

Economic Round-up: July 2023

More macro data now points towards slowdown in global manufacturing activity in Jul'23. While China and USA are seeing soft landing, Eurozone economies are facing the maximum brunt. Latest services sector PMIs are showing relatively more resilience. In the US, tightness in labour market seems to be easing. In addition, elevated prices and rates are impacting retail sales and housing demand, signalling that Fed may opt for a long pause now after delivering a rate hike in Jul'23. A pause from ECB is also expected soon on account of worsening economic conditions and ebbing inflation. China's economic data (trade, consumption, PMIs) is making a strong case for more government (fiscal/monetary) stimulus. On the domestic front, South-West monsoon has picked up pace and surplus rainfall is being recorded (5% above LPA) till 4 Aug 2023. This has resulted in overall improvement in sown area (+0.4% YoY as of 4 Aug). RBI in its Aug'23 policy is expected to keep the policy rates unchanged. Our in-house BoB ECI index is showing that CPI will settle at 5.8% in Jul'23.

Global growth: Growth across regions seems to be losing steam with both manufacturing and services activity wavering. Within manufacturing, Eurozone has been the most hit, followed by US and China. Drop in new orders and export orders has impacted production and employment. Drop in demand from key Asian markets has been the driver. On the other hand price index in PMIs has seeing inching up in the US. Price pressures remain muted in China owing to faltering domestic and external demand. China's GDP expended less than expected and retail sales, FAI growth and trade data are showing signs of stress. In US, labour market tightness is coming off, and consumption and real estate sectors are facing the impact of elevated rates. In Europe, Germany's Ifo business sentiment index and ZEW economic sentiment index signal weakness is expected to continue.

Global Central Banks: In Jul'23, BoE, Fed, and ECB hiked rates by 25bps each, while RBA unexpectedly decided to hold rates unchanged. BoJ kept policy rate steady but surprised the markets by tweaking its tolerance for deviation in 10Y bond yield up to 1%. Many analysts believe that this was done to support the Yen and gradually phase of its YCC curve policy and begin scaling back on its ultra-loose policy measures. In case of Fed, investors now expect a long pause, before rate cuts are announced sometime next year. On the other hand, ECB and BoE are expected to hike rates atleast one more time, before pausing. Across all major regions (except Japan and China), rates are expected to remain elevated in CY23, in order to bring inflation back to targeted levels.

Key macro data releases: India's **trade deficit** narrowed to US\$ 57.6bn in Q1FY24 from US\$ 62.6bn in the same period last year. Overall, we expect India's CAD to be within a range of 1.2% to 1.5% of GDP in FY24.

On the industrial production side, Core sector output expanded to a 5-month high at 8.2% in Jun'23, compared with 5.0% in May'23. Coal output accelerated in Jun'23. Infrastructure linked industries such as steel continued to grow at robust pace. However, cement output registered some moderation. We expect the IIP growth in the range of 5-6% in Jun'23.

CPI inflation rose more than our expectation of 4.6% to 4.8% in Jun'23 from 4.3% in May'23, on the back of 152bps increase in food inflation to 4.5% in Jun'23 from 3.0% in May'23. Core CPI (excl. food and fuel) remained stable at 5.1%. The miscellaneous component however noticed an increase from 4.9% in May'23 to 5.2% in Jun'23. This was driven by transport and communication inflation.

Global developments

Growth momentum continues to get dragged

JP Morgan Global PMI index for Jul'23 shows that global growth is further losing momentum with composite output index declining to 51.7 from 52.7 in Jun'23. Main drag is coming from Eurozone, in particular, Germany, France and Italy. China, US, and UK are also witnessing a slowdown.

In the US, ISM manufacturing index shows that activity continued to decline in Jul'23 (46.4), albeit at a slower pace from Jun'23 (46.0). New orders and production, both fell, but at a moderate pace. Notable trends were seen in employment—which continues to dip sharply, and prices—which are seeing some build-up in pressure. ISM services PMI too showed slowdown in activity as the index was down to 52.7 in Jul'23 from 59.2 in Jun'23. Business activity, new orders, new export orders, employment, all rose at a slower pace in Jul'23. On the other hand, prices inched up (mainly for beef, diesel fuel, electrical components, gasoline, natural gas, labour-construction/skilled). Elevated prices are also impacting household consumption. Retail sales growth softened to 0.2% in Jun'23 from 0.5% in May'23, led by smaller receipts at service stations and building material stores. Auto sales (+0.3%) were supported by higher demand from businesses rather than households. Rise in financing cost (highest in 16 years) is impeding demand. Some easing in the labour market will further strain domestic demand. Non-farm payrolls in Jul'23 rose to 187k (est.: 200k), from downwardly revised 185k in Jun'23 (earlier reported at 209k). Higher financing cost has also led to decline in existing home sales, which fell to 5-month low in Jun'23 by 3.3% to 4.16mn units (est.: 4.2mn).

Eurozone's (EZ) economy is in slightly more worse shape. HCOB manufacturing PMI for EZ dropped to 38-month low of 42.7 in Jul'23 from 43.4 in Jun'23. This is the sharpest deterioration since May'20 and was led by Germany and Austria. In Germany, PMI index fell to 38.8 (worst since May'20) from 40.6 in Jun'23. Weakness was visible in France's manufacturing sector as well (45.1 versus 46). New export orders from key markets in Asia fell as some waited for their stocks to run out before placing new orders. This also impacted employment. Output prices came down following reduction in input costs. In case of the services sector, the slowdown was less evident with index settling at 50.9 in Jul'23 versus 52 in Jun'23. Regional disparities were more prominent in this case. In Germany while activity still remains in expansionary zone (52.3 from 54.1), in France, it contracted further (47.1—lowest since Feb'21; 48.0 in Jun'23). Outlook for the coming months also remains bleak. Germany's ZEW economic sentiment index fell sharply to (-) 14.7 points in Jul'23 (est.: -10.5) from (-) 8.5 in Jun'23. Its Ifo business climate index was also down to 87.3 in Jul'23 (est.: 88) from 88.6 in Jun'23 as higher interest rates globally are expected to dampen demand.

China released its Q2CY23 GDP data, showing that economic activity rose (6.3%) less sharply than anticipated (7.3%), but was still up from Q1 (4.5%). Weakness in the real estate sector (mainly property prices), acted as the main drag on growth. Faltering exports was another reason. Industrial activity and retail sales had begun slowing down from Jun'23, suggesting that Q3 growth will be even weaker. The official manufacturing PMI shows that activity remains in contraction with index at 49.3 in Jul'23 versus 49.2 in Jun'23. Non-manufacturing PMI slowed for the 4th consecutive month in Jul'23 and is down to 51.5. Retail sales eased to 3.1% in Jun'23 following 12.7% surge in May'23. FAI growth also softened to 3.8% in H1CY23 from 4% during Jan-May'23 period. Trade is also showing signs of weakness (exports down by -12.4% versus est.: -9.5% and -7.5% in May'23). Only industrial

production surprised positively (4.4% in Jun'23 from 3.5% in May'23). However, as other major global economies slow, production is unlikely to hold in the coming months and will also see moderation.

Global central bank decisions

In line with market expectations, US Fed hiked rates by 25bps in its Jul'23 policy meeting, thus taking the benchmark rate to 22-year high of 5.25-5.5%. Steadiness in economic activity (GDP growth), "robust" job additions and "elevated" prices, pushed Fed to hike rates. The Central Bank again cautioned over trajectory of prices and job growth, and now expects "moderate" economic growth versus "modest" rate of growth expected earlier. While this view is expected to keep rates elevated for longer than earlier anticipated, CME Fed watch tools indicates that there is till 87% probability that Fed will keep its rates unchanged in Sep'23 after delivering its final rate hike in Jul'23. Fed in its statement has however stated that policy decision will be data dependent.

Bank of England (BoE) also in its Aug'23 policy meeting decided to lift the key policy rate by 25bps to 5.25% from 5% earlier. The decision was not unanimous (6-3 split decision). While 6 members voted for 25bps hike, 2 members were in favour of 50bps hike and 1 member in favour of keeping rates unchanged. Central Bank statement reiterated that it is committed to bringing inflation down to 2% mark, for which either the rates will be left elevated for long or more tightening can be expected. Market participants are expecting policy rate to peak at 5.75% by the end of CY23. Pace of wage growth is more worrying for the central banks rather than profit margins of the companies. Wage growth is expected to slow in the coming months, according to survey results of BoE. Thus inflation is also projected to come down. Surprising resilience of economic activity has also led to BoE upgrading its growth forecast for CY23 to 0.8% (0.6% in May'23). On the other hand, downward revisions were made for CY24 (0.3% versus 0.6%) and CY25 (0.3% from 0.8%).

Much in line with expectations, ECB in its Jul'23 meeting raised its key policy rate by another 25bps to 3.75%. The Central Bank acknowledged that inflation is coming down (5.3% in Jul'23 from 5.5% in Jun'23), but at a slower pace and the bank is committed to bringing inflation down to 2% on a durable basis. While moderation in energy prices is helping the headline print, core CPI still remains a concerns. Increase in wage growth pushed services inflation higher to 5.6% in Jul'23. Elevated prices has already pushed Eurozone economy into recession and latest macro data (PMIs, credit growth) and investors thus expect policy rate to peak at 4% in CY23, implying possibility of one more rate hike in Sep'23 or later. ECB President in the press conference confirmed that there will be no rate cut this year.

Defying market expectation of 25bps hike in Aug'23, Reserve Bank of Australia (RBA) kept its policy rate unchanged at 4.1%. This was done in order to give itself more time to assess the impact of rates on real economy. RBA reiterated that inflation is declining but still remains at elevated levels and that some more tightening might be needed in future to bring it down to targeted levels. Tightness in the labour market is cause of concern for the bank and outlook on household consumptions remains a key uncertainty.

Bank of Japan in its Jul'23 policy decision kept its policy rate unchanged at (-) 0.1%, however surprised the markets by tweaking the Yield Curve Control (YCC) curve. The bank stated that it will continue to allow 10Y bond yield (0% target) to trade between +/- 0.5% but will use these upper/lower bound limits as "references" instead of "rigid limits". BoJ will now not intervene as long as the 10Y bond yield remains "below 1%" mark. Analysts believe that BoJ is gradually preparing to dismantle its YCC policy. This tweak also signals that performance of Yen is also being considered while making the policy decision and that BoJ might have underestimated the inflation risks.

Special studies

Update on corporate results for Q1-FY24

We are getting a better picture on the performance of the corporate sector for the first quarter of FY24. A sample of 940 companies shows that growth in sales has been muted while growth in profits has been upbeat at the aggregate level. However, as we exclude certain sectors the picture on profits changes quite significantly thus indicating that this growth in profits has not been broad-based.

The aggregate sample shows a sharp slowdown in growth in sales partly due to the high base effect with sales growing at a high rate of 43% in 2022. This was because sales were depressed in 2021 at this time due to the second lockdown imposed due to covid. Profit growth has witnessed acceleration this quarter with growth of 51.4% which comes on top of growth of 19.4% last year.

Excluding banks the picture changes decisively for sales growth which is now negative. Growth in net profit however, continued to be robust at 45.5%.

One further iteration can be done at this stage by removing the oil sector which was influenced by sharp variations in the crude price. The performance now looks better for sales but gets moderated significantly for profits

Growth in sales is now positive at 5.5% though that in net profits had moderated sharply to 11.5%.

Study on state fiscal deficits

Fiscal Deficit in FY23—A Recap

In order to analyse the health of state finances in FY23 and FY24, we start by looking at the trends in fiscal balance of states. Out of the 26 states analysed in this study, 12 exceeded their budgetary targets in FY23, while 14 reported consolidation. On an aggregate level, actual fiscal deficit these sample states came in at 2.9% of GSDP, unchanged from last year (FY22) and down from 3.4% projected in budgetary estimates (FY23BE).

In FY23, most significant breach was noted in case of states like Nagaland (+1537bps), Bihar (+808bps) and Mizoram (+423bps). Other states which exceeded their fiscal deficit targets by more than a percentage point, included North Eastern states (Meghalaya, Arunachal Pradesh, Assam, Sikkim), Himachal Pradesh and Punjab. Manipur, Andhra Pradesh and Haryana also exceeded their targets.

On the other hand, states like Uttarakhand (-219bps) and Chhattisgarh (-205bps) achieved fiscal consolidation of more than two percentage points in FY23. Other states which recorded consolidation by over/near a percentage point include: Kerala (-167bps), Jharkhand, Telangana, Odisha, Gujarat, Tamil Nadu, and Karnataka (-99bps). Smaller leaps were made by Rajasthan (-33bps), UP, W. Bengal, Maharashtra and Madhya Pradesh (-72bps).

GDP growth in FY23

Out of a sample of 26 states, nominal GDP growth in FY23 rose only in case of 5 states, while all others witnessed moderation. States like Mizoram, Assam, Bihar, Meghalaya and Manipur noted pick up in GDP growth. Despite

this, apart from Manipur, all other states significantly breached their fiscal deficit-GSDP ratio. Amongst the remaining 21 states, GDP growth in Nagaland, Uttar Pradesh, Arunachal Pradesh, Odisha and Karnataka slowed the most.

State finances in FY24—More realistic fiscal targets

In FY24BE, on an aggregate level, the 26 states analysed have projected their fiscal deficits to increase to 3.2% from 2.9% in FY23 (actual). As global growth slows, domestic economy activity normalises, and effects of pent-up demand wane, states will see moderation in revenue growth (in line with centre's finances). Further, as Elections approaches, some states have accounted for higher spending. Thus, projected fiscal deficit ratio is higher than actual deficits recorded in FY23. However, this is lower than what was projected in FY23BE (3.4%).

Upon making state-wise comparisons, it can be seen that out these 26 states, 15 expect their fiscal deficit to go up, while 11 are targeting consolidation. States expecting over 100bps increase in their deficit include: Arunachal Pradesh, Uttarakhand, Chhattisgarh, Jharkhand, Odisha, Kerala and Gujarat. Others are Karnataka, Madhya Pradesh (M.P), W. Bengal, Maharashtra, UP, Telangana, Tamil Nadu, and Punjab. Amongst these, Chhattisgarh, M.P. and Telangana are set to hold elections in Jan'24.

Out of the 11 states targeting consolidation, most ambitious projections have been made by Nagaland (-1597bps), Bihar (-858bps) and Mizoram (-563bps). Despite this, only Nagaland, Bihar and Haryana have targeted to bring down their fiscal deficits to 3% mark, while the deficit ratio of others (Meghalaya, Mizoram, Assam, Andhra Pradesh, Rajasthan, Sikkim, Himachal Pradesh and Manipur) will still remain above 3%. In the previous year (FY23), apart from Haryana and Andhra Pradesh, all others had significantly breached their budgeted estimates, hence progress of these states will have to be watched closely to assess if they will meet the projections this fiscal year. Rajasthan and Mizoram will be more in focus as they will hold elections during Dec'23-Jan'24 period.

Financing of fiscal deficit

In previous few years we notice that states reliance on market loans to finance fiscal deficit has come down. In the pre-pandemic period (FY19), states financed ~75% of the fiscal deficit through market loans (net). Compared to this, in FY23 ~69% of the deficit was financed through market loans. Reliance was high during the Covid-19 period (FY20-21). Amongst the states, in FY23, Andhra Pradesh, Haryana, Himachal Pradesh, Tamil Nadu and Telangana have excessive reliance on borrowings. On the other hand, Uttar Pradesh, Nagaland, Bihar, and Arunachal Pradesh are least reliant on market loans to finance their fiscal deficit.

IMF more bullish now?

According to the IMF, Global growth is projected to decline from an estimated 3.5% in 2022 to 3.0% in both 2023 and 2024. However the forecast for 2023 is modestly higher than predicted in the April 2023 which was 2.8%.

The Global Economic Outlook released yesterday points to the following:

- The rise in central bank policy rates to fight inflation continues to weigh on economic activity.

- Global headline inflation is expected to fall from 8.7% in 2022 to 6.8% in 2023 and 5.2% in 2024. Underlying core inflation is projected to decline more gradually, and forecasts for inflation in 2024 have been revised upward.
- The recent resolution of the US debt ceiling standoff and strong action by authorities to contain turbulence in US and Swiss banking reduced the immediate risks of financial sector turmoil.
- The balance of risks to global growth however, remains tilted to the downside.
 - Inflation could remain high and even rise if further shocks occur, including those from an intensification of the war in Ukraine and extreme weather-related events, triggering more restrictive monetary policy.
 - Financial sector turbulence could resume as markets adjust to further policy tightening by central banks.
 - China's recovery could slow, in part as a result of unresolved real estate problems, with negative cross-border spill overs.
 - Sovereign debt distress could spread to a wider group of economies.
 - On the upside, inflation could fall faster than expected, reducing the need for tight monetary policy, and domestic demand could again prove more resilient.

The Forecasts have been revised upwards from April for the world economy and all major economies, except Germany, which is expected to witness further decline in growth. In fact it is the only country to witness negative growth in 2023 within this set.

India's GDP growth has been pushed up by 20 bps, while the highest is 120 bps for Brazil followed by 100 bps for Spain. In case of Mexico and Russia it is 80 bps while it is 70 bps for UK. For Italy it is 40 bps. USA shares the same upward revision as India at 20 bps. Therefore there are sharp upgrades for several economies.

Some macro pointers

In most economies, the priority remains achieving sustained disinflation while ensuring financial stability. Therefore, central banks should remain focused on restoring price stability and strengthen financial supervision and risk monitoring. The IMF asserts that should market strains materialize, countries should provide liquidity promptly while mitigating the possibility of moral hazard. They should also build fiscal buffers, with the composition of fiscal adjustment ensuring targeted support for the most vulnerable. Improvements to the supply side of the economy would facilitate fiscal consolidation and a smoother decline of inflation toward target levels.

The Federal Reserve paused rate hikes at its June meeting but signalled further ones ahead, and the Reserve Bank of Australia, Bank of Canada, Bank of England, and European Central Bank have continued to raise rates. At the same time, in some other economies, particularly in East Asia, where mobility curbs during the pandemic restricted demand for services longer than elsewhere, core inflation has remained low. In China, where inflation is well below target, the central bank recently cut policy interest rates. The Bank of Japan has kept interest rates near zero under the quantitative and qualitative monetary easing with yield curve control policy.

Manufacturing activity and consumption of services in China rebounded at the beginning of the year when Chinese authorities abandoned their strict lockdown policies; net exports contributed strongly to sequential growth in February and March as supply chains normalized and firms swiftly put backlogs of orders into production. Nonetheless, continued weakness in the real estate sector is weighing on investment, foreign demand remains

weak, and rising and elevated youth unemployment (at 20.8% in May 2023) indicates labour market weakness. High-frequency data through June confirm a softening in momentum into the second quarter of 2023.

World trade

World trade growth is expected to decline from 5.2% in 2022 to 2.0% in 2023, before rising to 3.7% in 2024, well below the 2000–19 average of 4.9%. The decline in 2023 reflects not only the path of global demand, but also shifts in its composition toward domestic services, lagged effects of US dollar appreciation—which slows trade owing to the widespread invoicing of products in US dollars—and rising trade barriers. This means that Indian exports would face headwinds if demand is to remain low.

Main priorities according to the IMF

- Conquer inflation. Central banks in economies with elevated and persistent core inflation should continue to clearly signal their commitment to reducing inflation. A restrictive stance—with real rates above neutral—is needed until there are clear signs that underlying inflation is cooling.
- Maintain financial stability and prepare for stress. The fast pace of monetary policy tightening continues to put the financial sector under pressure. Strengthened supervision and monitoring risks to anticipate further episodes of banking sector stress is warranted. The intensity of supervision must be commensurate with banks' risks and systemic importance, and it is essential to address oversight gaps in the non-bank financial sector.
- Rebuild fiscal buffers while protecting the vulnerable. With fiscal deficits and government debt above pre-pandemic levels, credible medium-term fiscal consolidation is in many cases needed to restore budgetary room for manoeuvre and ensure debt sustainability.

Corporate debt structure in India

During the peak of Covid-19 pandemic, a phenomenon which gained prominence amongst Indian corporates was deleveraging-or a decline in overall debt. Despite lower interest rates, disruptions related to output and demand affected not only production but also investment decisions by companies which led to a decline in overall debt. Companies either repaid their costly debt or used their own funds to finance investment. In this study, an attempt has been made to understand the movement in overall debt of India Inc. over the last five years i.e. FY18 to FY22 and analysis the trends thereof.

For this exercise, a sample of 6,742 companies (ex. banks) has been considered, which are spread across 34 broad sectors and is based on the audited annual reports of these companies. Following observations can be made:

- From Rs. 62 lakh crores in FY18, total debt of India Inc. increased to Rs. 75.7 lakh crores in FY20. The pace of increase has slowed down since. In fact, in terms of YoY growth, after increasing at an average pace of 10.6% between FY18 to FY20, the pace of growth has come off to just 2.9% in FY21 and FY22.
- In terms of incremental debt as well, while debt increased at an average pace of Rs. 6.6 lakh crores per year between FY18 to FY20, it increased by only Rs 4.4 lakh crores in the next two years.
- Overall, in the last 5 years, debt has grown at a CAGR of 7.4%. The onset of South West monsoon was delayed this year by more than a week against expectation (1st Jun). While there is an expectation of normal rainfall, there is an upside risk of El Nino conditions forming which poses significant risk. However, severity of El Nino has to be taken in to account based on past years data. The result of normal and spatially distributed rainfall would be evident on sowing of Kharif crops as well on their prices in the coming months.

It is to be noted that the finance sector is the dominant one and accounts for nearly 50% of total debt in FY22. Hence, we analyze the trend in overall debt after removing the finance sector. The sample size reduces to 6,223 companies. After rising by 10.1% in FY19, the growth in debt has slowed down successively in the subsequent years. In fact, debt actually declined by 1.8% in FY21, and registered a marginal increase of 1% in FY22. In terms of absolute levels, debt has remained stagnant at ~Rs 43-44 lakh crores in the last 3 years. Interestingly, this also coincides with the period of a slowdown in fixed asset creation by these companies.

Sector wise growth in debt

Next, we analyze the trend in sector wise growth in debt. Some interesting observations that could be made were:

- In terms of share, the highest concentration of debt is in the finance sector at 45.4% in FY22. This comprises non-banking finance corporations (NBFCs), housing finance corporations (HFCs) and term-lending institutions. Notably, NBFCs and HFCs together account for over 60% of debt in this sector. This is because many of the NBFCs and HFCs are not allowed to accept deposits from the public and hence rely on borrowings to lend. Interestingly, while the debt of the overall sample rose by a CAGR of 7.4% during this period, debt in this sector increased at a higher rate of 12.5% in the last 5 years.
- The next three sectors, i.e. power, telecom and crude oil accounted for 27.8% of the total debt in FY22. High capital expenditure requirement in these sectors is the primary reason for higher debt in these sectors.
- In the power sector, debt increased by 5% between FY18-FY22, which was lower than the overall growth in debt.
- Telecom sector accounted for 7% of total debt in FY22. Notably, the total debt in the sector has increased at a sharp pace of 12% on a 5 Year CAGR basis, much higher than overall industry growth. Expenditure related to 5G spectrum auctions is the primary driver for increased debt levels in this sector in recent times. Importantly, two major companies accounted for over 50% of the total debt in this sector.

- In case of crude oil, debt increased at a CAGR of 9% to Rs 4.7 lakh crores in FY22. Higher working capital needs and a squeeze in profit margins due to elevated oil prices, was one of the factors behind this.
- In the infrastructure sector, debt increased at a subdued pace of just 4.8% on a CAGR basis. Lockdown restrictions in FY21 and FY22, amongst other factors impacted this sector.
- Debt in the iron and steel declined 3.4% in the last 5 years. This sector had been deleveraging at an accelerated pace during the pandemic, as higher prices improved profitability. In fact, debt in the sector reduced by 11.8% in FY21 and further by 12.3% in FY22. However, the situation is expected to have reversed in FY23 with government's capex push and increased demand from real estate sector necessitating the need for additional capacity.
- Growth in debt for real estate was at a much slower pace of 1.5% amidst a fall in demand.
- For the auto sector, debt increased at a pace of 5.2% on a CAGR basis in the last 5 years. It must be noted that this sector faced multiple challenges in the form of lower demand during the Covid-19 pandemic, semiconductor issues etc. which impacted profitability.
- Apart from these major sectors, several others noted debt growth lower than the industry growth. These include: chemicals, textiles, logistics etc. On the other hand, for sectors such as retailing, trading and consumer durables the increase in debt was at a faster rate than the industry level in the last 5 years.

Company wise concentration of debt:

An important point to note is that the overall debt of India Inc. is heavily concentrated within a few big conglomerates. Some interesting observations which can be made after looking at company wise profile of debt are:

- Top 100 borrowers accounted for 67.8% of total debt in FY22.
- The top 50 borrowers accounted for over 50% of the total debt in FY22.
- In fact, in FY22, the top 10 companies accounted for 32.2% of the total debt.
- For 67, out of the 100 companies, CAGR of growth in debt in the last 5 years was higher than the growth in overall debt i.e. 7.4%.

House wise concentration of debt:

In terms of ownership wise distribution of debt, major concentration of debt is seen for owner-led companies. These accounted for 51% of the total debt in FY22. The top 5 owner-led groups accounted for more than 16% of the overall debt in FY22. This increases to ~25% if another 5 owner groups are added to the list. It is also interesting to note that the CAGR growth in debt for these companies was at ~10%, which is higher than the industry average of 7.4%.

PSUs have the second largest concentration of debt in FY22 at about Rs. 26.6 lakh crores or 33% of total. In terms of CAGR growth, debt has risen at a pace of 10.9% which is higher than the growth in overall debt. MNCs accounted for a miniscule 2.2% of total debt in FY22, with a CAGR of 5.6%.

The rest of the debt is concentrated in private companies (companies which do not fall in any of the above categories). Their share stood at 13.5% of the total debt in FY22. However for these, the growth in debt was somber at just 4.4% for the period under consideration.

Debt-equity ratio:

Debt is an integral part of any business and hence should not necessarily be viewed as an aberration. Business needs require funding and hence debt is an acceptable as well as indispensable part of any business entity. Governments as well as companies rely on borrowings to fund their operations. However, the issue begets importance if the debt becomes unsustainable. There are a number of measure to assess this, however in this analysis we are limiting ourselves to the most commonly used metric which is the debt to equity ratio.

The debt-equity ratio is defined as total debt to net worth. It is imperative for this ratio to be less than 1. The table below gives the debt-equity ratio of various sectors over the last 5 years. For the purpose of this exercise, finance sector has not been included as these tend to have a higher debt-equity ratio due to the inherent nature of their business.

India's crude import-Growing phase

India is amongst top 5 importers of crude oil across the globe. Over 85% of India's demand for oil is met through imports on the back of the demand surge. India's import of crude oil has grown to 237mn tonne with Russia becoming one of biggest suppliers of the same in FY23. Share of Russia had grown to more than 20% in FY23 and as of FYTD'24 (Apr-May'23), it commands a share of around 39%. The Russia-Ukraine conflict resulted in easier availability of oil from Russia at a discounted price when compared with other countries or even international crude price. This note takes a look at the volume and price of crude oil in the span of 2-years.

Import of Crude in the last 2-years

India relies on other countries to meet up its ever growing demand of crude and related products. The dependency on oil imports for domestic consumption as a result has been an uphill. On a volume basis, back in FY22, India's imported a total of 220mn tonnes of crude oil from the globe, with Russia having a meagre share of 2% for the year. On the other hand, India has imported a total of 237mn tonnes in FY23 and Russia's share has grown remarkably by over ten times to double digit level of 21.5%.

In terms of cost, the price paid for 1 barrel of crude oil in US\$ was different from different countries in FY23. Russia was charging US\$ 84/bbl, while Nigeria was charging US\$ 108/bbl. The average international crude price for this period was at US\$ 95.1/bbl. With the beginning of the Russia-Ukraine conflict, the geo-political climate changed across the globe. It also brought to the fore the changing dynamics of the supply and demand pertaining to crude oil with certain countries imposing sanctions. Given this backdrop, Russia has turned out to be one of the largest supplier of oil to India by supplying oil at a much discounted price and even boosting profits for Indian firms.

How are things faring now in FY24?

In FYTD'24 (Apr-May'23), India has imported total of 44mn tonnes of crude oil from across the globe. Of this, Russia has a share of 38.6% in the total pie. On price front (Fig2), for FYTD'24 average price of crude per barrel

charged by Russia was at US\$ 69.2 compared with US\$ 97.1 charged by Kuwait. The average crude oil price for FYTD'24 stands at around US\$ 79.5/bbl. Russia continues to be a much cheaper alternative to meet India's growing demand.

Recently, when compared with Mar'23 India's imports has edged up by 0.1mn tonne to 7.9mn tonne in Apr'23 and in May'23 it has accelerated further to 8.9mn tonne. Price wise, India had to pay US\$ 68.2/bbl in Apr'23 (70.2/bbl in Mar'23) and US\$ 70.2/bbl in May'23 when it bought crude from Russia. International price of crude for Apr'23 was US\$ 83.4/bbl against US\$ 75.7/bbl for May'23. In all, the ever growing demand of crude oil has been covered through discounted price from Russia

The liquidity situation in banks can be assessed using incremental credit and deposits for the first two months ending June 2nd. It can be seen that the increase in deposits this year has been of the order of Rs 6.59 lakh crore against Rs 2.68 lakh crore last year. Hence even though incremental credit has been higher at Rs 3.33 lakh crore as against Rs 2.52 lakh crore in 2022 the net surplus has increased even after adjusting for higher incremental investments. Against a deficit of Rs 1 lakh crore last year, it was in surplus of Rs 1.33 lakh crore.

The higher growth in deposits can be attributed to two factors. The dominant factor was the exchange of the Rs 2000 note as the last fortnight witnessed an increase of Rs 3.26 lakh crore (the exact amount cannot be known as deposits have also been rising smartly before this announcement). The second is the higher interest rates being offered by banks. Households are aware that the present rate cycle is over and that there would be no further rate hikes by the RBI. This being the case there has been urgency shown to lock into higher interest rates at this point of time.

Does a term premium exist?

The 10-year bond yield is taken to be the market benchmark for movement in interest rates and hence all policy decisions taken by the central bank have an immediate impact here. While banks may fine tune their deposit and lending rates based on different considerations, the bond yields are considered to be the first touch point of the impact. Within the array of bonds, the 10Y bond has been seen to be the most sensitive instrument and this holds in almost all countries. Hence any global comparison is made with this bond. The last few years have been complex for the bond market because central banks took interest rates right down during Covid-19 and then started increasing the same when inflation rose. Central banks have different inflation targets when it is overtly stated and in the western countries a number of 2% is widely pursued. For India it is 4%.

A question often posed which is analysed is the 10-year bond yield when juxtaposed to the central bank rate which in our case is the repo rate. What should be the ideal term premium of a 10-year bond over the repo rate? Repo rate is the overnight rate and a 10-year bond should ideally quote above this rate. This is the theoretical view point which does not hold when one looks at the difference between the two (premium/discount) today. In the selected list of 22 countries, 7 have a term premium while it is a discount for the other 15 nations. In India, the difference is around 57 bps and is the highest in South Africa followed by Turkey where it is above 150 bps. Japan has a premium of 57 bps followed by Indonesia with 45bps. The largest discount is in case of Brazil where it is above 300 bps. Therefore, drawing global parallels is difficult to ascertain the range of this term premium for any country.

Brazil and Mexico had rates above 200 bps as the central bank rates are in double digits. For Canada, the central bank rate is 5% and the 10-year is at a discount of 158 bps. It is the same with USA. There are clearly no patterns here in terms of linkage with the central banks rate. The answer is to hence look at the Indian market independently.

Looking at the movement of the term premium of the 10-year bond in the Indian context for the last 20 years or so, the difference between the average 10-year yields during a particular regime of repo rate has been plotted here. Hence, if the repo rate remained unchanged during the pandemic period the average yields for all the months would be juxtaposed with the repo rate of 4% to calculate the difference. The pattern is interesting because it does not show a definite direction. There are some thoughts that come up through the jagged pattern as the inverted V shaped phases are distinct with the amplitudes being smaller with time. A convergence of the two did take place in Feb'15 which was an aberration. After peaking in May'22 when the RBI started increasing the repo rate, the premium has come down due to both the repo rate being increased and the bond yield diminishing. A term premium of around 50bps looks likely in this scenario. But is this what the trend shows?

The average term premium for the two decades period was high at 94bps, with a standard deviation of 0.86, which indicates high volatility. At this premium the 10-year yield should be around 7.45-50%. Again there is no clear picture here with the average varying from 18bps in the period up to 2008 to as high as 153bps in the last 5 years. Therefore, here too there is indication of high volatility. Several other factors are at work here which include state of liquidity, RBI operations in the market, market expectations of what the Fed could be doing (more important in recent times although it started post QE being adopted as a policy in the west), inflation and its expectations, government borrowing programme among others.

It has also been observed that when the repo rate crosses 7%, the term premium comes down sharply and even goes into the negative zone when the former was above 8%. Conversely, as the repo rate comes down the term premium also tends to increase quite sharply and also crossed 200 bps when it was less than 5%.

At a parallel level, an attempt was made to regress the term premium/discount with the repo rate for the period covering these 58 time periods. The results show that the coefficient of determination is quite high at 0.59 though the standard error of the equation is fairly high at 0.56. The coefficient as well as the intercept terms are significant. Interestingly the forecast for the repo rate at 6.5% comes to a difference of 100 bps which would mean a 10-year yield at 7.50%. A lower repo at 6.25% would indicate a 10-year yield of 7.39%.

A factor that can affect the 10-year yield is inflation and this has also been considered in an alternative regression model which however starts from 2012 onwards when the new CPI was introduced. Here the adjusted R-square was higher at 74%, though the coefficient for inflation was not significant at the 5% level. But interestingly the forecast for the 10-year bond indicates a similar picture assuming inflation at 5%. With repo rate at 6.5%, the 10-year yield is 7.47%, 7.35% when repo is 6.25% and 7.24% with repo at 6%.

There has been no definite trend or pattern in the term premium on a 10-year bond. On an average basis the premium is close to 100bps which is also enforced by a regression analysis. However, the noise factor or standard deviation is quite high given the wide variations in the premium. With these limitations on the statistical sides, the premium does work out to approximately 100 bps at a repo rate of 6.5%.

Mutual funds do better than bank deposits in Q1

This financial year started off quite significantly for the banking system in terms of business. To begin with, the government had removed the long term capital gains tax benefits for debt mutual funds, which gave a sense that savers would migrate to bank deposits. The proxy demonetization of the Rs 2000 note gave a fillip to banks as people deposited most of the notes in their accounts. This was a collateral benefit for banks as around Rs 2.36 lakh crore that came in by June 30 on this count. On the other side, stock markets did very well with the Sensex scaling new heights which was supported a lot by FPI money coming in. In this situation it was interesting to gauge how the banks performed vis-a-vis mutual funds during the three month period of Apr-Jun'23.

Some observations:

1. Growth in AUM of mutual funds was higher at 12.6% compared with 6.2% for banks when compared over Mar'23.
2. Accordingly the ratio of AUM-MF to deposits improved from 21.8% to 23.2%. On an incremental basis (June over March), this ratio was as high as 45%.
3. Contrary to expectations, income schemes did well with 14% growth that is comparable to that of equity. Hybrid and the 'others' category also grew at a faster pace than bank deposits.
4. Time deposits of banks have grown at a lower rate of 5.3% indicating that the Rs 2000 notes deposited could have gone into the non-term deposits accounts.
5. The good performance of the stock market has been one driver of the increased interest in mutual funds. This may account for the slight increase in share of equity funds in AUM, which significantly was not at the cost of income funds (debt).

It does appear that bank deposits would continue to face competition from this segment in the months to come. It would be pertinent to note that since Mar'23, the WADTDR on fresh loans came down from 6.48% to 6.32% between March and May. This was down for both public and private banks while there was an increase for foreign banks from 5.60% to 5.66%.

Data Releases

Currency outlook

Global growth and inflation continue to show diverging trends. While growth in major advanced economies has been under pressure, US economy continues to remain on a strong footing. This has made guessing the future course of policy action highly uncertain. While the dollar remained under pressure for most part of the month, robust macro data i.e. Q2CY23 GDP and jobless claims has once again raised the possibility of more rate hikes. In response, DXY has rallied which is weighing on INR. We expect INR to trade in the range of 82/\$-83/\$ in the next fortnight. Support is likely to come from FPI inflows and RBI intervention, while rising oil prices pose a significant risk to the trajectory.

Bond Market Round-up

Growth remained comparatively on better footing for US, Eurozone and India; thus risk on sentiments led firming up of yields of these economies. Global central banks remained cautiously dovish. Softening inflation data, moderation in employment cost index and well anchored inflation expectations in the US, might reflect that policy rate has peaked in the US. A prolonged data dependent pause might be incumbent for major economies including India. However, on domestic front, food induced inflation is worrisome, with supply shocks getting aggravated on account of skewed monsoon and disruption in production. Thus some upside risk to India's 10Y yield cannot be ruled out. We expect it to settle in the range of 7.15-7.25% in the current month. Only comfort would come from favourable liquidity conditions and government's measures to assuage supply side concerns.

BoB ECI: How prices look in Jul'23

BoB Essential Commodity Index (BoB ECI) has picked up sharply by 4.9% (MoM) and 6.5% (YoY) in Jul'23. For the 4 days of Aug, it rose by 7.5% (YoY). This is attributable to sharp upswing in tomato prices followed by onion, tur, salt, milk and rice. Thus food inflation is quite broad based as of now. Tomato with a weight of 0.6% in CPI (10% of vegetable index) has shot up by 175.9% (YoY). This directly adds 17bps to the CPI data for Jul'23. Further, favourable base has also faded in Jul'23 (30bps: unfavourable base).

Another incipient shock may be the onion price shock which itself showed a 4.5% YoY increase in Jul'23 from 4.4% decline in Jun'23. Also production of this vegetable has been lower as per 1st AE of 2022-23 and the Dec-Jun crop have been impacted due to weather vagaries, which is reflected in prices. The Oct-Dec harvest would help in cooling off inflation, but before its arrival the Q2 inflation data might face some upside risk. The only respite is short lived cycles of vegetable inflation. Thus against this backdrop, CPI in Jul'2 is expected to settle ~5.8%, with risks tilted to the upside.

Monsoon and Sowing: Update

All India cumulative seasonal rainfall is 5% above LPA as of 4 Aug2023. The distribution of rainfall has pushed kharif sowing higher compared with last year. Sown area of rice, sugarcane and oilseeds have registered an improvement. Pulses sowing continue to lag, though there still has been some improvement since last week. In hindsight, as major part of pulses sowing has already been completed, we do not expect sowing levels to be higher than last year. On distribution of rainfall, region wise, Southern Peninsula and Eastern region have recorded lower rainfall and are in the deficient zone during this period. North West and Central region continue to register surplus rainfall.

Trade in Q1FY24

India's merchandise trade deficit narrowed to US\$ 57.6bn in Q1FY24 from US\$ 62.6bn in the same period last year. While imports declined by US\$ 23.3bn, exports were lower by US\$ 18.3bn. Lower commodity prices contributed to the decline in trade deficit. With global commodity prices now normalizing, imports may see further reduction in value terms. Even domestic demand may see some correction which will also keep import bill muted. Exports, both services and merchandise have been impacted due to weakness in global economic activity, which is likely to continue. Overall we expect CAD to moderate in FY24. This along with a recovery in FDI and FPI inflows will support the rupee.

Services exports have also shown signs of slowing down. In fact, services exports moderated to just 5.2% in Q1FY24, after increasing by 35.4% in Q1FY23. However, as services imports decelerated even more, the net services balance remains higher at US\$ 35bn, compared with US\$ 31.1bn in the same period last year. Overall, we expect India's CAD to be within a range of 1.2% to 1.5% of GDP in FY24. This combined with a recovery in foreign inflows (FPI and FDI), should keep India comfortably placed in terms of external stability. Hence, we expect INR to remain stable and trade in the range of 81-83/\$ this year.

Core industries

Growth in India's core sector output (which carry a weightage of 40% IIP) expanded to a 5-month high at 8.2% in Jun'23, compared with 5.0% in May'23. Out of a total of 8 industries, 5 posted positive growth. Coal output accelerated to 9.8% in Jun'23 (against a growth of 7.2% in May'23). Infrastructure linked industries such as steel continued to grow at robust pace, registering a growth of 21.9% in Jun'23, against a growth of 10.9% in May'23. On the other hand, cement output registered some moderation at 9.4% in Jun'23 (15.3% in May'23). Electricity production improved to 3.3% in Jun'23. Electricity output is expected to pick up further in the near term. Growth in crude oil, natural gas and refinery improved to 9.8% (7.2% in May), 3.6% (-0.3% in May), 4.6% (2.8% in May'23) respectively in Jun'23. Fertilizer output slowed down to 3.4% in Jun'23, against a growth of 9.7% in May'23. Against the above backdrop, we expect the IIP growth in the range of 5.5-6.5% in Jun'23. During Apr-Jun'24, output of core sector expanded by 5.8% compared with 13.9% in the previous year.

CPI inflation

CPI inflation rose more than our expectation of 4.6% to 4.8% in Jun'23 from 4.3% in May'23, on YoY basis. Notably, this number comes at a base of 7%, which is quite a favourable one. The entire jump in CPI was driven by a 152bps increase in food inflation to 4.5% in Jun'23 from 3.0% in May'23. For Q1FY24, CPI increased by

4.6%, in line with RBI's projection. Food inflation was the primary driver especially vegetables and pulses. Heatwave conditions and erratic rains have resulted in sudden spike in few components of vegetable inflation. The high frequency data of prices in Jul'23 show that on retail front, prices of cereals, masoor dal, edible oil and vegetables are posing upside risk. On wholesale front as well, edible oil and vegetables are witnessing fair degree of increase, hence pronounced pass through to these prices in the coming days cannot be ruled out in entirety.

Core CPI (excl. food and fuel) remained stable at 5.1%. The miscellaneous component however noticed an increase from 4.9% in May'23 to 5.2% in Jun'23. This was driven by transport and communication inflation (2.5% in Jun'23 from 1.1% in May'23, YoY). But this is purely a base phenomenon. Even education inflation went up and this component actually showed a momentum on a sequential basis. Other demand driven components of core such as household goods and services showed moderation both on YoY and sequential basis, thus enumerating the fact that past transmission of repo rate hike are translating into real demand.

Overall we expect headline CPI to be in the range of 5-5.5% in FY24. However, before taking a call on rates it would be prudent to watch whether current increase in inflation is a one-off event or not. We expect RBI to remain on hold for now, in CY23.

WPI inflation

Headline WPI fell more than expected in Jun'23. It was down by (-) 4.1% versus our estimate of (-) 2.7% and (-) 3.5 % in May'23, to reach its lowest point since Nov'15. Food inflation eased, albeit at a slower pace in Jun'23 (-1.2%) compared with last month (-1.6%), and continues to remain in deflation for the second consecutive month now. Within food, deflation accelerated in the category of vegetables (-22% in Jun'23 versus -20.1% in May'23) and fruit price index also fell (-0.9% versus 1.9%).

Fuel and power inflation slipped further into deflationary territory as it came in at (-) 12.6% in Jun'23, down from (-) 9.2% in May'23, supported by favourable base (50.9% in Jun'22 versus 49% in May'23). In Jun'23 as well, deflation in mineral oil index continued for the third consecutive month (-19.5% versus -16.2% in May'23). Under the other major head of fuel and power, inflation index for electricity (0.6 % versus 9.7%) also cooled down, while that for coal recorded notable increase (5.0% versus 2.5%).

Core inflation remained in deflation for the 4th consecutive month in Jun'23 as it fell to (-) 2% from (-) 2.2% in May'23, thus recording a slower pace of contraction, indicating build up in pressure. Manufactured products inflation also declined at a slower pace to (-) 2.7% from (-) 3% in May'23. Of the 22 commodity sub-indices, 14 indices rose at a slower pace in Jun'23, led by chemicals, electrical equipment, other non-metallic minerals, and textiles. Inflation index for basic metals registered slowdown in its pace of deceleration (-5.5% versus -9.2%).

IIP growth

IIP growth expanded to a 3-month high of 5.2% in May'23, above our expectations (4.5%) and compared with a growth of 4.2% in Apr'23, led by broad based improvement across all sectors. Growth in manufacturing and mining sector expanded to 5.7% and 6.4% against a growth of 5.2% and 5.1% respectively in Apr'23. Output of electricity was back in green in May'23 at 0.9% after contracting by (-) 1.1% in Apr'23. Amongst manufacturing sectors, at least 14 out of 23 sub industries registered higher growth in May'23. Manufacture of motor vehicles (13.4% versus 3.6%) registered the highest improvement, followed by leather products (1.8% versus -6.5%),

rubber products (6.3% versus 1.8%) and non-metallic minerals (10.2% versus 6.1%). Slower pace of contraction was registered in manufacture of furniture (-20.5% versus -29.4%), wearing apparel (-20.9% versus -29.1%) and computer, electronic product (-5.7% versus -11.1%). On a MoM basis, IIP growth has improved by 3.2% in May'23 whereas seasonally adjusted series have increased by only 1.7%.

Within use-based, barring FMCG and infra goods output, other sectors registered much higher growth in May'23. Growth in capital goods output nearly doubled in May'23 at 8.2% against 4.6% in Apr'23. Consumer durable output moved back to the positive territory as it expanded by 1.1% in May'23 against a contraction of (-) 2.5% in previous month. Intermediate goods output edged upwards to 1.6% (0.4% in Apr'23). Moderation in output of infra and FMCG goods was noticed with growth decelerating to 7.6% (10.8% in Apr'23) and 14% (15% in Apr'23) respectively in May'23.

Going ahead, domestic demand continues to showcase a mixed picture with strong GST collections, manufacturing PMI and steady credit growth. However, slow pickup of South-West Monsoon with some states still in the deficient territory, requires careful monitoring. Rural demand also hinges on how well and spatially distributed rainfall is received across the country. Concerns over global economic slowdown will add to the ongoing woes around weak export demand.

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For further details about this publication, please contact:

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