs of slowdown. In Europe, continued weakness in manufacturing and service sector activity, along with elevated levels of inflation and interest rates, is pushing the economy towards a recession. In China, lacklustre global demand and slowing infra spending in the real estate sector is hampering demand. In the wake of renewed geopolitical tensions (Israel-Palestine war) and to assess the impact of tight monetary conditions, major global central banks, including RBI, have decided to maintain their hawkish pause. Labour market conditions will be watched closely to gauge future trajectory of rate action by Fed.

Global growth: Global growth trends remain mixed. In the US while domestic consumption is supporting growth so far, led by gains in labour market and slowing inflation, manufacturing activity remains dismal. Spill overs from tight monetary conditions are further expected to play out in the coming months, thus slowing down the economy. However possibility of a recession has been ruled out by Fed. In Eurozone, both service and manufacturing sector growth has taken a hit, also leading to job losses and contraction in GDP in Q3. In Q4, conditions are likely to worsen further. Due to this, China's export growth has been impacted and it is resulting in faltering manufacturing activity as well. Restrained amount of spending in the infrastructure sector is further impacting demand conditions and consumption growth. Analysts await more monetary stimulus measures to be announced to boost growth.

Global Central Banks: In Oct/Nov'23, US Fed, ECB, BoE, BoJ and Bank of Canada held rates unchanged. Fed's policy statement remained hawkish as it reiterated that future rate hikes cannot be ruled out inflation continues to remain elevated and economic growth is proving to be more resilient than previously anticipated. BoE and ECB have also maintained that they will allow policy to remain restrictive by keeping rates higher for longer in order to bring inflation back to targeted levels on a durable basis. BoJ, while maintained its stance of keeping the policy ultra-loose, it tweaked the YCC again, thus signalling a possible shift towards roll-back of accommodative policy measures.

Key macro data releases: Corporate performance of India Inc. in Q2FY24 shows that at the aggregate level, while sales growth has slowed down substantially, profit growth has seen a stellar revival. However, if we exclude the BFSI sector, net sales growth this year is showing a contraction of 1.8%. Higher interest rates during the year have benefitted banks and financial institutions, resulting in an improvement in their financial performance in Q2FY24, which has been offsetting the drag in other sectors.

CPI inflation came in at 5%, mainly brought down by moderation in the food as well as core categories. Inflation for food and beverages was at 6.3%. While base effects tempered these numbers, pressures remain in case of cereals, pulses, milk products and spices. Core inflation also came down further to 4.5%, and there was moderation cross all categories with inflation being less than 5%.

Global developments

US economy resilient; Europe under stress

Divergent trends emerged between major economies, as Q3CY23 GDP showed that US economic activity rose by 4.9%, while it contracted by (-) 0.1% in Germany and Eurozone and is estimated to have contracted in Japan and UK as well. Further, at the start of Q4, global PMIs show that manufacturing activity remains a major drag across major-US, China, Eurozone, Japan in Oct'23.

In the US, manufacturing ISM dipped to 46.7 (est.:49) last month from 49 in Sep'23. New orders, inventories and imports fell markedly. On the other hand, input prices fell less sharply. However, some of the other macro indicators point towards resilience in economy, as also pointed out in Fed's latest policy statement. Initial jobless claims for the week ending 21 Oct 2023 came in at 210k (est.: 208k), versus 200k in the previous week. Despite the increase, these levels remain ultra-low. According to Fed Chair, pre-pandemic level of immigration is boosting the labour market, without hurting inflation. US retail sales growth is also maintaining momentum with 0.7% increase in Sep'23 (est.: 0.3%), following 0.8% rise in Aug'23, led by sale of motor vehicles and higher spending on eating out. Further, new home sales also surged in Sep'23 (+12.3%) to reach 759k units—highest since Feb'22 (676k units in Aug'23), as home prices fell. GDP growth in Q3 was up by 4.9%, following 2.1% increase in Q2 and also up from estimated 4.2%. Jump in private consumption, inventory investment, government spending, and exports, drove growth. Supported by restrictive monetary policy, inflation has been brought below 4% mark (last seen in May'23) as it settled at 3.7% in Sep'23—unchanged from Aug'23, but a tad higher than estimated 3.6%. Going ahead, owing to visible strength in economic activity, Fed does not see possibility of a recession in the US in the near-term.

Economic conditions in the Eurozone on the other hand are much weaker. GDP growth in Eurozone in Q3 fell by (-) 0.1%, versus est.: 0% and 0.2% increase in Q2. This was driven by contraction in Germany's economic activity (-0.1% versus +0.1% in Q2) and sharp slowdown in French economy (0.1% versus 0.6%). Flash PMIs show that manufacturing conditions deteriorated further at the start of Q4, with index falling to 3-month low of 43.0 in Oct'23 from 43.4 in Sep'23. Even services activity continues to be hit with PMI level down to 32-month low of 47.8 in Oct'23 versus 48.7 in Sep'23. These numbers indicate worsening demand conditions in both sectors. Survey results also showed first downturn in employment since Jan'21, as new orders and backlog orders declined. Looking ahead, while Germany's IFO business climate posted a slight increase in Oct'23 and inched up to 86.9 (est.: 85.9) from 85.8 in Sep'23, the current conditions index still points towards a recession with activity estimated to contract by (-) 1%. On the brighter side, substantial dip in inflation may help boost demand in the coming months.

China's official manufacturing PMI shows that activity fell back into contraction in Oct'23 as PMI index slipped to 49.5 (est.: 50.2) from 50.2 in Sep'23. The non-manufacturing PMI index also reflected slowdown in activity (50.6) compared with the previous month (51.7 in Sep'23). Weakness in the real estate sector, led by reduced spending on infrastructure impacted the demand conditions. Both export and import orders fell in Oct'23. Trade data confirms the trend as exports had fallen for the 5th consecutive month in Sep'23 (-6.2%) on back of slowdown in Europe and Asia. Until Sep'23, both retail sales and industrial production were supportive of growth as sales rose by 5.5% (4.6% in Aug'23) and production was up by 4.5% (unchanged from Aug'23). FAI growth remains a key drag (3.1% between Jan-Sep versus 3.2% between Jan-Aug).

RBI

RBI's policy came out on expected lines with both stance and rates being kept on hold. Growth and inflation estimates were also retained at the same level and 6.5% and 5.4% respectively, for FY24, from its Aug'23 policy projections. This policy again reiterated the 4% target band as inflation and highlighted on being vigilant towards the same. It stressed upon the need to carefully monitor recurring incidence of overlapping price shocks and persistence and generalization of the same. In that context, spill over from global food and energy shock cannot be ruled out. Governor's statement also signalled some tightening liquidity conditions going forward and highlighted that liquidity distribution in the banking system remains skewed. Further, RBI signalled that the option of OMO sales contingent on the evolving liquidity conditions will be kept open.

Global central bank decisions

In line with market expectations, US Fed again left its policy rates unchanged at 5.25-5.5% in the Oct/Nov'23 meeting. While analysts believe that policy rates in the US may have reached their peak, the current pause remains hawkish in nature, as the Governor reiterated that inflation remains elevated and economy activity is resilient, hence the central bank will not shy away from hiking rates if needed. Much better than expected US GDP in Q3, sticky inflation, tightness in labour market, and on-going geopolitical tensions will ensure that rates remain higher for longer.

Bank of England (BoE) for the second consecutive time since Dec'21 left its policy rate unchanged 5.25% in its Nov'23. The decision was not unanimous with 6 out of 9 members opting for a pause and the other three voted for a 25bps hike. Retail inflation has remained sticky at 6.7% in Sep'23 and Aug'23. The Central Bank has forecasted sharp reduction in inflation in Oct'23 (below 5%), but believe that it will remain above 2% target till end of CY25 (earlier forecast was Q2CY25). Volatility in oil prices owing to geo-political tensions remained a key concern for the bank. Thus it further signalled that rates will remain higher for some time and discussion on rate cuts is premature.

Following other major central banks, ECB also decided to pause in its Oct'23 meeting, after hiking rates for 10 consecutive times since Jul'22. The central bank reaffirmed that the monetary policy is restricted enough to bring inflation back to targeted levels if rates are kept elevated for long. According the latest forecast, CPI is expected to average 5.6% in CY23, 3.2% in CY24 and 2.1% in the "medium-term".

Bank of Japan continued with its stance to maintain ultra-loose monetary policy and kept the policy rates unchanged. However, the policy statement had a hawkish tilt, as it tweaked the Yield Control Curve (YCC) again and will now accept upper limit for 10Y sovereign bond at 1% "as a reference". This decision was approved with 8-1 majority. The dissenting voter wanted even greater flexibility in the YCC. The central bank confirmed that there will be no limit on bond purchases required to defend this target level of yield. In addition, inflation forecasts were also revised upwards. Core CPI for fiscal year 2023 is now estimated at 2.8% (2.5% earlier), for 2024 at 2.8% and 1.7% for 2025.

Special studies

Revised Kharif projections for 2023-24

India witnessed below normal rainfall in 2023 after a span of over 4-years (of normal and above normal rains) with a deficiency of 6% below LPA. Region wise, rainfall has been deficient across two of the regions including South Peninsula (92% of LPA) and North East region (82% below LPA). Rainfall in North West, Central region stands at 101% and 100% of LPA. Overall Kharif sowing has inched up marginally with much higher acreage in rice. However, pulses and oilseeds sown area logged lower sowing. Given this backdrop, we expect marginal improvement in Kharif output.

Introduction: India's south-West monsoon was tad lower than normal rainfall this year. Actual rainfall received during this period was 820mm against the long period average of 868.6mm. Though in the rain fed agricultural region also called as monsoon core zone, the rainfall received was normal at 101% of LPA. Amongst 36 subdivisions, 3 of them (covering 9% of the region) received excess rainfall, followed by 26 subdivisions (73% of area) which received normal rainfall and 7 subdivisions had registered deficient rainfall. These included, Kerala, Jharkhand, Gangetic West Bengal, Bihar, East UP, and states in North-eastern region (Nagaland, Manipur, Mizoram and Tripura). On a monthly basis, across all the 4-months, August experienced the highest deficiency (64% of LPA) while July (113% of LPA) and September (113% of LPA) registered excess rainfall. Despite fears of El Nino, rainfall activity turned out to be marginally lower than last year.

Kharif sowing in 2022-23: As of 30 Sep 2023, the overall Kharif sowing area improved by 0.2% compared with last year. Rice sown area had advanced by 1.9% followed by higher sowing for coarse cereals (up by 1.8%) and Sugarcane (7.6%). Acreage of pulses declined by (-) 4.2% led by lower sowing of Arhar (-4.9%) and urad (-1.3%) compared with last year. Oilseeds and cotton has logged in lower sowing area, with the exception of soybean and castor which has registered some improvement amongst oilseeds. Jute and Mesta (-5.6%) recorded lower acreage than last year.

Expectation from Kharif harvest: The harvest season for kharif crops has been in full swing. We expect some pickup in overall output with crops such as rice and sugarcane registering improvement. However, some drag will be seen with pulses, cotton and jute.

The projections made in our analysis are on the assumption of there being no damage to crops on account of excess monsoon. The forecasts are based on extrapolations from the past involving area sown and productivity under various scenarios.

What has been the consumption story so far in manufacturing?

The ongoing festival season which also coincides with the harvest time in rural areas will be crucial in determining the future direction of industry. The performance of industry in the first 5 months of the year has been steady with growth in IIP at nearly 6.1% (7.7%). Consumer goods however have grown at just 4%, which is the same as last year. Production is being driven by a series of factors largely on the demand side. The supply side disruptions which started during the lockdown and ended by 2021 are a thing of the past. The shock of Ukraine war was short-lasting and it does look like that the system has adjusted to this disruption quite well.

In this context, we looked at how consumer goods production has fared in the first 5 months of the year.

Durable goods: Production of jewellery of gold has probably the most impressive performance with growth of 27.2% on top of 53.8%. Here it can be seen that demand has been robust for two reasons. Also the pent up demand would have contributed to this upsurge. The return to normal has meant that weddings are taking place in a big way where jewellery is purchased. Second, the progressive use of gold as an investment option has also caught on which happens during inflationary times. Therefore there has been a double benefit here. In fact, gold is considered a safe investment when other asset prices are volatile and this is what is seen here today.

For the bulk of consumer durable goods, growth has been low or negative. What is interesting here is that the high base effect has lowered the growth rate in 2023. Quite significantly in all the industries barring readymade garments, the production levels in 2022 were much higher than the pre-pandemic times which means that there is no longer the case of production levels being boosted due to declines witnessed during the lockdown phases.

The explanation then is that the pent up demand seen in 2022 has gotten diluted considerably here in 2023 which is what is being witnessed. The fall in output of mobiles/telephones does come as a surprise as this means that demand may be getting saturated. But given that PLI is to boost domestic manufacturing that goes beyond assembling parts, one can expect a revival here. Also based on what has been reiterated in the media by companies, high inflation has come in the way of demand. Normally when inflation is high households tend to cut back on discretionary spending which is what is being seen today.

FMCG industries: Here, a more diverse picture has been witnessed so far. Inflation has been high for products like detergents powder, toothpaste, soaps, coffee, instant foods etc. at above 5%. It has been more modest at less than 3% for hair oil, cigarettes, wines, oils, spirits, tea and shampoos. But generalized inflation has eroded real income and hence demand for some of these products.

With the exception of tea, soft drinks, toothpaste and detergent soaps, production of all other goods had returned to normal by 2022. Hence, the base effect of recovering from a fall in production was not witnessed in most products.

Again it can be seen that with the exception of wines where growth of 24% was registered on top of 27% last year, a large part of the growth this year was due to the base effect. Anecdotal evidence shows that the famous 'lipstick effect' worked last year and to some extent this year as reported by companies in these industries where preference has been shown to lower priced products or smaller packets with lower weight. Again the generalized inflation factor has been at work where real income has come down thus leading to lower purchasing power.

The next couple of months will determine whether consumption has actually picked up as producers increase their output. Rural demand will hold the clue here and there can be some pressure from lower output in some crops. Urban demand has been good for premium products so far which will persist through the season for both goods and services. Companies have so far reported on output performance up to September where a cautious picture has been painted.

The World Cup Cricket tournament would have added some spice to overall growth though could be more in the services space than manufacturing. The coming state government elections to be followed by the General Elections would also provide another nudge if not push to spending. Hence, the stage does seem set for a take-off which can set the tone for future growth in FY25 with the usual caveats in place.

How have interest costs responded to repo rate cycles

When we talk about monetary policy cycles, the first thing which pops up in our mind is how these interest rate decisions will impact borrowing costs. When the repo rate is changed it is expected that the lending rate too changes for transmission to be successful. The exercise here was an attempt to capture the same, considering the two recent policy rate cycles of RBI. When the pandemic started in March 2020 there was a dramatic easing in monetary policy, with repo rate hitting record low of 4%. This was also reflected in the Weighted Average Lending rate (WALR), witnessing more than complete pass through in the same period. Subsequently, the repo rate has been increased by 250 bps to 6.5%. Both these cycles involved lending rates coming down first and then going up. While borrowers may view this current cycle as imposing an additional burden, this is because abnormal conditions typified by the pandemic had made the interest rates come down to the lowest level. Hence, the present level of rates may be viewed as a correction. It is nonetheless interesting to see how interest costs of borrowers have moved and whether presently it is higher than the pre-pandemic times.

Our analysis showed that interest cost on outstanding loans as of Feb 2020 (under certain assumptions) got a benefit of Rs 0.61 lakh crore in FY21 and a further Rs 0.53 lakh crore in FY22 relative to FY21. In FY20, based on the WALR the interest outgo was Rs 10.16 lakh crore on a sum of Rs 101.05 lakh cr. However, in FY22, the cost advantage compared with the base year of FY20 was Rs 1.14 lakh crore while it was Rs 61,000 cr in FY21. Therefore a sum total of Rs 1.75 lakh crore was gained by all borrowers under these assumptions.

However, post pandemic period, with inflation hitting the wrong chord and demand gaining resilience, correction in repo was soon visible. With 250bps hike in repo in FY23 interest cost on outstanding credit has risen by Rs 0.33 lakh crore over FY22 as interest costs would have been Rs 9.35 lakh crore as against Rs 9.02 lakh crore in FY22. Extrapolating the same for FY24, on the basis of data available for 5 months till August, the interest cost would be Rs 9.91 lakh crore which is still lower than that before the repo rate was lowered in 2020 (Rs 10.16 lakh cr).

Since pandemic started there has been significant degree of rate action by RBI. During the pandemic, policy rate was reduced to a record low level of 4% to support the growth inflation dynamics, primarily growth requiring more handholding at that juncture. In the pandemic period, i.e. between Mar-20 to Apr-22, the pass through was visible in Weighted average lending rate (WALR) as well. In the pandemic period (Mar-20 to Apr-22), WALR on outstanding loans has fallen by 133bps. Thus, it is important to see how interest cost have fared during the same period, to get an idea about debt burden of borrowers.

In this exercise we have captured the recent two monetary policy cycles of RBI – one during the pandemic and the other post May 2022 when the rate hike cycle began. Taking pre-pandemic as the base year i.e. Feb-20 to be the starting point we attempt to capture how interest cost of borrowers have spaced out in consonance with the movement of policy rate. In this context two primary assumptions have been made:

- Credit outstanding as of Feb-20 is taken to be the base which is Rs 101.05 lakh crore. There is a caveat attached here considering that some loans might have been repaid and fresh loans might be repriced to the corresponding fresh WALR. But for computational convenience and to get a holistic picture, this assumption of fixing the level of outstanding credit deems fit for the purpose of our analysis.

- WALR on outstanding credit has been used to map the outstanding base credit of Feb-20, to arrive at the annual figures of interest cost, which is then adjusted on a monthly basis. It is assumed that the entire o/s amount is repriced every month at the new WALR.

- In this context, interest cost of the borrowers for the base year before the pandemic translated to Rs 10.16 lakh crore based on the WALR on o/s loans. This is arrived at by applying the outstanding WALR of 10.05% prevalent during that month on the outstanding credit of Rs 101.05 lakh crore. With easing of policy rate, interest cost came down to Rs 9.55 lakh crore in FY21. Thus, there was straightaway benefit of Rs 0.61 lakh crore in terms of reduction in interest burden in FY21. Notably, repo rate was reduced by 40bps (115 bps from March 2020) and the outstanding WALR saw a drop of 82bps during the same period (95 bps if March 2020 is also included).

- The same momentum was visible in FY22 as well, in which interest cost came down to Rs 9.02 lakh crore, translating to reduction in borrowing cost of Rs 0.53 lakh crore from FY21 and Rs 1.14 lakh crore compared with FY20. In FY22, repo rate was retained at its lowest level of 4%, whereas outstanding WALR was reduced further by 36bps.

With inflation trajectory reversing and demand gaining ground, the roll back of previous stimulus was visible. This marked the beginning of a tightening phase of monetary policy in consonance with global tighter policy response. From May-22 onwards, repo rate started moving up, with total hike amounting to 250bps as of date.

- In FY23, as a response to the tightening cycle, interest cost rose to Rs 9.35 lakh crore from Rs 9.02 lakh crore in FY21, an increase of Rs 0.33 lakh crore. In the same period, outstanding WALR has increased by 98bps in response to 250bps increase in repo rate.

- In FY24, we have information available till Aug'23, which states that interest cost in the first 5 months of FY24 translates to Rs 4.13 lakh crore. In the same period, outstanding WALR has risen by 10bps.

- For the remaining part of the year we reckon interest cost at existing WALR on outstanding loans will translate to Rs 9.91 lakh crore as interest cost.

How to interpret these numbers?

Assuming that the o/s credit as of Feb 2010 remained unchanged right through the subsequent period, the following follows.

- Interest cost for FY20 was Rs 10.16 lakh crore.

- In FY21 the cost came down to Rs 9.55 lakh crore and declined further to Rs 9.02 lakh crore in FY22. Compared with FY20, the cost was lower by Rs 61,000 crore and Rs 1.14 lakh crore respectively.

- If these two years are combined the savings in interest costs for borrowers amounted to Rs 1.75 lakh crore.

- In FY23 as interest costs rose, total payout was Rs 9.35 lakh crore which though higher than that in FY22 is much lower than the FY20 cost. Therefore, as RBI corrected the repo rate towards normal, borrowers were still not worse off compared to pre-pandemic times.

- In FY24, based on assumption of unchanged WALR, the interest cost will go up to Rs 9.91 lakh crore which is again lower than FY20 by Rs 25,000 cr.

Hence, it can be said that the increase of repo rate by RBI and the reaction of banks in terms of transmission has still not pushed interest cost to the pre-pandemic level. There is still some room for upward movement in WALR which will keep interest costs of borrowers at the pre-pandemic level.

State Borrowings-An Update

State governments recently concluded their borrowing program for Q2FY24 and announced planned borrowing for Q3FY24. As per plan, states were estimated to borrow Rs 2.4 lakh crore in Q2 and they managed to achieve 90% of their target with Rs 2.1 lakh crore of borrowing. In Q3, states have projected to raise another Rs 2.4 lakh crore from the markets. With this, total planned borrowing for states in FYTD24 (Apr-Dec) stands at Rs 6.7 lakh crore, of which Rs 3.8 lakh crore has been raised till 3 Oct 2023. Cost of borrowing for states in FYTD24 remained 17-35bps higher than G-Sec rates, and ranged from 7.31% (Gujarat) to 7.48% (Uttarakhand). Gujarat being one of the better fiscally managed state was able to raise money through short-term papers also at a lower rate. On the other hand, states with higher fiscal imbalances, like Punjab, Rajasthan, W. Bengal, Andhra Pradesh, borrowed through longer-tenured papers to manage cost. Further, states like Tamil Nadu, Telangana, and Andhra Pradesh also exceeded their targeted level of borrowing in FYTD24, while states like Gujarat and Maharashtra borrowed much less than planned.

In comparison, central government raised money in H1FY24 through long-term borrowing at an average yield of 7.2%. Other instrument for borrowing such as WALR show that cost of borrowing from SCBs was at 9.47% (as of Aug'23) and Corporates with AAA rated 10Y bonds could raise money at 7.64% in Q2. In FYTD24, WALR has increased by 15bps for SCBs and by 13bps for PSBs.

Actual versus planned borrowing-FYTD24

In FYTD24 state governments have together raised Rs 3.8 lakh crore from the markets so far (till 3 Oct 2023). Of this amount, Rs 2.1 lakh crore (~56%) was raised in Q2FY24 (Jul-Sep'23) by 23 states. Notably, this is slightly lower than Rs 2.4 lakh crore planned by in the indicative calendar. State-wise analysis for FYTD24 shows that:

- Out of 23 states, 12 states accounted for 90% of the borrowing and these included: Tamil Nadu, Andhra Pradesh, Maharashtra, Rajasthan, Punjab, Telangana, Haryana, Kerala, W. Bengal, Uttar Pradesh, Madhya Pradesh and Bihar.
- Tamil Nadu and Andhra Pradesh raised the maximum amount from the market, and both exceeded their planned target of borrowing in FYTD24.
- Other states which exceeded their target were: Rajasthan, Punjab, Telangana, Kerala, Bihar, J&K, Manipur, Nagaland and Mizoram.
- Most significant increase in actual borrowing compared to planned borrowing was done by Andhra Pradesh (+Rs 8,500 crore), Telangana (+Rs 6,300 crore) and Tamil Nadu (+Rs 5,000 crore).

- There were certain states which raised market loans considerably less than anticipated. These include: Uttar Pradesh, Gujarat, W. Bengal, Maharashtra, Haryana, MP, Himachal Pradesh, Uttarakhand, Goa and Chhattisgarh.
- Amongst these, major miss in target was seen by states like UP (-Rs 21,500), Gujarat (-Rs 15,000 crore each), West Bengal (-Rs 11,000 crore) and Maharashtra (-Rs 6,000). Better than expected revenue receipts could have lowered the need to enter the market for loans.
- States like Arunachal Pradesh, Karnataka, Puducherry and Tripura have not borrowed anything from the markets in FYTD24 so far.

Indicative calendar for state borrowings in Q3FY24 (Oct-Dec) shows that 26 states will collectively raise Rs 2.37 lakh crore, with ~54% of the borrowing expected to be raised by 5 states alone—UP, Karnataka, W. Bengal, Maharashtra and Tamil Nadu. Other major borrowers may include: MP, Rajasthan, Andhra Pradesh, Bihar, Telangana, Haryana and Punjab.

Cost of Borrowing for States

In FYTD24, weighted average yield for states ranged from 7.31% (Gujarat) to 7.48% (Uttarakhand). During the same period, 10Y G-sec yield ranged from 6.96% to 7.31%, thus leading to spread between SDLs and G-Sec to 17-35bps.

Apart from Uttarakhand, other states which had to borrow at notably higher rates were Manipur, Bihar (7.47% each), Punjab, Madhya Pradesh (7.45% each), Goa, Uttar Pradesh and Assam (7.44%).

Amongst the states which were able to borrow at more favourable rates were Maharashtra (7.36%), Himachal Pradesh (7.38%), Mizoram and Tamil Nadu (7.39% each).

The weighted average cost for states also depended upon the tenors under which they borrowed. For the purpose of this analysis, we divided securities under 4 buckets:

1. 4Y-7Y
2. 8Y-10Y
3. 11Y-15Y
4. Above 15Y

We note that majority (~34%) of the borrowing was done in the 8-10Y bucket, followed by more longer-tenured issuances (15Y+: ~33%), and 11-15Y range (~24%). Only few securities were issued in the 4-7Y bucket (~9%).

- States like Haryana (~85%), Punjab (80%), Maharashtra (77%), and Andhra Pradesh (~53%), focused on 8-15Y papers.
- Rajasthan's preference was split equally between 11-15Y and 15Y+ buckets.
- Kerala, J&K, Tamil Nadu and W. Bengal only borrowed through 15Y+ securities.
- On the other hand, borrowing by states like Chhattisgarh, Gujarat and Telangana, was more skewed towards the shorter-end of the curve (4-7Y).

Cost of borrowing through other instruments

Central government securities: In FYTD24 so far (till 6 Oct 2023) union government has borrowed Rs 9.18 lakh crore at an average cost of 7.2%. In Q2FY24 (Jul-Sep), central government raised Rs 4.77 lakh crore at 7.26%. In H1, majority of the borrowing was done in the 10-40Y bucket, followed by 5-10Y bucket. Least amount was raised through auction of 2-5Y papers. In H2 as well, bias will be towards longer-end borrowing with papers of 10Y and above (14Y, 30Y, 40Y and 50Y) accounting for a major chunk of borrowing (~72%). At the beginning of Oct'23, cost of borrowing has seen a rise, with average yield rising to 7.44% in the 6 Oct 2023 auction.

WALR: The weighted average lending rate (WALR) on fresh rupee loans sanctioned by SCBs averaged 9.29% in FYTD24 (Apr-Aug). Within SCBs, a higher rate is charged by private sector banks (10.16% as of Aug'23) in comparison to public sector banks (8.8% as of Aug'23). As compared to Mar'23, WALR for SCBs has risen by 15bps (9.32% in Mar'23), with major change visible in case of PSBs (+13bps from 8.67% in Mar'23). For private sector banks, WALR is up by 8bps (10.08% as of Mar'23).

Corporate bonds: To compare the cost of borrowing by corporates and state/central government, we looked at AAA corporate bond yields. In H1FY24, corporate AAA rated 1Y bonds traded at an average of 7.53% (7.73% as of Mar'23), 3Y at 7.63% (7.80% as of Mar'23), 5Y at 7.60% (7.85% as of Mar'23) and 10Y at 7.61% (7.81% as of Mar'23). At the start of H2 (Oct'23 onwards), yields saw some inching up, with average yield on 1Y paper inching up to 7.69%, 3Y at 7.73%, 5Y at 7.77% and 10Y at 7.70%., but still remain lower than what was seen at the end of previous fiscal year.

Asset turnover ratio, a proxy for capacity utilization

Often when we talk about the non-financial sector, an important indicator to look at is the capacity utilization rate. This indicates the potential for fresh investment as existence of spare capacity is a disincentive to invest more. RBI data sheds light on the same. But we do not get an idea about the same in different industries. In this note, we looked at the turnover to fixed assets ratio - a different way of looking at capacity utilization from the P&L and Balance sheet data of companies. It shows the output that is sold (a proxy for production) based on a level of capital stock. A higher ratio will mean improvement in the capacity utilization rate. This gives us a better sectoral picture and the aggregate industry data is almost in tandem with the direction of capacity utilization rate data published by RBI. Few important facts which emerge include:

- Turnover to Fixed assets ratio of the sample companies showed an improvement post Covid19, driven by pickup in sales post normalization of economic activity. After coming down to 1.42 in FY20 and further to 1.24 in FY21 (due to lockdown), it has come to a level of 1.73 in FY23. However, it is marginally lower than the peak ratio of 1.77 in FY14. This intuitively shows that capacity utilization has improved over time after coming down during the lockdowns.

- However industries such as consumer durables, FMCG, healthcare, media and entertainment and ship building have lower ratios in FY23 compared with FY20 which indicates that their capacity utilization rates are still lower compared with pre-Covid19. There is hence surplus capacity in these sectors.

- The asset-turnover ratio has however surpassed the previous peak in the last 10 years in the following industries: chemicals, construction material, electricals, gas transmission, industrial gases, iron and

steel, logistics, paper, realty and trading. This means that there is clear case of improved capacity utilization as these industries are generating more turnover with the given physical capital.

- There are some industries which are nearing the peak level ratios meaning thereby that there is still potential to produce and sell more given the existing stock of gross fixed assets. These are infrastructure, hospitality, IT, mining, non-ferrous metals, power and textiles.

- The sectors that have still to catch up with their peak ratios in the last decade are the following: telecom, realty, plastics, healthcare, diamonds & jewellery, capital goods, auto and agricultural products.

Background:

When we talk about growth in the manufacturing order books, an important term which often comes up is the underlying capacity utilization (CU) of the sector. CU refers to the ratio of production to installed capacity or in simple terms the ratio of actual output produced in the economy to the potential output, given the resources. RBI comes up with periodical survey results where we get an idea about the overall capacity utilization rate of the economy. But there is a caveat. The same information is not available with respect to different industries.

RBI data on capacity utilization is computed at par National Industrial Classification (NIC) and then aggregation is done taking a weighted average rate of separate CU rates that are calculated with respect to different industries. Though it gives a broader picture about input output mix, whether it's over utilized or underutilized; yet we have no industry specific information at hand. This is crucial because some industries have inherent nature of running at excess capacity while some operate at below capacity contingent on underlying demand conditions, availability of raw materials and other supply side bottlenecks and financing constraints. For example, in general the capacity utilization rates of intermediate goods tend to be higher than others given their nature. Thus arriving at conclusions, sector wise picture is crucial.

We looked at Turnover to fixed asset ratio of different industries over the years, to get an idea on turnover generated on a given set of assets. Intuitively if this ratio of sales to assets comes down, it means that there is still enough capacity to produce more given the state of capital stock which gets reflected in lower capacity utilization. Hence there is likely to be less new investment forthcoming.

We looked at the balance sheet and P &L statement of 1,580 companies as well as a sub-sample of 1,284 non-BFSI companies. For turnover, net sales of companies have been used and for fixed assets we have taken the gross block of companies which incorporates goodwill, land, buildings, furniture, plant and equipment, amongst others. Sales is taken as a proxy for production and has the limitation of ignoring use of stocks, which it may be assumed evens out over time.

The approach was to look at how much turnover is created by the existing stock of capital. As this ratio improves there is indication that there is higher utilization of existing capacity. Conceptually it is different from capacity utilization but gives us broadly a similar picture. In the absence of data on capacity utilization this ratio indicates well the directional progress.

Data shows that turnover to fixed assets ratio has picked up post Covid19 induced slowdown. From 1.24 in FY21, it rose to 1.51 in FY22 and to 1.73 in FY23. In fact, it has surpassed the pre Covid19 level of 1.66 observed in FY19, almost at the level seen in FY14 of 1.77. Hence, at the macro level it does appear that India Inc. has regained the capacity utilization levels at peak time.

In case of non-BFSI companies, broadly, the trend of Turnover to fixed asset ratio corroborates with the direction of capacity utilization rate data of RBI, i.e. whenever RBI's data has shown moderation/inching up of the rate, the turnover to fixed asset ratio has moved in the similar direction.

Industry wise picture relative to covid19:

If we compare the Mar'23 figure with Mar'22, industries such as industrial gas and fuels, infrastructure, crude oil, automobiles and chemicals have shown fair degree of increase in the ratio, ranging from 0.35-0.75%. Within infrastructure, the ratio is considerably higher for engineering – construction sub sectors. Within automobiles, the ratio is high for two and three wheelers and passenger cars. For Chemicals, the ratio is higher for sub sectors such as fertilizers, paints and pesticides and agrochemicals.

The 5 period analysis shows that for industries such as trading, realty, chemicals, construction material, iron and steel, paper, electricals and industrial gas and fuels, the catch up to the turnover to fixed assets ratio has already happened.

Industries which are lagging:

The 5 period analysis shows that for major industries such as consumer durables, media, ship building, healthcare, and FMCG the turnover to fixed assets ratio is lower which shows that some pickup in sales, is needed to catch up to the pre-Covid19 level.

What past 10 Years data convey?

Evaluating past period data, it is clear that some improvement in the ratio has occurred of late but still the current ratio at 1.48 is comparatively lower compared to the level seen in Mar-14 at 1.53. The data is excluding banks and financial companies.

The asset-turnover ratio has however surpassed the previous peak in the last 10 years in the following industries: chemicals, construction material, electricals, gas transmission, industrial gases, iron and steel, logistics, paper, realty and trading. This means that there is clear case of improved capacity utilization as these industries are generating more turnover with the given physical capital.

There are some industries which are nearing the peak level ratios meaning thereby that there is still potential to produce and sell more given the existing gross fixed assets. These are infrastructure, hospitality, IT, mining, non-ferrous metals, power and textiles.

The sectors that have still to catch up with their peak ratios in the last decade are the following: telecom, realty, plastics, healthcare, diamonds & jewelry, capital goods, auto and agricultural products.

Hitman and King's cover drives to boost India's GDP

The World Cup has begun and the cricket fever has gripped the nation. India is hosting the event for the fourth time. The tournament is spread over 45 days with 48 matches between 10 teams. We estimate that at least around 25 lakh people are set to witness the sporting extravaganza at the 10 venues across the country for the 48 matches to be played, while even a larger number is expected to watch the highly anticipated tournament from their homes across the globe. Organizing a tournament of this magnitude is likely to bring in considerable economic benefits for India.

There are a number of facts which need to be considered here. The event is expected to draw people from all over the world, and hence ticket sales will be a huge source of revenues. Apart from this, the aviation and transport industry will also benefit. Hospitality sector comprising hotels, food industry and delivery services will also see a brisk increase in their businesses. There is also the case for sentimental purchases of merchandise. This is particularly important as the World Cup also coincides with the peak festive season in India which suggests that retail demand may see a leg-up. We have tried to ascertain the overall impact of the World Cup with certain caveats in the next section.

Assessing the sector-wise impact

First and foremost, ticket sales will be an important item of spending. Based on the stadium capacity and charges for each ticket, we expect the total ticket sales to the tune of Rs 1,600-2,200 crores. This is based on the assumption of varied attendance for each match with all India games registering 100% attendance.

Apart from this, the total viewership for the tournament (through mediums such as TV, OTT etc.) is expected to be far larger than last time (552mn-Indian viewers for the 2019 World Cup-BARC data).

The sponsorship/TV rights for this grand event can account for another around Rs 10,500-12,000 crores on a conservative basis. These include official broadcast rights for both digital and TV medium, including revenue added though the other marquee sponsors for advertisements during the course of the event. It must be noted here that while the telecast rights and sponsorships usually are for a longer period and no necessarily pertain to a singular event, the total has been included here as we assume that World Cup will be the key trigger for these.

For the tournament, the teams will be traveling across cities along with the umpires and commentators, total expenses for this is likely to be around Rs 150-250 crores. We are assuming that each team contingent is of 25-35 members including players and other support staff (but not families). This includes the expenses pertaining to hotel stay as well.

The event will also attract foreign tourists and they will be spending on hotel, food, travel, including shopping which will add Rs 450-600 crores, assuming there are 1,000 tourists coming for each of the match. However, we do see upside to this number and the number of 1,000 has been taken to be very conservative.

Similarly, domestic tourists (travelling to venues) will be spending Rs 150-250 crores for interstate travel, hotels and food. Moreover, people will also be travelling in the same city to catch a game and spend on fuel cost along with expenses on food. This is estimated to be Rs 300-500 crores.

The expenditure on event management, gig workers (volunteers) and the security expense during the entire duration of the game will add another Rs 750-1,000 crores. The event will further trigger purchases of sports memorabilia and other merchandise items adding Rs 100-200 crores. For screenings of these matches at restaurants, cafes and home viewers ordering food through apps will add a sum of Rs 4,000-5,000 crores during the entire duration of the event.

Based on this, the total expenditure during the World Cup is expected to be in the range of Rs. 18,000-22,000 crores. The grand sporting event is expected to boost the services sector with tourism and hospitality sector benefitting the most out of it. The success of hosting this mammoth event will provide a strong boost to the overall GDP for FY24.

Apart from this, the government is also likely to mop up its tax collections through ticket sales, GST on hotels, restaurants and food delivery etc. GST and tax collections during the entire event across different categories is expected to add to the government coffers which will give the government additional fiscal space.

How about inflation?

Services inflation will be impacted for sure as prices of airlines tickets, hotel accommodation, etc. have gone up for this period. Also, the prices charged by the informal segment in the services sector (which is not tracked in the CPI index) would show a substantial increase. However, this would be restricted to these 10 cities for the period of October and November only. As these trends are also witnessed during these months due to seasonal impact of festival season, the impact of the World Cup could be hard to separate. The upward bias in inflation on this score could be between 0.15-0.25 percent for these two months (without separating the festival spending impact).

In conclusion:

The last Cricket World Cup in 2019 in England was an outstanding success and contributed handsomely to UK's GDP. There is an expectation of a similar story to be repeated, this time for India. It is anticipated to be the one of the most watched sporting events, aggregating audiences from across the globe. The extravagant event through direct and indirect impact will boost the country's GDP and provide a fillip to the consumption sector.

Overall, we believe that the World Cup has the potential to boost India's GDP, more so because it coincides with the festive season. Consumption sector, particularly services consumption is likely to receive the maximum boost. Hospitality and tourism sector are likely to benefit the most.

In terms of impact on GDP, with an estimated additional output of Rs 18,000-22,000 crores attributed to the World Cup, the impact on gross value added is estimated to be around Rs 7,000-8,000 crores. This will be incremental GDP at the primary stage of expense.

Data Releases

Currency outlook: Rupee continues to be better placed on global scale

INR slipped to a fresh record-low of 83.29 to the dollar in the last session, after the FOMC kept rates steady. Even so, INR has remained largely range-bound in the last fortnight supported by active currency management by the RBI. While the commentary from the Fed was mixed, markets largely believe that Fed rates have peaked, with expectations of rate cuts in the second half of CY2024. This will be positive for INR. Apart from this, while FPI outflows have continued, oil prices have eased significantly and further upside looks limited as the war in Middle-East has so far remained contained. Based on this, we expect INR to continue to trade in a narrow range in the next fortnight. We see a range of 83-83.5/$.

Bond Market Round-up

US 10Y yield exhibited quite a bit of volatility. While sharp sell-off was witnessed in Oct'23, it got reversed in the last trading session. Fed policy remained on expected lines with Fed Chair acknowledging a slightly resilient economy and a tighter labour market backdrop. However, money market is pricing in end of the rate hike cycle, which in turn supported yields. Apart from US, 10Y yield in Japan noticed some change post BoJ's twitch in its YCC program by scrapping its reference to daily bond purchasing at a fixed level of 1%.

India's 10Y yield exhibited a slight discomfort from RBI's surprise announcement of OMO sales in its policy document. Apart from this, volatility in crude prices and rise in US yield also retained pressure on domestic yields. Liquidity conditions continued to remain tighter with current deficit at around 0.24% of NDTL. RBI is already conducting OMO sales in the secondary market to some degree. Going forward, this may continue to rule out any additional pressure on yields from a formal calendar announcement. We expect India's 10Y yield to trade in the range of 7.30-7.40% in the current month with risks tilted to the upside. We need to observe how indicators like growth in credit, deposits as well as inflation progress during the month.

Update on corporate results announced so far

With more companies announcing results, the picture for corporate performance of India Inc. in Q2FY24 has become much clearer. We now have a sizeable sample of 692 companies. At the aggregate level, while sales growth has slowed down substantially, profit growth has seen a stellar revival.

However, if we exclude the BFSI sector, net sales growth this year is showing a contraction of 1.8%. Higher interest rates during the year have benefitted banks and financial institutions, resulting in an improvement in their financial performance in Q2FY24, which has been offsetting the drag in other sectors. On the other hand, profitability improves even further if banks and other financial institutions are removed from the picture, due to improved margins.

Fiscal update

Centre's revenue position in H1FY24 (Apr-Sep'23) moderated slightly to 19.5%, compared with 24.1% increase seen till Aug'23. On the positive side, gross tax receipts remained broadly stable with growth at 16.3% in H1 versus 16.5% as of Aug'23. Within this, both direct (25.4% versus 26.6%) and indirect (6.6% versus 7.8%) tax collections slowed a tad. On the spending front, overall expenditure growth slowed further 16.2% from 20.3% as

of Aug'23. This was due to moderation in both revenue spending (10% versus 14.1%) and capex (43.1% versus 48.1%).

CPI inflation

Retail inflation at 5% in Sep'23 was mainly brought down by moderation in the food as well as core categories. Inflation for food and beverages was at 6.3%. While base effects have tempered these numbers, pressures remain in case of cereals, pulses, milk products and spices. The final outcome of kharif harvest will have a bearing on inflation from hereon. Core inflation has come down further to 4.5%, and there is moderation cross all categories with inflation being less than 5%. For the miscellaneous group inflation is elevated for health (5.9%) and personal care at 8.5%. Here the process of passing on higher input costs is still on.

Services like airlines and hospitality have already witnessed increase in inflation which will get reflected in data going ahead. 13 of the 22 states had inflation of above 5%. The highest was 6.5% in Haryana and Rajasthan while the lowest was Delhi with 2.2%. Rural inflation was higher than urban at 5.3% while the latter was 4.7%. The higher weight to food products caused this spike in inflation. Going ahead we expect inflation to be above 5% in the coming months and average 5.5% for the year. This single data point will not really be of importance for the RBI which will be monitoring: El Nino effect in Asia, Kharif crop numbers, evolution of the Israeli crisis among other factors.

The repo rate will be kept unchanged till June 2024 when it can be seriously considered for discussion as RBI forecasts of inflation are above 5% for next three quarters.

Growth in Industrial Production accelerates

IIP growth at 10.3% is overstated due to the base effect (-0.7% last year) and hence should be viewed against this backdrop. All manufacturing sectors witnessed positive growth. Garments and chemicals witnessed negative growth. This can be attributed to lower growth in exports as these two are export dependent. The electronics industry also witnessed negative growth which again can be linked to existing high stocks and lower export demand.

Use based classification shows that durable goods have for the first time registered positive growth though it comes over -4.4% growth last year. Primary, infra and capital goods all recorded double digit growth. Though growth in 2022 was low, the numbers were positive. We need to see if such buoyancy gets reflected in the sales of India Inc in their Q2 results. This high growth in IIP corroborates with the buoyant PMIs and GST collections. The next two months should ideally see sustained growth if rural demand revives – this has been a lacuna so far.

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