

## Economic Round-up: January 2024

IMF has raised its global growth forecasts for CY24 to 3.1% from 2.9% predicted in Oct'23. This is due to significant upward revisions to estimates for US and China. US economic strength is signalling a soft landing, as labour market still remains strong (non-farm payrolls, ADP employment) and GDP in Q4 slowed less sharply than expected. Improvement in consumer sentiment indices (conference board and University of Michigan), pick up in ISM manufacturing index, and softening inflation expectations also support this view. In case of China, as GDP growth in CY23 (5.2%), surpassed government's target (~5%) and more stimulus measures are announced, the slowdown in CY24 is estimated to be less than what was earlier predicted. On the other hand, forecasts for Eurozone remain bleak, as tensions in Middle East, impact of supply chain disruptions due to tensions in Red Sea, continue to impact growth. German economy contracted in CY23 and is expected to decline further in Q1CY24. Taking note of easing inflation and pressure on growth, ECB is expected to begin cutting rates from Apr'24. US Fed and BoE will follow.

**Global growth:** US economy has entered CY24 on a stronger footing, while Eurozone and China are facing challenges. Weak export demand is hampering growth in both regions. In case of Europe, while tensions in Middle East pose a significant threat to growth, in case of China, it's the deepening property crisis which is a major concern. Stimulus measures announced by PBOC and those signalled by government may help revival in growth.

**Global Central Banks:** In Jan'24, US Fed, ECB, BoE, and BoJ continued to keep their respective rates on hold. Fed's policy statement remained dovish as the bank confirmed that it will lower rates this year. However, rate cut in Mar'24 was ruled out by Fed Chair Powell given the strength in the economy. Analysts now expect a rate cut in May'24 meet. ECB and BoE are also expected to begin their rate cut cycles around the same time. However analysts are pencilling in aggressive rate cuts by Fed, on account of cooling inflation and labour market. BoJ is expected to move away from its negative rates this year, beginning with increasing short term rates from Apr'24.

**Key macro data releases:** According to **interim Union Budget for FY25** announced, fiscal Deficit (as % of GDP) estimated to be lower (5.8%) than targeted (5.9%) in FY24. In FY25BE, it will be brought down to 5.1%. In FY25, Centre's capex spending is expected to increase to Rs 11.1 lakh crore from Rs 9.5 lakh crore as per FY24RE. Gross borrowings for FY25BE are targeted at Rs 14.13 lakh crore, down from Rs 15.4 lakh crore as per FY24RE. NSO has estimated that **Indian economy is expected to clock a growth of 7.3% in FY24** from 7.2% in FY23. GVA growth is estimated lower at 6.9% (previously 7%). Manufacturing paints a bright picture registering much higher growth at 6.5% in FY24. Construction and mining sector too are expected to grow at much faster pace.

**CPI inflation** surprised, coming in at lower than expected (5.9%) at 5.69% in Dec'23. The moderate inching up of CPI was on account of a slight unfavourable base. Food inflation remained sticky inching up to 9.5% from 8.7% in Nov'23. Core CPI (excl. food and fuel) moderated further to 3.9%. All broad sub components of core noticed a drop in inflation in Dec'23. Especially the demand driven components such as, clothing and footwear, household goods and services, personal care and effects.

## Global developments

### Global growth: Soft landing versus Hard landing

IMF has recently revised its global growth forecast upward to 3.1% from 2.9% (Oct'23 projection). This is due to upward revision in growth estimates for US (2.1% from 1.5%), China (4.6% from 4.2%) and India (6.5% from 6.3%). The Fund now expects a soft landing in the US versus hard landing predicted earlier. On the other hand, estimate for growth in Eurozone has been revised lower to 0.9% from 1.2% earlier, dragged by Germany (0.5% from 0.9%) and France (1% from 1.3%).

Resilience in US economy continues, with US GDP, labour market, consumer confidence, and production standing firm. Latest data shows that GDP rose by 3.3% in Q4CY23, lower than 4.9% in Q3, but much higher than estimated growth of 2%. The boost came from private consumption, state and federal spending, and non-residential fixed investment. This has raised hopes of a 'soft landing' for US economy versus a 'hard landing' anticipated earlier. Even labour market supports this view, as latest data shows that non-farm payrolls rose by 353k in Jan'24 versus est.: 185k and 333k in Dec'23. Average hourly earnings were also up by 0.6% (MoM) in Jan'24 versus est.: 0.3%. Conference Board consumer confidence index rose to 114.8 in Jan'24 (highest since Dec'21) from 108 in Dec'23, led by improvement in both—present situation and expectations index. Even University of Michigan consumer sentiment index for Jan'24 rose, and inflation expectation softened for one year ahead (2.9% versus 3.1% last month). On the production side, US ISM manufacturing index signals that activity contracted at a slower pace in Jan'24 as the index rose to 49.1 from 47.1 in Dec'23. New orders noted the most improvement (52.5 versus 47), even as new export orders fell. Input price index also inched up (52.9 versus 45.2). In Dec'23, factory orders were up by 0.2%, following 2.6% increase in Nov'23.

Eurozone's manufacturing PMI showed that output contracted at a slower pace in Jan'24, as the index rose to 46.6 from 44.4 in Dec'23. This was on account of softer contraction in both new orders and factory output. Job losses also moderated and input price pressures continued to decline. Two major economies of Eurozone (Germany and France) reported slowdown in pace of contraction in manufacturing activity. However, conditions in Germany still remain bleak, as also indicated by the IFO index. The index dropped to 85.2 in Jan'24 from 86.3 in Dec'23. The dip was led by both current situation and expectations index. Amongst the sectors, only manufacturing sector noted some improvement in index, while services, trade and construction fell. The institute now expects economy to decline by (-) 0.2% in Q1CY24, following (-) 0.3% contraction in CY23. Some analysts expect (-) 0.3% decline in CY24 as well, as stimulus from federal budget came in below expectations and tensions in the Middle East are expected to cause supply chain disruptions.

China's official manufacturing PMI inched up a tad to 49.2 in Jan'24 from 49.0 in Dec'23, supported by improvement in new orders and production. On the other hand, non-manufacturing PMI improved to 50.7 from 50.4 in Dec'23, led by services activity. Construction activity lent support to growth, but the pace is slowing as the index fell from 56.9 in Dec'23 to 53.9 in Jan'24. In Q4CY23, China's GDP was up by 5.2%, following 4.9% rise in Q3. In CY23, GDP was up by 5.2%, thus surpassing government growth target (~5%). The target is similar for CY24, however, key risks to growth have increased as property crisis has deepened further at the start of CY24. Home prices in Dec'23 fell for the 6<sup>th</sup> consecutive time and at the fastest pace in 9 years. Property sales were down by (-) 8.5% in CY23 and new construction starts fell by (-) 20.4%. Unemployment rate in Dec'23 inched up to 5.1% from 5% in Nov'23. To provide boost to growth and ease credit conditions, PBOB has lowered RRR by 50bps, which in turn will free up 1tn Yuan (~US\$ 140bn) in long-term capital. Another tranche of stimulus of 2tn Yuan is also on the cards in the coming weeks.

## RBI

MPC members are again expected to keep policy rates on hold, by keeping repo rate unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. RBI is also expected to leave the stance of “withdrawal of accommodation” unchanged. GDP and inflation projections may also be left unchanged.

## Global central bank decisions

US Fed again kept its policy rates unchanged at 5.25-5.5% for the 4<sup>th</sup> consecutive time in Jan'24 meeting. The policy statement dented hopes of a rate cut in Mar'24, but reiterated that the central bank has reached the peak of its rate tightening cycle, and will begin cutting rates at some point this year. Timing of that will depend upon incoming macro data. With labour market data still strong and consumer confidence also up, market participants are now expecting possibility of a rate cut in May'24.

Bank of England (BoE) for the fourth consecutive time since Dec'21 left its policy rate unchanged at 5.25%—16 year high, in its Jan'24 meet. The decision was not unanimous. 6 out of 9 members opted for a pause, 2 members wanted 25bps hike, and 1 member voted for 25bps cut. This was the first time since CY20 when a member voted for a rate cut. Inflation forecasts were revised downward, with the central bank now expecting inflation to touch 2% mark only briefly in Q2CY24, before rising again in Q3. On a durable basis, it is expected to reach the targeted rate only in late CY26 (Nov'23 forecast was late CY25). Risks to inflation were also highlighted as- supply side pressures owing to tensions in Middle East. Thus, the policy statement signalled keeping rates “restrictive for sufficiently long”. Analysts expect 4 rate cuts by the end of CY24 and BoE Chief in his recent interview has said that he “does not object that view”.

Following other major central banks, ECB also decided to pause in its Jan'24 meeting. However, unlike US Fed and BoE, ECB President Lagarde reiterated that it is still “premature to discuss rate cuts” and hinted that rates need to remain elevated for inflation to be brought down sufficiently. However, other members of the Governing Council have signalled that the central bank will sooner or later have to take cognizance of falling growth and inflation. Investors are expecting ECB to deliver 5 rate cuts this year, beginning from Apr'24.

Bank of Japan yet again retained its stance of keeping the monetary policy ultra-loose monetary policy in its Jan'24 meeting. However, the policy statement was more hawkish than expected, as BoJ announced that chances of meeting its price goal as gradually rising. The statement also hinted that even if BoJ decides to end negative rates, it will still keep monetary policy easy and not restrictive. The bank believes that increase in wage growth is gradually creeping into services inflation and hence supporting its inflation goal. Inflation projections were left unchanged at 1.9% for 2024 and 2025. Analysts expect BoJ to increase short-term rates in its Apr'24 policy.

## Special studies

### The Employment Scene

Employment has been a critical factor in the growth process of the economy as it provides a base for the build-up of consumption. The organized sector has data that can be taken from the Annual Reports which provides a fair sense of the direction. The study here sums the number of employees for a sum of 2975 companies in the last 5 years. It hence starts from a normal pre-Covid-19 year of March 2019 and traces movements till March 2023.

The aspect of employment has become important because it has been observed that in the last few years several companies have been rationalizing their headcount to align the same with their business models. Also the greater use of AI-ML does pose some challenges to job creation. Against this background the corporate picture gains more significance as this will be the first segment to be affected by both business cycles as well as the proliferation of technology.

There was a drop in headcount in FY21 due to the lockdown and a sharp recovery in FY22. Growth was of the order of 6.7% in FY22 and slowed down to 5% in FY23. This growth rate is impressive as it comes over a high growth rate. On a CAGR basis growth was 3.1% while the net additions over this 4-years period was 0.93 million.

During this period the CAGR of real GDP growth was 3.4%. Hence a ratio of 0.91 was clocked which is close to 1. The spread of employees across sectors is interesting. Top 10 sectors in 2023 accounted for 77% of the total number of employees. Interestingly the top three sectors that account for 48% of total are in the services industries covering IT, banking and finance.

This growth picture however varies across sectors. With the overall CAGR being 3.1% during this 4-years period, Table 1 lists the sectors that have grown at higher than the average rate. As can be expected the highest growth rates in employees was from the three sectors that had the highest share in total employment. Also interestingly the other three sectors that registered high growth rates in employee count were also in the services sector. Two conclusions can be drawn here. The first is that the manufacturing sector is yet to recover fully from the dual lockdowns in 2020 and 2021 and are yet to reach optimal capacity utilization which normally is a prerequisite before more labour and capital are employed. The second is that there has been a smart bounce back of the services sector which is also seen in the monthly PMI, which is the closest indicator one gets on the growth in this sector.

There are some sectors where there has been positive growth in employees count over this time period though there is still a long way to go. Here it can be seen that healthcare leads with 2.4%. This sector includes not just the pharma companies but also hospitals. It is the latter that has added buoyancy as it has been observed that the former has been affected by declining exports.

The sectors that have grown by less than 1% are ones that did witness a decline in headcount in the intervening years and picked up in FY22 to begin with and reached the FY19 level in FY23. Out of those that have yet to regain their pre Covid-19 levels, 4 of the 5 are in the consumer segment while iron and steel is linked with infrastructure. This also shows there is still no need to increase labour force even though the industry has performed well being linked to government capex. The rest of the 14 sectors which have a share of 22% in total

employment have witnessed significant decreases in headcount. Significant industries are construction material, agri industry, capital goods, power, non-ferrous, crude oil, media realty and auto among others. This is displayed in Table 4. Some of them have a considerable SME composition which has yet to pick up on the labour side.

### **Company level performance**

Of the 2,975 companies in the sample it was observed that 1,471 of them, or 49%, witnessed negative growth. This is an alarming number as it indicates that the overall growth of 3.1% was brought about by the other half of the sample companies. These 1,471 companies had witnessed a fall in headcount during this period by 0.82 million while the 1,504 companies had seen an addition of 1.74mn thus registering a net increase of 0.92 million.

A look at the top 100 companies which accounted for 65% of total headcount revealed that there were 31 which had witnessed a drop in employment of 0.315 million while the balance 69 had seen a net addition of 1.318 million.

There were 1,126 companies with headcount of less than 100 in FY23. Of this set of companies, 625 witnessed a decline in employment during this period.

For the aggregate sample, there were 465 companies which registered growth of above 10% while there were 307 in the range of 5-10%. The balance 732 companies with positive growth in employment had growth of between 0-5% during this period.

### **Concluding remarks**

The overall picture of employment is mixed. Top line growth was 3.1% which is roughly close to the real GDP growth during this 4-years period. There is a tendency for more jobs to be created in the services sector. Also in terms of number of companies witnessing an increase or decrease over this period, it is well balanced on both sides.

### **What production and price data of consumer goods say?**

A lot of talks are ongoing about the consumption picture of Indian economy. Broadly indicators of private consumption demand have painted a mixed picture. Retail credit has remained firm while some moderation in services activity such as PMI data, air passenger and passenger vehicle sales data, have shown that pent up demand phenomenon is slowing down. The core inflation data, especially core services, which also captures the consumption demand has softened considerably. As per our calculation, 'core services' inflation is trailing below 4% for the past three months (currently at 3.6%). Thus, we have looked at the production and price angle for both non-durables/FMCG and durable consumer goods segments.

For the production angle, cumulative growth rate of IIP for Apr-Nov'23 period is compared with same period of previous year. Production is taken to be synonymous with consumption as data on the latter is not separately available. For the price picture, disaggregated data of CPI has been used. Notably for CPI, the cumulative growth rate is for Apr-Dec'23 period and for IIP the corresponding is for Apr-Nov'23 period, as IIP comes with a lag of one month. But nevertheless, it gives a broad idea, and the one month lag of IIP is ignored in this analysis.

**Key highlights:**

- Among the 42 items of consumer non-durables or FMCG segment within IIP, production of 24 items have registered moderation in growth during Apr-Nov'23 compared to the same period of previous year.
- Within consumer durables, out of 27 items, 18 items have registered a drop in production.
- The price picture also enumerates some softening of underlying demand conditions, with sharp moderation seen in major discretionary spending reflected in softening of price of durable goods.
- The price-production data when put together clearly shows that for major consumer non-durables/FMCG food products, inflation has impacted sales, which is reflected in the moderation in production data.
- For consumer durables, the pent up demand phenomenon for major white goods has gotten diluted, which have impacted their production.
- However, moderation in production of certain items such as essential wear, passenger cars and some daily items of household consumption such as hair oil, tooth paste, despite moderation in inflation reflect certain degree of strain on the underlying demand conditions.

**Section 1. FMCG segment:**

Here two things clearly emerges 1) for certain food products, higher inflation has impacted sales, reflected in lower production data, 2) for certain daily items of household consumption, production has fallen despite softening of inflation, reflecting strain in demand conditions.

Amongst food products, except butter and ghee, the growth in all segments is trailing behind last year. The fall in production is more pronounced for fruit Juice including concentrates, chocolate & cocoa powder, spices, coffee, jams, jellies, marmalades and skimmed milk. It can be said that higher inflation in these categories has impacted demand for these products, which in turn was reflected in their moderation in production.

However for other items such as Breads, buns, croissants, biscuits, cakes and other bakery products, both price and production have been lower. However price inflation is still high at above 5% across the board and hence have witnessed higher increase in prices for the second successive year. These are processed food items, thus increase in prices is attributed to elevated prices of wheat and maida which goes into the making of these products.

For miscellaneous items, different price production picture emerges. For toothpaste and hair oil, increase in production is line with falling inflation, as well as a negative base effect. In addition to this, demand for items such as shampoo, creams and lotions which may be a discretionary spending for certain categories of consumer, have witnessed fall in production even with inflation easing. This is indicative of households reallocating their expenditures and moving more to essential goods. Detergent soaps are essential and have witnessed high inflation of 6.1% even though lower than last year. Hence demand has been relatively more positive.

In case of sin goods inflation has been relatively low at between 2-3.2%. Growth in wine consumption has increased which could be reflective of changing consumer tastes. Beer production growth was low at 3.8% over a very high base of 2022. The same holds for cigarettes though it is possible that health concerns may have slowed down demand. However, it needs to be seen if such a pattern continues for a longer period of time before the conclusion can be validated.

## **Section 2. Durables segment:**

For certain items the pent up demand phenomenon is slowly fading. This is seen for items such as refrigerators, travel goods, watches, AC, mobile and computers. For most products growth in 2022 was very high which has moderated or declined in 2023. The fall in production of computers may also be due to return to work rather than work from home phenomenon which was seen during the Covid-19 period. The fall in production of passenger cars despite moderation in prices, somehow hints at moderation in purchasing power. Even fall in production of essential wear despite moderation in prices also reflect some strain in demand conditions. Inflation too has played a role with rates being above 5% for most products. Interestingly in 2022 higher inflation did not come in the way of demand as households increased consumption due to the limited access to such products during the pandemic.

Another side of the durable goods data, is pick up in production of items such as ceiling fan, bicycle. The first hints at pickup in real estate activity, which is noteworthy. Inflation has also moderated for all these items, which in turn supported demand. However the same is not witnessed in case of TV sets where growth in production is marginal after falling in 2022. Here it can be attributed to changing tastes of consumers as people have switched over to watching OTT programmes on laptops and mobile phones thus obviating the need to have a TV set at home. Therefore, even though inflation was marginally negative, it did not lead to an increase in production.

## **Section 3. Price Production matrix:**

In this exercise, we examine how the price-production dynamics of consumer goods-FMCG and durable goods segment have panned out in totality. The last two sections have given us a disaggregated picture, where some bit of lost momentum was observed in case of demand for durable goods. The matrix is an attempt to consolidate the same and arrive at a conclusion.

Here also we get the same conclusion, for FMCG segment, the matrix is more distributed, with 29% of the items noting fall in production and the corresponding increase in price level, clearly reflecting the price-production relationship. However, here also demand story shows some bit of strain as 27% of items are noting both fall in production as well as fall in prices.

## **Global Commodity price movements in 2023**

Global commodity prices have witnessed correction in CY23. The correction in prices is broad based and pronounced in case of energy, metals and edible oils. Muted demand conditions have also supported the same in CY23. Also PMI readings globally have pointed that input prices are falling at a sharper pace. Another thing which has come out is that for most commodities, prices are still elevated compared to CY19 (pre pandemic level). This suggest that prices are likely to converge to their mean levels. Thus statistically, it supports an even sharper downward correction. But the recent geopolitical tensions in the Red Sea may outweigh all those statistical advantages and some upside risks to overall inflation going forward cannot be discounted.

### **Commodity prices have undergone correction in CY23:**

- Global commodity prices have witnessed correction in CY23. This is broad based across all categories such as energy, grains, edible oil, cash crops, metals etc. The latest World Bank data on prices of major commodities show that the sub-category products have seen a reversal in the upward trend, which was a result of geopolitical tensions, supply side bottlenecks, amongst others seen in CY22.
- Within energy, sharp correction was visible in Natural Gas prices, with moderation being sharpest for US. Even crude oil prices have seen a downward trend in CY23 over CY22.
- Within edible oils, all categories such as coconut oil, groundnut oil, palm oil and soybean oil have fallen sharply.
- Within grains, wheat prices have fallen, whereas rice still provides some discomfort due to adverse weather conditions.
- Among, major cash crops, rubber and cotton prices have fallen. However, sugar and tobacco prices remained firm due to supply concerns.
- Within metals, the correction is broad based, with zinc and aluminium leading the decline and for precious metals, buoyant demand conditions and volatility in dollar have kept prices elevated as a resort to safe haven demand.
- For Fertilizers, Urea prices have inched down considerably, whereas phosphate prices are yet to witness some correction.

**On domestic front as well**, WPI data in CY23 (till Nov'23) shows the transmission of lower global commodity prices into domestic pieces. Moderation was seen across major items. Decline in prices were visible for items such as crude oil, major edible oil components such as palm, soybean and coconut oil. Grain prices remained elevated, especially rice. Among cash crops, cotton and rubber have noticed decline. Within metals, aluminium, lead and zinc have declined sharply and there has been broad based fall in metal prices.

- What comes out distinctly in this table is that though considerable degree of softening across major commodities have been noticed, still prices are higher than pre pandemic period. Some uncertainty in global demand and correction in supply constraints have supported prices in CY23, but still major commodities statistically should converge to their mean reversion levels. But a lot of it is contingent on the evolution of demand-supply dynamics in the near term.
- As seen in the figure below, for crude oil, wheat, urea, aluminium, the actual prices are showing that convergence to their Mean +SD level for the lower bound should happen. This is also visible across other commodities.

**Upside Risks:** The Red Sea issue has already flared up with recent US and allies retaliatory attacks in response to attacks of ships in the Red Sea. As per reports, sea transport accounts for 30% of all shipping containers and majority of all global trade in goods. The Red Sea, is also the shortest sea route between Asia and Europe. Thus any disruption would definitely more than outweigh any downward correction that is a statistical possibility. The WCI composite container freight index is already surging. Thus, near term upside risks to prices cannot be ruled out.



## Trend in FPI flows

After a dismal start, FPI flow into India picked up pace, cumulatively totalling US\$ 28.7bn in 2023. While equity segment continued to outperform, encouraging trend was also visible in the debt segment, particularly in the last few months of the year. Improved corporate profitability, stable domestic macros, range-bound inflation and a stable political environment favour India as a preferred investment destination. India's inclusion in JP Morgan's bond index in Jun'24 as well as hopes that India might subsequently be included in other bond indices has been a key driver of FPI inflows in the debt segment. The trend is likely to persist and gather more pace in the first 2- quarters of 2024. This will be positive for INR, which is likely to trade with an appreciating bias in 2024.

### **FPI inflows in 2023:**

FPI flows into India witnessed a turnaround in 2023, registering inflows of US\$ 28.7bn compared with outflows of US\$ 17.9bn in 2022. In fact, inflows in 2023 were the highest since 2017, when FPIs poured in US\$ 30.8bn in the domestic market. However, true to their nature, FPI flows exhibited a great deal of volatility throughout the year as can be seen in Figure 1. While the first quarter of the calendar year was marked by outflows to the tune of US\$ 3bn, this was more than compensated by inflows of over US\$ 14bn in the next quarter. There was a steady moderation in FPI inflows thereafter. This coincided with increased uncertainty over the future Fed rate trajectory, with most investors banking heavily on the Fed's higher for longer narrative. After reaching a peak of US\$ 6.8bn in Jun'23, FPI inflows started decelerating and finally turned negative in Sep'23. Outflows intensified further in Oct'23, but recovered in the last two months of the year. Expectations that Fed rates have peaked led to foreign spurred interest of foreign investors. In fact, inflows of US\$ 10.1bn in Dec'23 are the highest ever monthly inflows recorded in a single month.

### **Global scenario:**

At the global level, the situation is similar. US continues to remain the most preferred choice of foreign investors in 2023 as well, however the quantum of flows is lower this year, so far (data upto Oct'23). France has also maintained its second spot in 2023, with inflows likely to be substantially higher than last year. Other advanced economies such as Germany, Italy and UK have also been able to pull back foreign inflows, after a disappointing show last year. In Japan, inflows into equity picked up in 2023, but were still not enough to counter the outflows from the debt segment

While FPI generally shied away from EM markets in 2022, prospects of lower US rates have led to renewed interest in EM countries. Within EMs, India remained the top pick of foreign investors due to its strong growth fundamentals. Other countries such as Brazil, Thailand and Indonesia also saw a resurgence in FPI inflows in 2023. China, which continues to grapple with economic challenges on multiple front, witnessed huge outflows of above US\$ 300bn in 2022. There has been some improvement this year with inflows of US\$ 1.2bn so far, led by hopes that fiscal and monetary support will aid economic recovery in the country.

### **What drove the FPI interest in India?**

The primary drivers of FPI movement in India has been market perception of the trajectory of Fed rates and the strong performance of India Inc. While the year started with most market participants believing that the Fed is likely to remain aggressive while hiking rates amidst persistently high inflation and continued strength in labour

market. Fed commentary also remained fairly hawkish, signaling a tighter for longer narrative on rates. However, as the year progressed, these expectations were tempered leading to varied conjectures about the timing of a rate cut. These expectations gained prominence towards the end of the year with signs of a slowdown in both US inflation as well as labour market.

Expectations that the Fed is likely to start its rate cut cycle from Mar'24 itself, buoyed investor sentiments. The changing expectations around the Fed rates can be captured to an extent by the movement in US 10Y yield. More importantly, from the perspective of FPI flows, it is the interest rate differentials which determine the direction of flows. Figure 3 plots FPI flows into India with the yield differential between India and US10Y yields. The movement in 10Y yields in turn captures market's expectations of the direction of policy rates. As can be seen, a widening of yield differential in favour of India leads to higher inflows and vice-versa. Apart from this, India's strong growth fundamentals along with range-bound inflation also makes it a preferred choice amongst foreign investors.

### **Equity inflows:**

FPI inflows into equity totaled US\$ 20.7bn in 2023, a 3-year high. In the last 20 years, FPI equity inflows have exceeded US\$ 20bn only 5 times. The bulk of inflows were concentrated in Dec'23 alone (close to 30%). Strong profitability of India Inc. along with a stable monetary policy regime has increased the attractiveness of India in the eyes of foreign investors. In Rupee terms, 2023 saw the highest even equity inflows on record.

The buying spree of foreign investors was also reflected in the relative outperformance of Sensex vis-à-vis other global markets. Amongst EM markets, Sensex was the best performer registering a growth rate of 18.7%. EM markets gained about 7%. Even when compared with major developed countries, India did much better. While US stock markets rose by 13.7%, equity markets in UK were only 3.8% higher, suggesting investors' continued confidence in India. Sensex surged to a record high in Dec'23, the same month which saw the highest ever equity inflows in a single month.

The sector-wise picture closely mirrors the trend seen in corporate profitability. Sectors which have performed well in terms of profitability have gained the interest of investors and have seen the maximum amount of inflows. Banks and financial institutions have done consistently well this year, and hence have attracted a bulk of inflows this year. At US\$ 5.7bn, FPI inflows into financial services accounted for over 27% of total inflows in 2023. Capital goods sector has also attracted inflows of US\$ 5.1bn as the government's capex push has greatly benefitted this sector. Auto and auto components also registered stellar financial performance in Q2FY24 and hence ranks high on the investors list with inflows of US\$ 3.6bn. Together the top 3 sectors accounted for close to 70% of total inflows. Conversely, sectors such as oil and gas and IT have not been able to elicit investor attention due to their grim prospects

### **Debt inflows:**

Debt inflows into India witnessed a turnaround in 2023 and recorded inflows of US\$ 7.3bn. Of this, almost 50% came in Nov-Dec'23, amidst a sharp correction in US yields. Apart from the correction in global yields, prospects of India's inclusion in JP Morgan Bond index and Bloomberg Emerging Market Index have also spurred foreign investors' interest in India's debt market. This can be gauged from the fact that FPI investment under Fully Accessible Route (FAR) has increased to Rs. 1.3 lakh crore in 2023, compared with Rs. 61,260 crores in 2022.

For the 23 securities which are eligible for inclusion under the JP Morgan bond index, the holding ratio of outstanding position has shown a sharp improvement. While the share of outstanding position to aggregate holding was in the range of 0.15-5.43% in Sep'23, it has improved to 0.16-8.32% as of 29 Dec 2023, with higher preference for bonds with maturity below 10 years. This suggests that FPI's could be front-loading their investment in these securities, and this trend is likely to gather pace in the first-half of 2024. As of Dec'23, only around 31% of the total limit in the debt market is utilized by FPIs. Hence, there is a sizeable potential for FPIs to invest in the debt market.

### **Conclusion:**

In 2023, FPI inflows into rebounded sharply. The sharp turnaround was attributable to India's buoyant growth macros and improved corporate profitability. This trend is likely to continue even in 2024 as India maintains its place as the fastest growing major economy in the world. In Jan'24 so far, FPIs have poured in US\$ 1bn in India. With Fed looking set to start its rate cut cycle soon, investors' preference is likely to continue favoring high yielding EM securities, with a particular affinity to India. Apart from this, India's possible inclusion in other global bond indices is likely to attract even more debt inflows. Equity inflows are also likely to keep pace, with sectors witnessing improved profitability attracting bulk of inflows. This will be positive for India's external stability, particularly since FDI inflows this year have been lacklustre. This should support INR in the near-term.

### **Household credit, a stimulus to growth?**

Recently, in India's context, credit to households has been under the radar. With overall personal loan growth rate far outpacing aggregate credit demand (currently overall personal loan growth on YoY basis is at 30.1% and aggregate credit demand run rate is at ~20%) and higher delinquency rates in certain products of household loans such as credit card and 'other personal loan' segments (small valued loans without collateral); red flags have been raised by the regulator. As a regulatory response the risk weights in respect of consumer credit exposure (except housing, vehicle and loans secured by gold) was increased by 25% points to 125%. In fact, consumer credit exposure of NBFCs for such segments have also attracted a higher capital charge. RBI's recent Financial Stability report has also expressed concerns about risks to consumer credit regarding risk profiling, declining standards of underwriting and rolling over of debt.

At the same time it is a well-known fact that growth in several developed countries has been fostered by consumerism that has been aided by leverage. Against this backdrop, it is interesting to see how overall household credit in India has grown compared to major peers. Is the pace of growth alarming relative to other markets? Have savings grown at the same pace as overall growth in credit? The response to these questions will give us some idea about the assets-liability mismatches of households. Towards the end, we have conducted an exercise to see whether the increase in household credit is contributing to stimulating private consumption demand.

### **Key findings:**

- India's credit to GDP ratio of household sector has been increasing at a steady pace.
- The ratio is higher compared to major EMs.
- In absolute terms as well, India's household credit figure is reflective of the fact that households have increased borrowing in tune with rising consumption demand.

- However, when compared to other advanced economies such as US, UK, the ratio of household credit to GDP in India still shows there is room for further increase.
- Savings on the other hand have shown some degree of moderation. This is true for India as well as other economies. Hence there is a gap between assets and liabilities portfolio of households.
- We have conducted an exercise where household consumption is regressed to household credit. The result of the exercise shows that over the years, credit has emerged as an important contributor in fuelling private consumption demand across countries, which is positive for growth. It can hence be said that under the umbrella of prudent regulation quality consumer credit can actually be a driver of economic growth.

### **Section 1: Credit to GDP ratio of households:**

Among major G20 economies, India stands at 10th position in terms of household credit to GDP ratio. An immediate conclusion is that logically economies with a larger size of GDP have a higher ratio. India has a household credit to GDP ratio of 40.3%, which is lower than major advanced economies such as US with ratio of 73.7%, United Kingdom with ratio of 80.7%, Germany at 53.5% and Japan at 67.5%.

In comparison to major EMs however, India's ratio is impressive. In pecking order it is only next to South Korea and China. Thus compared to the median level of credit to GDP ratio of households of EMs, India outperforms the others. In fact, India's ratio overtakes South Africa, Indonesia, Russia, amongst others reflecting thus a developed credit market.

### **Section 2: How India's household credit demand fared over the last few years**

India's ratio has picked up considerably compared to pre Covid-19 times. One thing which stands in contrast to ordinary notion is the sudden surge in the ratio during Covid-19 period. This is mostly driven by a lower GDP print thus driving the overall ratio higher. Thus it is more of statistical in nature. But the current ratio has reached similar levels. This is more due to structural phenomenon such as pick up discretionary spending, favorable demographic and rising aspirations of middle class. From a ratio of 34.5% in Mar'19, it has risen to 40.3% in Jun'23.

To analyse whether the ratio has outperformed or underperformed simply due to statistical effect of the denominator we focus on the actual growth of household credit demand, rather than only seeing the ratio where an inflated or deflated GDP plays a crucial role.

We have looked at the trend of 10 Year CAGR of household credit, both in US\$ terms as well as in terms of local currency unit, across different economies. It is seen that for India the growth has been impressive. In US\$ terms, it ranks second amongst major G20 economies, whereas in local currency unit, it stands among the top 5. Thus improved regulation, easing financial conditions and a diverse credit market have contributed to such an enhanced pace of catch up for India.

### **Section 3: Savings aspect**

The relationship between household savings and household credit can be examined next. The 10 Year CAGR of household savings of major economies declined, while credit offtake by households has picked up pace. Generally,

the gradual run down of savings has resulted in increased borrowings. For India, the 10 year CAGR in gross household savings has been 8.4% with gross financial savings increasing by 10.8% and physical assets by 7.1%.

For major economies such as Germany, France, Italy and Japan, savings of household have declined, whereas household borrowings have picked pace. Notably, for most of the economies, the 10 Year CAGR of household borrowings is higher than the 10 Year CAGR of household savings, explaining the asset-liability gap of household.

#### **Section 4. Relationship between household consumption and household credit:**

Recently, in India's context there have lots of talks about the pace of growth in uncollateralized consumer credit, which has raised regulatory concerns, as highlighted earlier. Thus keeping this as a backdrop, we wanted to check whether pick-up in consumer credit is worrisome or not?

- In this exercise we wanted to look whether growth in household credit is fuelling private consumption demand.
- The empirical data for 17 cross section units and across 10 time periods have been used.
- Here cross section units are countries and time periods run from 2010-2019.
- We have used all data sets in their local currency units at current prices, to evaluate the growth rate.
- To get a better clarity of how the household credit have evolved over time in giving consumption the desired push, we have segregated our data into 5 time periods. So the first set encounters time period 2010-2014 and the second one 2015-2019. We have opted out post Covid period as the results are spurious in nature due to discrepancy in data.

We regressed household consumption with explanatory variable as household credit. This is a limitation of our exercise of using fewer explanatory variables. However, we repeated the exercise including gross savings as another explanatory variable. The results in that case were not satisfactory. Theoretically, the fixed effect model has emerged as the appropriate choice of model confirming a positive relationship between household consumption and household credit. The results of Redundant Fixed effects test and Hausman test also confirms the superiority of fixed effect model over constant coefficient model and random effect model.

Coefficient of household credit is 0.15 and the R-square (coefficient of determination) is 0.88. This was for the period 2010-2014. In the second quinquennium this coefficient improved marginally to 0.19 with the R-square being 0.94.

The conclusion drawn is that there is strong merit in growing household credit as it has positive effects on consumption and hence GDP growth. Given the higher ratios for the developed countries, there is plenty of scope to augment this segment of credit by banks. But also it is imperative that there are no disruptions in terms of asset quality as such shocks can push the system back. This is how the recent RBI move can be viewed as it brings in growth with discipline.

#### **States slow on capex, but sharper on subsidies**

For the purpose of this study, data on capital expenditure of the government for the centre and states up to November was used. For the 8-month period, the centre had spent 58.5% of the targeted amount of Rs 10 lakh

crore which is 58.5%. This has been the trend in the past too; and the balance 4 months witness a distinct acceleration based on the progress on other fronts of the budget especially revenue collections.

The states this year have tended to lag the centre. Out of the Rs 7 lakh crore of capex that was projected by a set of 26 states (whose data is provided by the CAG), Rs 3.18 lakh crore was spent which is around 45%. Clearly there is a longer distance to be covered by these states.

The states have been classified into 4 groups. The 'pro-active states' are those that have completed above 50% of their capex in the first 8 months. These will have fewer challenges in meeting their targets. 5 of the 7 states are from the south. Further, Telangana and Madhya Pradesh were states which had state elections and could have been more aggressive on this score.

The regions which achieved 40-50% of the target are called 'conservative states' that would have some challenges in meeting their targets but could get closer to the same. This is so because even if they do want to spend in the last couple of months based on their revenue flows, they would need to have projects in hand to enable the same. There were 8 such states of which 5 were relatively small.

The 'not-so-sure' states are the critical ones which met targets between 30-40% of total. This is an important category because it has 4 states which are the largest spenders on capital. These are Uttar Pradesh, Maharashtra, Gujarat and Karnataka which together account for a little over 50% of total capex of states. Their joint achievement is 35.5% of the annual target. The laggards are those which have achieved less than 30% of the annual target and Punjab and Chhattisgarh are in this set which are relatively larger in size.

CAG also provides information on subsidies disbursed by various states. Information is available for only 18 states and excludes some like Punjab and Tamil Nadu which traditionally have large outlays. Here it was observed that out of the total allocation of Rs 2.26 lakh crore for the year almost Rs 1.25 lakh crore has been disbursed with the ratio being 65.6%.

- Total target met at a consolidated level is running on par with the time period gone by.
- 5 states had spent at the same rate as the sample average or above and included Andhra Pradesh, Madhya Pradesh, Bihar, Meghalaya and Himachal Pradesh.
- Uttar Pradesh and Gujarat had achieved between 50-60% of the target.
- Maharashtra, Odisha, Chhattisgarh, Kerala, Haryana and Telangana had met 40-50% of the target.
- Uttarakhand, Jharkhand, West Bengal and Assam were less than 30%.
- The largest spenders on subsidy were Maharashtra, Gujarat, Uttar Pradesh and Rajasthan. They accounted for 46% of the total Rs 2.26 lakh crore of state subsidy. While Tamil Nadu is not included in this analysis, the state had the second highest amount of subsidy budgeted for the year at Rs 36,027 crore.
- Interestingly the coefficient of correlation between the target met for subsidy and capital expenditure was at 0.36 which is less than 50%. Though the sample is small as it consists of 18 states only, the conclusion can be that those with accelerated capex spending could be slower when it comes to disbursing subsidy and vice versa.

## Concluding remarks

Data up to December shows that private sector investment may not have yet picked up in a broad-based manner and hence the heavy lifting is still to be done by the government – both centre and states. States are more constrained by FRBM norms and could cut back on capex to ensure that the fiscal deficit targets are adhered to. Therefore, possibility of slippage would be tied to the revenue earned in the next few months. Subsidies on the other hand could be exceeded though it would be unlikely for any economies to be drawn with states having underspent as has been the case in the past.

## State wise GST collections has variation

GST is a consumption based tax and broadly reflects the growth in consumption in the economy. While this tenet is accepted it is interesting to see how states have performed so far on the basis of SGST. The top line number is impressive for the economy with growth of 11.7% which is higher than the 8.7% growth in final consumption witnessed in the first half of the year.

Some interesting features of the GST collections during the nine-month period April-December 2023 are as follows:

- The highest share in GST is the IGST which accounts for a little more than half of total collections.
- Share of SGST is higher than CGST and hence states have a big role to play when it comes to contributing to overall GST.
- In terms of growth, IGST has slowed down to 8.5% which is the level of growth in total consumption while SGST has grown at 15.2% and CGST by 16.4%.
- The share of cess is lowest at 7.2% but grew by 12.7%.

Against this background, the collections through SGST can be examined to ascertain any patterns in the levels of consumption across different regions. The top 10 states account for  $\frac{3}{4}$ th of overall GST collections. Maharashtra has the highest share with 21.2% followed by a distant second by Karnataka with 9.3%, Gujarat 8.4% and Tamil Nadu with 8.2%. UP is fifth with share of 6.8%.

The overall SGST collections increased by 15.2%. As can be seen, 8 states have driven the overall collections with growth higher than the national average. Maharashtra, Karnataka, Tamil Nadu, UP, Haryana, Telangana, MP and Uttarakhand are the states to register more than 15.2% growth this year. Gujarat, West Bengal, Delhi and Odisha are among the top 10 largest contributors where growth was slower with the former two growing by less than 10%. This is indicative of consumption being uneven across geographies.

Looking at the collections for the balance regions, we note that majority of the smaller states/Uts have registered robust growth in SGST collections. But they have a total share of just 3.2% in total collections.

## Some concluding remarks

The main takeaway here is that there is reason to believe that growth in consumption cross states has not been uniform across regions this year. This may explain why overall consumption in the country has not been growing at a higher pace despite signs of pent up demand being spoken of by several sectors. Large states like Gujarat

and West Bengal have yet to pick up pace and any improvement can hence add to the overall consumption as well as tax collections.

Odisha, Rajasthan and Chhattisgarh have registered growth of less than 11% during this period and could have pushed back on the rural side with agriculture not performing as well as was expected. As consumption evens out in these states, there is reason to be optimistic of even higher collections in the coming months.

### **New investment announcements remain low**

Indian economy appears to be on the road to achieve GDP growth of around 6.6-6.7% for FY24. A question that is often posed is whether or not investment has picked up. Here there are varying signals that are received from the market. Several companies have stated in their investor presentations that they would be expanding capacity which is a good sign. One indicator that is available is the information on new investment announcements. CMIE provides this data on a quarterly basis. The quarterly data shows some pick up in Q3 of FY24 at Rs 2.15 lakh crore as against Rs 1.87 lakh crore in Q2. However, the amount is still very low compared with the earlier 10 quarters. Announcements are only intentions and may not necessarily materialize.

Also quarterly data could be prone to time factors with announcements being made at different times of the year. Therefore, a better way to look at them is to track the announcements on a cumulative basis. At Rs 10.8 lakh crore for the first three quarters investment announcements are at the lowest if 2020 is excluded, which was during the lockdown. Hence, there is definitely a case of investment still being low and not picking up at the desired rate.

In this context, it is also interesting to see as to in which sectors have these announcements been made. Almost 49% of the investment intentions are in the services sector of which transport services contributes to 94% of the total. This is mainly in the aviation sector with orders being placed for new aircrafts by some companies. Within manufacturing which has a share of 28%, chemicals and machinery have larger shares of 42% and 19% respectively. The power sector continues to be a driver with share of 21%. Hence clearly the intentions are biased towards 4 sectors.

The other aspect of investment intentions is the ownership pattern. The share of government companies came down to 20.7% from 23.2% in 2022. But in absolute terms there was a fall in both government and private companies, and within private, both Indian and foreign sectors witnessed a decline. Therefore, there is a still a long way to go for revival of investment. One factor holding back investment could be excess capacity in several sectors. RBI data for June shows the average at 73.6%. The other is uncertainty due to the Elections next year as there is a tendency for companies to wait and watch before investing. The third factor could be high interest rates and the expectation of repo rate cuts next year in the second quarter of the fiscal.

On the funding side too one can see that there is weak evidence of pick up in investment. The broad sectors which have raised funds in the corporate bond market as per CMIE is listed below.

Two features which stand out here are that overall issuances in 2023 are lower than that in 2022. Further, the share of financial services is the highest at 78.3% as against 72.2% last year. Another source of funding which is bank credit shows that the growth in credit to large manufacturing is low at 3.6% - which is lowest across all sectors. Also the share in total credit has come down from around 20% last November to 17% this November.



**Concluding remarks**

Data on new investment announcements do indicate that industry in general is still in a wait and watch mode. Hence, only specific sectors have witnessed an increase in such intentions. It is dominated by airlines industry as of the first three quarters. Power, chemicals and machinery are the other three sectors with significant shares. The same picture comes also from the financial side where bond issuances are dominated by the finance companies and there is limited traction in bank credit to large manufacturing.

## Data Releases

### Currency outlook

INR has strengthened by 0.3% in 2024, consolidating a gain of 0.2% it made in 2023. This is significant, as the rupee's gains came against the backdrop of a stronger dollar. In fact, INR is the best performing major currency against the dollar this year. India's resilient growth story along with a comfortable external position, along with RBI's intervention have kept INR mostly range-bound in the last couple of months. While the macro backdrop is highly favourable for the rupee, we believe that the appreciation in the domestic currency is expected to be gradual. RBI is likely to absorb foreign inflows to build up its buffers to cushion against the eventuality of sudden capital outflows, amidst India's increased interconnectedness in the global financial system. Based on this we anticipate a range of 82.5-83/\$ in the next fortnight. For 2024, we believe INR to trade with an appreciating bias and slowly inch towards 82/\$.

### Bond Market Round-up

Sell off in global bond market was seen in Jan'24 and Feb'24 (till 2<sup>nd</sup> Feb). It was led by US and the undertone of Fed. Globally, central banks are expected to embark on the easing cycle but the timing might be pushed back as underlying macro picture gives a confusing signal in terms of growth-inflation dynamics. Domestic yields got support from Union Budget. Lower than expected gross borrowing numbers, fiscal prudence; supported yields. Post Budget, it has fallen by 9bps. We expect it to trade in the range of 7-7.10% in the current month. Downward bias persists from a favourable inflation print. Liquidity deficit is likely to persist and remain in the range of 1.0-1.2% of NDTL. This is primarily on account of higher pace of increase in credit than deposits. Going forward, RBI may come up with some measures to improve durable liquidity which has shown moderation.

### Union Budget 2024-25

Fiscal Deficit (as % of GDP) estimated to be lower (5.8%) than targeted (5.9%) in FY24. In FY25BE it will be brought down to 5.1%. Revenue Deficit-GDP ratio is expected to decline from 2.8% as per FY24RE to 2% in FY25BE. In FY25, Centre's capex spending is expected to increase to Rs 11.1 lakh crore from Rs 9.5 lakh crore as per FY24RE. As a % of GDP, capex ratio is expected to rise to 3.4% (FY25BE) from 3.2% (FY24RE). Gross borrowings for FY25BE are targeted at Rs 14.13 lakh crore, down from Rs 15.4 lakh crore as per FY24RE.

### FY24 growth estimated to surge to 7.3%

GDP growth for FY24 has been estimated at 7.3% against an increase of 7.2% in FY23 on a YoY basis. This acceleration is led by higher growth in government expenditure which is expected to be grow by 4.1% against a growth of 0.1% back in FY23. Moreover investment demand has seen some moderation, but is still expected to clock double digit growth of 10.3% (11.4% in FY23). However, the dip will be visible in private consumption which is expected to drop down to 4.4% in FY24 (from 7.5% in FY23) which is a concern. Growth in both exports and imports also likely to take a back seat due to weakness in global economy with growth softening to 1.4% (previously 13.6% in FY23) and 13.2% (earlier 17.1%) respectively in FY24.

**GVA to be dragged down:** GVA growth is expected to moderate a bit to 6.9% in FY24 compared with a growth of 7% in FY23. This was higher than our expectation of 6.7%. Manufacturing and mining sector have registered a robust growth of 6.5% (1.3% in FY23) and 8.1% (4.6% in FY23) respectively in FY24, the same has been

reflected by industrial production. Construction sector is expected to clock double digit growth of 10.7% from 10% growth registered in FY23. Within services, financial services is expected to record a healthy growth of 8.9% in FY24 (7.1% in FY23). On the other hand, some moderation is expected in trade, transport and hotel (6.3% vs 14.0%) signalling sluggish demand from the tourism and hospitality industry. Even Agriculture sector has been a disappointment with growth down to 1.8% in FY24 (4% in FY23) on the back of uneven rainfall which resulted in lower Kharif estimates. There are further concerns emanating from Rabi sowing. Electricity sector is also pegged to record lower growth of 8.3% in FY24 compared with 9% in FY23.

## Core sector performance

Core sector growth for Dec'23 came in at the lowest at 3.8% in the current financial year. While admittedly the high base effect was at play, there was also a slowdown in the infra sector. The government spending on capex was steady but the same was not seen in the private sector.

Coal continued to do well at 10.6% notwithstanding the high base effect. Higher mining in preparation for greater demand due to the winter for power was a reason for this increase. Electricity however slowed down reflecting partly lower industrial activity. Fertilizers growth at 5.8% was steady which kept pace with demand which would be waning as the sowing for Rabi season concludes virtually in this month. Steel production at 5.9% was good given high base effect. Higher demand for capital goods and automobiles kept production growth up. Cement production slowed down reflecting lower demand on the construction side though the base effect was high as growth was at 9.5% last year. The oil basket showed low growth with the exception of natural gas. Lower price of crude partly explains lower value. On a cumulative basis, which gives a better picture as it irons out monthly disturbances, growth was at the same level as last year at 8.1%. With the exception of crude oil all other segments performed well which is a positive sign. We could expect growth in IIP to be in the region of 2-3% for Dec'23.

## WPI out of deflation

**Food inflation at 4-month high:** Headline WPI fastened to 0.7% in Dec'23, lower than our estimate of 1.5%, but following 0.3% increase in Nov'23. The jump was driven by food inflation which rose by 5.4% in Dec'23, up from 4.7% in Nov'23. Within food, rate of inflation in case of vegetables (26.3% in Dec'23 versus 10.4% in Nov'23), spices (29.7% versus 27.5%) and other food items (9.4% versus 1.6%) rose significantly. Amongst vegetables, out of 19 items, prices were up for 12 items, with major push coming from items like Onions (+91.8% in Dec'23), tomato (81.7%) carrot (19%) and cauliflower (13%). Inflation for items like food grains (8.4% versus 9.7%), milk (6.9% versus 7.9%), and fruits (4.6% versus 8.4%) also rose, but at a slower pace. Within food grains, paddy inflation inched up a tad (10.5% versus 10.4%), while wheat inflation decelerated (-1.4% versus 2.5%). Pulses inflation remains elevated, but is showing signs of slowdown (19.6% versus 21.6%). These trends are in line with movement in international prices. As indicated by World Bank's pink sheet, paddy prices had risen by 39.6% in Dec'23 following 39% increase in Nov'23, while wheat prices continue to decline, albeit at a slower pace (-22.3% in Dec'23 versus -29% in Nov'23). In CY23, our food inflation moderated to 2.8% from 8% in CY22.

**Fuel and power inflation:** Deflation in fuel and power inflation accelerated once again in Dec'23 as it fell by only (-) 2.4% compared with (-) 4.6% decline in Nov'23. This was on account of slowdown in deflation in mineral oil index (-2.7% versus -5.7% in Nov'23) and electricity index (-3.9% versus -5.3%). On the other hand, coal inflation remained unchanged from last month for the 4th consecutive month at 1.8% in Dec'23. In CY23, fuel & power inflation fell by (-) 1.2% after noticing 34.3% jump in CY22. Within mineral oils, in Dec'23, build up in pressure

was visible in case of Petrol, HSD, Naphtha, and Furnace Oil. The movement is in line with international crude prices which on YoY basis, fell by only (-) 4.9% in Dec'23 compared with (-) 9.7% decline in Nov'23. Oil prices remain broadly steady so far around US\$ 77-78/bbl in Jan'24. If prices inch back up owing to geopolitical risks (Red Sea tensions) then it can add pressure on headline WPI in the coming months.

**Decline in core WPI accelerates:** Core inflation remains in deflation for the 10th consecutive month in Dec'23, and the pace accelerated as it fell by (-) 0.6% compared with (-) 0.5% in Nov'23. Deflation in manufactured products also deepened, as it fell by (-) 0.7% in Dec'23 following (-) 0.6% decline in Nov'23. Of the 22 commodity sub-indices, 12 indices fell at a faster pace in Dec'23 than Nov'23 led by, basic metals, other manufacturing, tobacco, fabricated metal products computers/electronics, and motor vehicles. Within basic metals, pace of contraction in case of zinc slowed (-6.7% in Dec'23 versus -7.6% in Nov'23), while inflation index for Copper (2.1% versus 4%) and Lead (1.1% versus 2.9%) continued to inch up, though at a slower pace. Index aluminium fell further in Dec'23 (-3.6% versus -1.6%). On an international level, as reflected in World Bank's pink sheet, deflation fastened in case of Zinc (-20% in Dec'23 versus -13.5% in Nov'23), Lead (-8.6% versus 4.2%) and Aluminium (-9.1% versus -6.3%). on the other hand, increase in copper prices softened (0.3% versus 1.7%).

## CPI inflation

**CPI below estimate:** CPI inflation surprised, coming in at lower than expected at 5.69% in Dec'23, on YoY basis (BoB Best: 5.55%) and against street estimate of 5.9%. The moderate inching up of CPI is on account of a slight unfavourable base. Food inflation remained sticky inching up to 9.5% from 8.7% in Nov'23. This was led by firming up of prices in vegetables (27.6% from 17.7%), pulses (20.7% from 20.3%) and sugar (7.1% from 6.6%). Despite some stickiness, moderation in 7 out of 20 broad categories of food has been observed. Among them, the most notable was meat and fish (1.1% from 2.2%), cereals (9.9% from 10.3%), spices (19.7% from 21.5%), amongst others.

**Core CPI (excl. food and fuel)** has moderated further to 3.9%. All broad sub components of core noticed a drop in inflation in Dec'23. Especially the demand driven components such as clothing and footwear (3.6% from 3.9%), household goods and services (3.4% from 3.5%), personal care and effects (7.3% from 7.8%), are easing considerably. Apart from this, other services inflation such as health (5.1% from 5.5%), education (4.8% from 5%) and recreation and amusement (at 3.1%) are all losing its earlier stickiness. Some of it is partly attributable to base effect. In fact core services inflation as per our analysis is trailing ~3-3.1%.

**Fuel and Light inflation** has fallen by 1% from 0.8% decline seen in Nov'23, on YoY basis. This is on account of lower Kerosene prices.

**Way forward:** CPI print came in slightly higher than our estimate. However, the moderation of prices was evident from the correction in major items of vegetables, which is now coinciding with the harvest month. Further correction is also forthcoming. The high frequency price data of Jan-24 enumerates the same. Our in house BoB ECI has fallen by 0.8% in Jan-24, with major sequential drop seen in onion, tomato, salt, sugar, pulses and cereals. Rabi sowing is also slightly lagging behind. Thus we do not see any immediate upside risk to inflation. However, the recent developments in Red Sea might pose upside risk to international crude prices. The transmission to domestic prices is limited, as pump prices are unlikely to change in the immediate to medium term. The next two months will also witness favourable base and CPI is likely to be in the range of 4.5-5%.

## Growth in Industrial Production slows down

**IIP growth eases:** IIP growth moderated down to 8-month low of 2.4% in Nov'23 much below our expectations (6%) and compared with a growth of 11.6% in Oct'23. The slowdown was primarily attributable to moderation across all the sectors. Growth in mining and electricity sector eased to 6.8% (13.1% in Oct'23) and 5.8% (20.4% in Oct'23) in Nov'23. Output of manufacturing sector decelerated down to 1.2% in Nov'23 against a growth of 10.2% in Oct'23. Amongst manufacturing sectors, barring one sub-division, all the other subdivisions have registered much slower growth in Nov'23. Manufacture of leather products (-16.2% versus 16.5% in Oct'23), electrical equipment (-16.8% versus 13.2%), machinery and equipment (-0.9% versus 26.1%) and manufacture of furniture (-30.5% versus -7.2%) have recorded sharpest contraction in Nov'23. The only subdivision that has registered positive growth is manufacture of coke and petroleum products at 14.2% (2.4% in Oct'23). On a FYTD basis (Apr-Nov), industrial growth has edged up to 6.4% in FYTD'24 from 5.6% in FYTD'23. Mining and manufacturing growth has expanded to 9.1% and 5.8% respectively in FYTD'24, while electricity growth has moderated by 7.7% in FYTD'24 (9.8% in FYTD'23).

**Broad based slowdown:** Within use-based, all the sectors have registered much lower growth in Nov'23. Growth in primary goods slipped down to 8.4% against a growth of 11.4% in Oct'23. Even intermediate and infra goods have registered sharp deceleration at 3.5% (9.4% in Oct'23) and 1.5% (11.3% in Oct'23) respectively in Nov'23. The subdued growth raises some concerns for construction and real estate activity. Capital goods output contracted sharply down to (-) 1.1%, a 13-month low from a double digit growth registered in Oct'23. Moreover, growth in rural demand has been tepid and has added to concerns around consumption story, the output of both consumer durable and FMCG output has also declined in Nov'23 to (-) 5.4% and (-) 3.6% respectively.

**Way Forward:** Going ahead, the focus is expected to shift towards interim budget which is a vote on account with the possibility of higher capital outlay with the objective to support growth. As the global economy is likely to witness slowdown, exports are expected to be weaker and needs to be monitored carefully. For other indicators, domestic economy remains resilient with the advance estimate also suggesting a much higher growth in FY24. Industrial output for Oct-Nov'23 has expanded to 7% against a growth of 1.8% in Oct-Nov'22.

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**For further details about this publication, please contact:**

Economics Research Department

Bank of Baroda

[chief.economist@bankofbaroda.com](mailto:chief.economist@bankofbaroda.com)