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India's Economic Perspectives in 2022-23:

A PROGNOSIS

प्रिय साथियो,

पिछले दो वर्ष वैश्विक और भारतीय अर्थव्यवस्था के लिए उतार-चढ़ाव भरे रहे हैं. इस दौरान आर्थिक पूर्वानुमानों में बार-बार संशोधन की आवश्यकता पड़ी और हमेशा अनिश्चितता की स्थिति बनी रही. वैश्विक एवं भारतीय अर्थव्यवस्था के पटरी पर लौटने एवं इसमें सतत् वृद्धि का संकेत मिलने से पूर्वानुमानकर्ताओं के लिए एक राहत की स्थिति बनी. परंतु मौजूदा युद्ध के माहौल में एक बार फिर से सप्लाइ चेन के बाधित होने और मुद्रास्फीति में वृद्धि की संभावनाओं के कारण राहत का दौर अल्पकालिक साबित हुआ.

इस पृष्ठभूमि में हमारी आर्थिक अनुसंधान टीम ने इस वर्ष की संभावनाओं का आकलन प्रस्तुत किया है. यह कार्य निश्चित तौर पर जोखिम भरा है क्योंकि तेजी से बदलते परिवेश में अचानक चीजें बदल सकती हैं. परंतु हमारे पास आगे बढ़ने, अनिश्चित भविष्य के लिए योजना बनाने तथा स्थितियों के अनुरूप अपने आकलनों में निरंतर सुधार हेतु तैयार रहने के अलावा कोई विकल्प नहीं है.

हमें विश्वास है कि आपको यह आकलन उपयोगी और रोचक लगेगा. हम पाठकों से अपने बहुमूल्य विचारों एवं सुझावों को प्रेषित करने का अनुरोध करते हैं ताकि अपने आकलन को अद्यतन करने के दौरान हम इनका उपयोग कर सकें.

शुभकामनाओं सहित,

संजीव चड्ढा

प्रबंध निदेशक और मुख्य कार्यपालक अधिकारी

Dear Reader:

The past two years have been a roller coaster ride for the world and the Indian economy. Forecasts have had to be revised ever so often and any certitude has been grossly misplaced. So it was a relief to forecasters when it seemed earlier this year that the global and Indian economy had returned to a predictable and a steady upward trajectory a post pandemic recovery was in train. But with war clouding the horizon, supply chains disrupted again and inflation appearing to become entrenched, this has proved to be only a short reprieve.

Against this backdrop, our Economics Research team has put together a Prognosis on what to expect in this year. Admittedly this is venturesome, as in this rapidly changing environment things can alter unrecognizably in short order. But there is no option for all of us but to look ahead, plan for what is an uncertain future, while being prepared to constantly readjust our assessment as events unfold.

We do hope that you would find this Prognosis useful and interesting. We would also be grateful to our readers to share their perspective and feedback which would be invaluable as we update our assessment during the year.

With regards

Sanjiv Chadha
Managing Director & CEO

Indian Economy Prognosis: What to expect in FY23

FY23 has begun on a rather sombre note for the Indian economy with mixed signals. The impact of the war on the economy has started being witnessed in different areas which has increased the level of uncertainty. Starting on 24th February, the war has lasted longer than expected with no foreseeable end in sight. The pains from the interlinkages of all countries under the umbrella of globalization has meant that gradually it is getting harder to remain insulated from the influences of both the war as well as sanctions.

On the other side, there have been some very positive signals received from the data that has been released in first quarter of FY23 which indicates that the economy did well enough in the four months following the beginning of the war. GST collections have been buoyant and services PMI is also showing improvement. Industrial growth including crore sector growth has been impressive for April. Exports growth too has been steady though growth slowed in May, thus brushing aside initial fears of the war impact. There is always the question mark on whether this will continue on the present path or will be interrupted along the way.

Against this background we present below our expectations for the economy for FY23 where we have made projections on various economic parameters after weighing both the positive tailwinds in favour as well as the speed breakers that could be encountered. With conditions changing quite dynamically, it must be pointed out at the onset that all forecasts are subject to change as the environment is dynamic. The immediate impact of the war and sanctions was seen on crude oil prices which soared. However, with time, as the impact of sanctions set in, edible oils became more expensive due to the disruptions. This spread further to wheat, where prices have been increasing in India for various other reasons. The entire trade matrix has changed and in the midst of the Fed tightening their rates and liquidity, which was known from the beginning of the year, the tone and language in their meetings has caused currencies to gyrate at a different pace. Therefore, all these forecasts would be subject to continuous review with the evolving conditions.

GDP growth

The overall growth in the economy will definitely slow down relative to FY22 which has been pegged at 8.7% by the NSO. The factors that would be driving growth would be:

- Good farm output on the back of a normal monsoon. We admit that a good monsoon is not a guarantee for higher harvest and that there can be variations across crops given the distribution of the rainfall. Yet, this is a reasonable assumption to make as a normal monsoon is a necessary though not sufficient condition for a good kharif crop.
- Pent up demand to drive consumption to a certain extent especially in services, though high inflation can mitigate against this phenomena.
- Capex push by the central government and a limited extent by states will bring about some chain reactions from the private sector
- Industrial growth to be supported to an extent by the PLI scheme
- Being largely a domestic driven economy the disruptions to trade will not be a major stumbling block for domestic growth unlike in case of countries that are export dependent.
- Industrial growth expected to expand by 6-6.50% in FY23.

Table 1: India's Nominal GDP growth expected at ~15%

	FY18	FY19	FY20	FY21	FY22	FY23E
GDP growth Constant prices	6.8	6.5	3.7	(6.6)	8.7	7.2
GDP growth Current prices	11.0	10.6	6.2	(1.4)	19.5	15

Source: CEIC, Bank of Baroda Research I E: Bank of Baroda Estimates

Table 2: GDP to expand by 7.2% in FY23

Activities	Growth in 2022-23
Agriculture, forestry and fishing	3.5-3.75%
Mining and quarrying	4-4.5%
Manufacturing	5-5.5%
Electricity, gas, water supply & other utility services	6-7.0%
Construction	9-9.75%

Activities	Growth in 2022-23
Trade & repair services	9-10.0%
Financial	8.5-9.0%
Public administration and defence	7.25-7.75%
GVA	6.9-7.0%
Net Taxes	0.3%
GDP	7.2%

Source: CEIC, Bank of Baroda Research

The factors militating against growth would be:

- High inflation especially on food basket will come in the way of discretionary consumption.
- Capacity utilization rates in sectors such as those related to consumption may still be low to drive further investment.
- Government may have to cut back on capex to meet the fiscal targets as expenses on free food, fertilizer subsidy have increased.
- Corporate profitability may not be high this time as input costs may have to be carried by them. One round of price hikes did take place in second half of FY22 and companies may choose to wait and watch as inflation is very high today.
- Higher interest rates will mean that investment will be restricted to those industries that are doing well in terms of demand and hence can affect SMEs in particular.
- Job creation will be a continued challenge this year too.

Investment

The investment rate defined as the gross fixed capital formation rate has been coming down in the last few years though there has been an improvement in FY22 more due to statistical base and revival post the lockdown affecting FY21. The pace of investment will be driven by the following factors:

- The commitment of the central government to capex of Rs 7.5lakh crore.
- The states maintaining their share of capex which for FY22 was targeted at Rs 6.67 lakh crore.

- The improvement in capacity utilization which as of March'22 was 74.5%. Ideally a rate of 78-80% leads to new doses of investment.
- The interest rate regime especially when it comes to investment by the MSMEs.

The investment environment will still not be broad based and restricted more to the infra related sectors such as steel, cement, chemicals, and less on the consumer side involving industries like FMCG, drugs and pharma, durables, auto. Therefore we believe that there will be a growth of 14.7% in GFCF with the resulting rate in nominal terms being 28.8-29%.

Table 3: Growth in GFCF

	FY18	FY19	FY20	FY21	FY22	FY23E
Growth in GFCF current prices	11.0	15.6	3.0	(8.3)	28.4	14.7
GFCF as % of GDP	28.2	29.5	28.6	26.6	28.6	28.8-29.0

Source: CEIC, Bank of Baroda Research | E: Bank of Baroda Estimates

Agriculture to hold clue

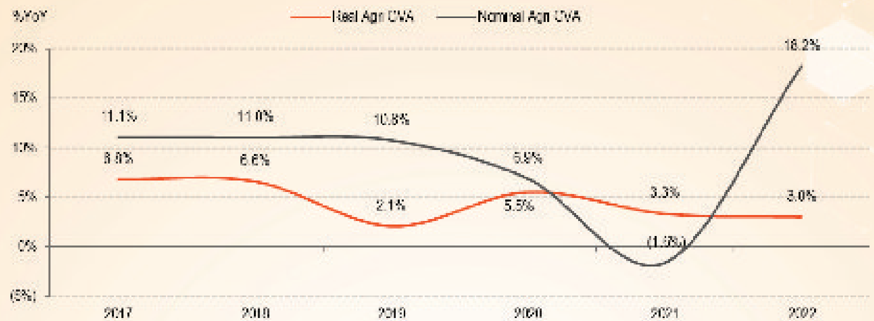
The IMD has predicted a good monsoon this year (4th year in a row) which is good news for both kharif as well as rabi crops. Our analysis shows that a good monsoon is a necessary though not sufficient condition for good agriculture output and what would be important is the spatial distribution as well as timing of arrival, progress and departure. Based on past trends and the present heat wave which has enveloped the country that has affected some of the rabi projections for the previous year, our projections are given below.

Table 4: Agriculture growth

	FY18	FY19	FY20	FY21	FY22	FY23E
GVA in agriculture	6.6	2.1	5.5	3.3	3.0	3.5-3.75
Foodgrains (Mn tonnes)	285.0	285.2	297.5	310.7	314.5*	320.0
Oilseeds (Mn tonnes)	314.6	315.2	332.2	359.5	385*	395-400

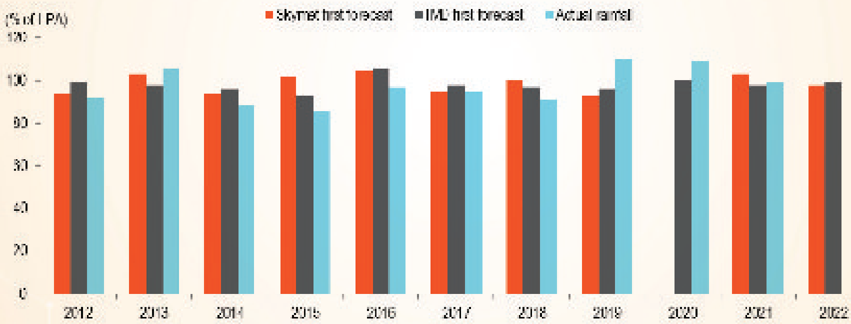
*Source: CEIC, Bank of Baroda Research | *3rd Advance Estimates, E: Bank of Baroda Estimates*

Figure 1: Agriculture growth over the years



Source: CEIC, Bank of Baroda Research

Figure 2: Expectation of normal monsoon by IMD in 2022



Source: CEIC, Bank of Baroda Research

Figure 2 above shows that monsoon is expected to be normal this season as depicted by both IMD and Skymet. We need to however monitor the arrival of the monsoon as it affects the cropping pattern. Further the spread of the monsoon across geographies is important as it has a bearing on specific crops prospects. While the northern states have better access to irrigation facilities, the same does not hold for interior India especially the central territory. Here it is imperative that monsoon is normal so that crops like soybean, pulses, cotton, maize are able to record satisfactory output. Also important is the withdrawal of the monsoon. It has been observed in the past that a late withdrawal of the monsoon in October-November has damaged crops at the time of harvest. This pattern has become more frequent in the last few years which can be a hurdle for the kharif crop. Therefore, a good monsoon is only a prerequisite for having a normal kharif crop and the other traits will guide the final outcomes.

Data on procurement of wheat and rice is provided below in Table 5.

Table 5: Procurement of rice and wheat

Year	Wheat	Rice
2013-14	25.09	31.85
2014-15	28.02	32.04
2015-16	28.09	34.22
2016-17	22.96	38.11
2017-18	30.83	38.19
2018-19	35.80	44.39
2019-20	34.13	51.83
2020-21	38.99	60.19
2021-22	43.34	57.9*
2022-23	18.8	

*Source: Ministry of Consumer Affairs, Food and Public Distribution | *As on: 30 Jun 2022*

It must be pointed out that food procurement has been a challenge for the FCI this year with procurement till June 30th for wheat being only 18.8 mn tonnes. Quite clearly the procurement for this season will be significantly lower than that in 2021-22 which can be attributed to a lower crop as well as diversion for the open market including exports.

To support kharif production for 2022 the government has increased the MSP at higher rate in order to ensure procurement targets are met. MSP of paddy, Jowar, oilseeds, cotton has been increased sharply by 5.2%, 8.5%, 8.9% and 6.2% respectively for the agriculture year 2022-23. We may expect similar increases for the rabi crops too this year.

Agricultural output prospects will be important from the point of view of both supply and demand. As it provides food to the people there is a direct impact of supplies and prices. For the food processing industry, availability at stable prices is the clue so that the process is seamless and smooth. On the demand side, a large part of the rural demand emanates from this segment and an increased income is necessary for sustaining growth of the consumer goods sector.

Furthermore, against the backdrop of the ongoing conflict between Russia-Ukraine, agriculture prices are bound to increase too with prices of wheat, diesel and fertilizers already registering an uptick.

Industrial prospects look mixed

One of the major driving factors of industrial growth will be the PLI which has been introduced by the government with an outlay of Rs 1.97 lakh crore spread over the next 3-4 years. The PLI is a very important part of the government's agenda on fostering industrial growth. It is an incentive based scheme and maps the subsidy which is given which is around 5% of turnover to companies which are able to fulfil certain obligations in terms of sales and investment over a period of 3-4 years. Hence rather than being a freebie, it is linked to performance.

The number of applications for the PLI in various sectors is given below which indicates the interest in the scheme. (These numbers are only indicative as they change regularly over time. The idea of presenting this information is provide indicative numbers on the response to this scheme by various companies).

Table 6: Status of PLI schemes

Sector	Scheme outlay (₹ crore)	Number of applicants approved
Large Scale Electronics Manufacturing	40,995	n.a.
Manufacturing of medical devices	3,420	21
Manufacturing of critical KSMs/ Drug Intermediates and APIs	6,940	49
Advance Chemistry Cell (ACC) Battery	18,100	4
Electronic/Technology Products	5,000	n.a.
Automobiles & Auto Components and Drone Industry	57,042	95
Automobile and Auto Component Industry	42,500	95
Drone and drone components	120	14
Pharmaceuticals drugs	15,000	55
Telecom & Networking Products	12,195	31

Sector	Scheme outlay (₹ crore)	Number of applicants approved
Textile Products: MMF segment and technical textiles	10,683	61
Food Products	10,900	149
High Efficiency Solar PV Modules*	24,000	3
White Goods (ACs & LED)	6,238	61
Speciality Steel	6,322	Last date for application extended to 31 May 2022
IT hardware	7,350	14

*Source: PIB, Bank of Baroda Research I *Allocation was increased in the Union Budget FY22 from an initial allocation of Rs 4,500 crore*

The sectors that have been exhibiting steady growth in turnover in FY22 and are likely also to see similar tendencies in FY23 are steel, cement, chemicals, food products. These would be the overall growth drivers. Consumer based industries like durables, FMCG, automobiles could face challenges in case high inflation comes in the way of discretionary expenditure. For FYTD23, industrial production rose to 12.9% compared with 67.3% last year.

On the negative side, the high base effect will tend to moderate growth numbers this year just like the low base effect helped to prop up number in FY22. Further, the present power crisis will come in the way of both the electricity sector as well as manufacturing, thus pressurizing overall growth. The government is still in the process of ensuring that power Gencos are adequately stocked with coal by ensuring that they increase their imports to regularize their supplies so as to have fewer interruptions. This can be a negative factor for manufacturing in case the issue is not resolved as with the arrival of monsoons, the supply of coal would be hampered.

Inflation will be a factor playing on demand for consumer goods. FMCG companies have already raised their prices of goods which will come in the way of demand. With prices of metals, rubber products, plastics going up, prices of automobiles as well as consumer durable goods would witness an uptick which will affect demand.

The table below gives our expectations of growth for different sectors for FY23

Table 7: IIP growth expected to slow to 4.25-4.75% in FY23

	FY18	FY19	FY20	FY21	FY22	FY23E
IIP growth	4.4	3.8	(0.8)	(8.4)	11.3	4.4

Source: CEIC, Bank of Baroda Research I E: Bank of Baroda Estimates

For FY23, it is expected industries such as furniture, computer, wood and food products will grow in the range of 5-10%. While, other industries including, textiles, tobacco, leather, paper rubber and electrical equipment will grow in the range of 0-5%.

Table 8: Sector-wise growth estimates

Growth range	Industries
0-5%	Textiles, Beverages, Tobacco, leather and related products, Paper, printing, coke and refined petroleum products, Rubber, other metals, Electrical equipment, other manufacturing
5-10%	Furniture, other transport, computer, electronic, Wood product, Food products

Source: CEIC, Bank of Baroda Research

Services sector to rise

A quick indicator of the progress of the services sector is the PMI for services which shows distinct improvement Since Feb'22 as the lockdown restrictions were eased for the sector and industries within were allowed to operate normally. There has been evidence of pent up demand driving operations of services as seen below for some critical service sectors.

	Units	Dec	Jan	Feb	Mar	Apr	May	Jun
Services PMI	Index	55.5	51.5	51.8	53.6	57.9	58.9	59.2
Railway freight	YoY	7.2	7.7	6.6	6.7	9.4	14.6	11.3
Air passengers carried	YoY	59.1	(8.7)	4.7	44.2	95.3	502	291
Air passengers carried	million	25.1	15.3	17.7	24.4	24.3	26.9	25.4

	Units	Dec	Jan	Feb	Mar	Apr	May	Jun
E-way bills	YoY	11.6	9.5	8.3	9.7	28.0	84.1	36.2
E-way bills	million	71.6	68.8	69.1	78.2	75.2	73.6	74.5
Port cargo	YoY	(0.6)	(2.8)	(4.5)	0.8	5.5	8.9	13.5
Diesel consumption	YoY	1.5	(6.4)	(0.9)	6.6	7.9	31.7	23.9

Source: CEIC, Bank of Baroda Research

With the re-opening of economy and removal of travel restrictions, tourism sector is benefiting. Air passenger growth a proxy for the same has seen revival in number of passengers flying every month. In FY22, air passengers carried rose to 189mn compared with 115mn in FY21. This implies an average of 15.8mn passengers every month versus 9.6mn passengers in FY21. However, this remains considerably lower than 341mn passengers carried in FY20 (run-rate of 28.4mn passengers/month), indicating there is potential for improvement in FY23 (current run-rate at 25.5mn passengers/month).

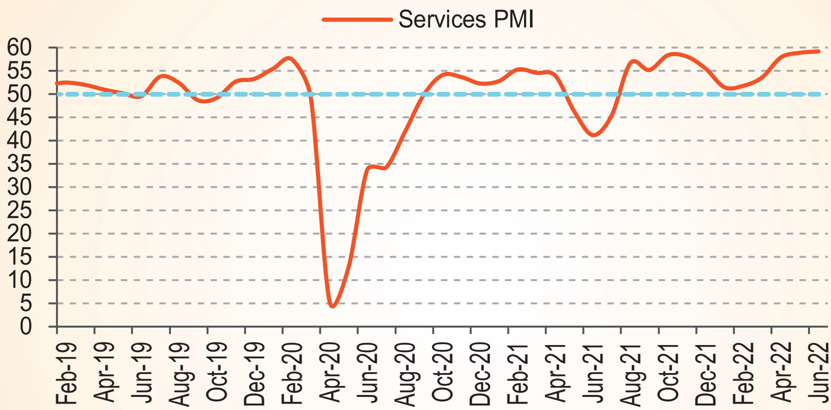
On the other hand, services PMI has already surpassed FY20 level (51.9) in FY22 (52.3). Latest print suggests that FY23 is on to an even better start with PMI index averaging 58.7 in Q1FY23 compared with 47.2 in the same period last year. Even rail freight, a key indicator of domestic trade, has shown pick up in pace in the early months of FY23, with freight volume growth averaging 11.8% so far (Apr-Jun) compared with 17.7% in FY22, and (-) 0.9% (FY20) and 5.3% (FY19) in pre-pandemic years.

Stamp duty collections, a proxy for real estate sector, had also gathered momentum in FY22 and remain on the same path even at the start of FY23 in Apr-May'22. Major states like Maharashtra, UP, Tamil Nadu, Karnataka, Telangana, Gujarat, have seen uptick in their stamp duty collections in FY22 and have even surpassed FY20 (pre-pandemic) levels. For instance, stamp duty collections of Maharashtra was above Rs 35,000 crore, up from ~Rs 29,000 crore in FY20. Similarly, in UP collections crossed Rs 20,000 crore versus Rs 16,000 crore in FY20. Telangana saw 1.9X jump with collections above Rs 12,000 crore compared with Rs 6,600 crore collected in FY20. Even at the start of FY23 (Apr-May), collections remain on solid footing with Gujarat collecting average Rs 1,090 crore as stamp duty compared with an average of Rs 869 crore every month in FY22. Similarly, UP has collected Rs ~1,967 crore (Rs 1,671 crore monthly average in FY22). Tamil Nadu (Rs 1,384 versus Rs 1,194 monthly average in FY22), Telangana (Rs 1,293 versus Rs 1,031 monthly average in FY22) and Karnataka (Rs 1,244 versus

Rs 1,168 monthly average in FY22), are also showing pick up. Stamp duty collections in Apr-May'22 were even higher than Apr-May'19 (pre-pandemic) for majority of the states.

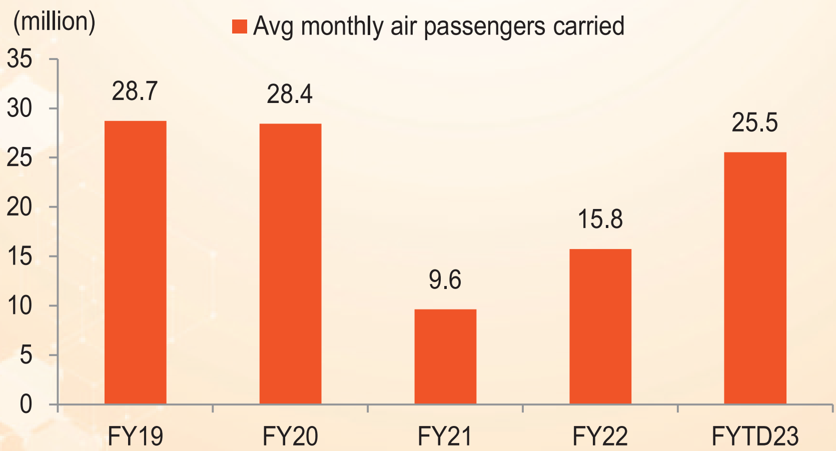
Another key variable showing improvement in economic activity is rising diesel consumption. In terms of volume, diesel consumption has risen by 10% in FY22, recovering from 11% decline in FY21 and 1% decline in FY20. Even in FY23, consumption growth has averaged 21.2% in Q1FY23.

Figure 3: Services PMI showing improvement



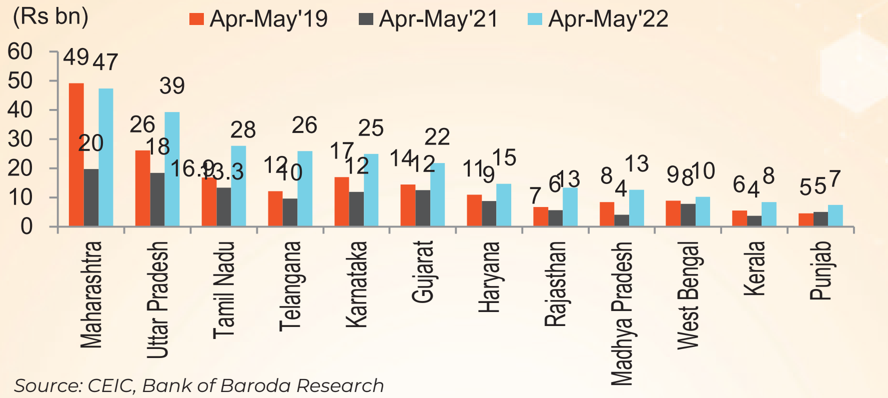
Source: Markit, Bank of Baroda Research

Figure 4: Monthly airline passenger traffic picking up



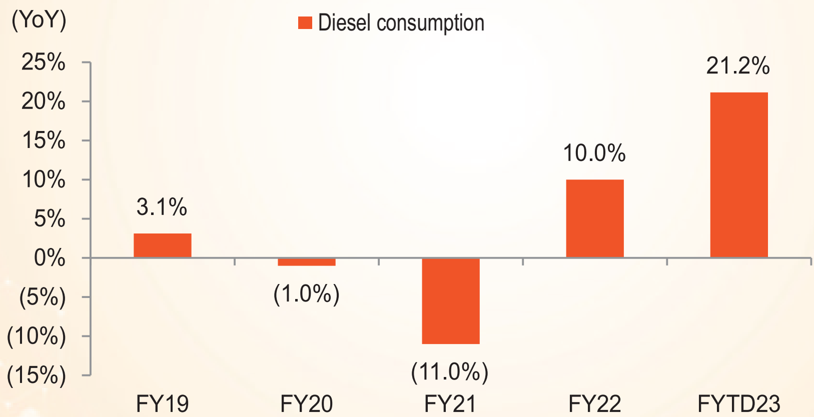
Source: CEIC, Bank of Baroda Research

Figure 5: Stamp duty collections of states robust in Apr-May'22



Source: CEIC, Bank of Baroda Research

Figure 6: Diesel consumption on an uptrend so far



Source: CEIC, Bank of Baroda Research

Keeping in view the current trends in high frequency services indicator, we expect that the major segments of the services sector will have the following prospects:

- Hotel industry will recover sharply this year along with an improvement in the tourist arrival and corporate travel returning to normal. All elements of the MICE segments are to witness turnaround. Meetings, incentives, conferences and exhibitions which are within the realm of corporate activity will witness a turnaround this year notwithstanding the other negative factors especially related to war induced inflation.

- Trade at both the wholesale and retail levels will normalize as the removal of restrictions will provide a boost to the retail segment.
- Warehousing and storage will receive another boost with the proliferation of trade as well as the demand for storage of farm products which is the main challenge today.
- Banking and finance will continue to move on a stable path with steady growth in deposits and credit.
- Real estate sector will also benefit from the pent up demand, though the major challenges will be in the cost area as prices of all inputs have gone up especially cement and steel which can affect demand. But commercial demand for office/business space will revive as most companies are now better placed to assess the requirement as the hybrid work space has now been defined by most of them.
- Public administration and other services will continue to grow by the trend rate as there will be no compromise on government expenditure under the present circumstances.

Based on performance of these segments we expect the services sector to grow by 8-8.5% in FY23.

Inflation: Not a shock but a habit

Inflation will be the Achilles heel this year for sure, given the prevailing trends in the economy. There is concern on both CPI inflation which is tracked by the MPC, and WPI which reflects how producer prices are getting aligned. The price environment is going to be guided a lot by a series of factors.

First would be the farm prospects and price movements which will be hard to conjecture today, as price shocks for products like tomatoes, onions and potatoes, which have been an annual feature especially post monsoon time can skew inflation numbers. Second, the global crude oil price holds a clue not just for fuel prices but also derivative products going through the supply chain including fertilizers, chemicals, plastics etc. Third, supply disruptions have also led to changes in global trade in farm products. Edible oil shock has been compounded with a wheat disruption that has led to high food inflation. Fourth, industry is already in the process of passing on higher input costs to final buyers due to the commodity price boom witnessed in 2021. With this second round of price increases there would be some pressure to consider options. Last, the government has already increased the MSPs quite aggressively this year which will have a bearing on benchmark prices in the market even where there is no direct procurement.

Under the present conditions where there are supply constraints there may be a temptation to increase prices further leading to higher inflation.

The two tables below clearly illustrate that both demand and supply side factors have impacted India's inflation print off late. Food inflation especially for items such as edible oils, cereals have been a result of supply shock. However, post lockdown with opening of services at full capacity, demand side pressure is visible in core inflation. Clothing, footwear, both durable and non durable inflation firmed up, clearly indicating that demand side pressure is gaining momentum.

Table 10: Pressure points in food inflation especially in vegetables, edible oils, protein based items

Components of food inflation	Wts	Inflation, YoY					
		FY20	FY21	FY22	Apr'22	May'22	Jun'22
CPI Food	39.1	6.7	7.8	3.8	8.3	8.0	7.7
Cereals and Products	9.7	2.8	3.9	0.6	6.0	5.3	5.7
Meat and Fish	3.6	9.3	15.4	8.0	7.0	8.2	8.6
Egg	0.4	4.5	12.8	8.1	0.0	(4.6)	(5.5)
Milk and Milk Product	6.6	2.9	5.4	2.8	5.5	5.6	6.1
Oils and Fats	3.6	2.9	15.9	27.7	17.3	13.3	9.4
Fruits	2.9	0.8	2.6	6.2	5.0	2.3	3.1
Vegetables	6.0	21.8	6.4	(6.0)	15.4	18.3	17.4
Pulses and Products	2.4	10.0	16.5	6.1	1.9	(0.4)	(1.0)
Sugar and Confectionery	1.4	0.9	2.6	2.4	5.2	4.3	4.2
Spices	2.5	4.3	11.0	5.3	10.6	9.9	11.0

*Source: CEIC, Bank of Baroda Research I Note: Components whose Apr'22 and May'22 and Jun' 22 inflation print surpassed 6% have been highlighted. *In double digit inflation for past 26months*

On the other side, the lockdown in China has slowed down the demand for commodities which will have a soothing effect. This will reverse as the economy opens up again. Further, with central banks across the world increasing their policy rates there is reason to believe that there will be moderation in demand which in turn will bring down commodity prices. At the domestic end a good well spread monsoon can regulate the prices. Also to the extent the repo rate hikes, which are expected to take it up to 5.4-5.65% work, excess demand forces can be curbed.

On the statistical side, there will be a comforting factor that can take inflation rate downwards even in the absence of prices moderating significantly. In particular the months of Jul and Aug 2022 will have some tempering effect as CPI inflation was high last year in these months. Further, government's supply side measures taken off late in terms of excise duty cut and also on edible oil prices front, would also provide some respite.

Table 11: Major items of core inflation showing upside risk

Components of Core	Wts	Inflation, YoY					
		FY20	FY21	FY22	Apr'22	May'22	Jun'22
Core Inflation	47.3	4.0	5.7	6.1	7.1	6.0	5.9
Pan,Tobacco and Intoxicants	2.4	4.2	9.9	4.6	2.7	1.1	1.8
Clothing and Footwear	6.5	1.6	3.4	7.2	9.9	8.9	9.5
Housing	10.1	4.5	3.3	3.7	3.5	3.7	3.9
Miscellaneous	28.3	4.4	6.6	6.7	8.0	6.8	6.3
w/w Household goods and Services	3.8	3.1	3.0	5.8	8.0	6.8	7.5
Durable	0.7	2.4	3.3	6.1	6.7	7.9	7.9
Non-Durable	3.1	3.2	3.2	5.8	7.6	6.1	6.9
Health	5.9	6.3	5.1	7.5	7.2	5.4	5.5
Hospital expenses	0.4	8.0	4.6	6.3	6.8	6.1	6.3
Medicine Non-Institutional	5.4	4.8	4.8	6.1	6.5	4.6	3.7
Others	0.1	10.9	2.3	6.4	7.8	6.1	6.4

Components of Core	Wts	Inflation, YoY					
		FY20	FY21	FY22	Apr'22	May'22	Jun'22
Transport and communication	8.6	2.4	9.8	10.1	10.9	9.5	6.9
Petrol, Diesel & Other lubricants	2.4	(1.3)	8.9	15.7	15.4	12.4	5.0
Transportation fares	4.0	1.8	13.9	9.0	8.3	8.6	5.5
Communication	2.2	3.1	6.1	5.6	6.0	5.1	4.9
Recreation and Amusement	1.7	4.9	5.1	6.5	7.3	6.0	7.0
Education	4.5	5.5	2.8	2.9	4.1	4.2	4.5
Books, Journals, Stationery etc.	0.9	4.4	3.8	4.2	4.5	3.2	3.6
Tuition fees & Others	3.5	5.0	3.0	4.5	4.0	2.6	5.4
Personal Care and Effects	3.9	5.6	11.3	4.3	8.6	6.2	6.7
Gold, Silver and other ornaments	1.2	11.4	30.6	7.7	5.2	0.4	(0.7)
Others	2.7	2.5	3.1	5.2	6.2	5.7	5.2

Source: CEIC, Bank of Baroda Research, Note: Components whose Jun'22 inflation print surpassed 6% have been highlighted.

On balance we do expect the following.

- There will be further increases in food prices due to the MSP effect.
- Crude oil prices will remain in the range of US$ 100-110/bbl for the year on an average basis. The best case is moving to the US$ 90-100/bbl range.
- There can be further increases in retail fuel prices as presently the OMCs have kept this in abeyance given the high inflation in the country.
- Secondary impact of higher crude oil prices through higher freight costs will be felt in the course of the year.

Table 12: Inflation to remain elevated in FY23

	FY18	FY19	FY20	FY21	FY22	FY23E
WPI inflation	2.9	4.3	1.7	1.3	13.0	12.0
CPI inflation	3.6	3.4	4.8	6.2	5.5	6.5

Source: CEIC, Bank of Baroda Research I E: Bank of Baroda Estimates

Monetary policy action: Only upwards

The MPC has shown a distinct turn to focus more on inflation than growth which was the goal pursued since the pandemic set in. The Apr'22 policy maintained a status quo on rates though there were indications given that there would be gradual withdrawal of accommodation. This was expedited in the interim policy in May'22 when the repo rate was increased by 40bps. In June the policy hiked the repo rate by another 50 bps with the stance now being in terms of withdrawal of accommodation.

We do believe that the withdrawal of accommodation will be to begin with restricted to the extra length the Committee went through in 2020 by lowering the repo rate to 4% from 5.15%. Therefore there will be further increases in the repo rate and we do expect that the financial year will see at least another 50-75bps with the possibility of more hikes depending on the evolving inflation situation. With average CPI inflation expected to be in the region of 6% this year, the real interest rate will be negative even at 5.4-5.65% repo rate.

In terms of sequencing of repo rate hikes it would be another 50-75bps rate hike in the current cycle to pertain the catch up effect and maintain price stability.

Banking to be steady

The banking system will continue to witness stable growth in business, though there could be moderation at the margin for credit and deposits growth.

Growth in bank credit will be driven by overall GDP growth. Retail credit is expected to continue to be the main driver for the banking sector. The continued focus of the government on housing will drive demand for credit. The question would however be whether or not the pace of last year will be sustained as with rising interest rates, the cost of finance will increase. As the EMIs matter more for this segment, with demand for housing expected to be stable, we may expect credit to be largely less affected except at the margin. Housing demand is more likely to be affected by home prices which have been rising as developers adjust the prices due to the higher raw material costs.

Credit to industry will be what has to be watched for. Higher cost of credit will come in the way of credit demand for SMEs in particular. They have already been buffeted by the lockdown and the subsequent waves of Covid-19. Further, the global disruption caused on price front will tend to militate against their operations and hence their business levels may not be at optimal levels. The decision on restructuring of their loans will have a role to play.

Large industry will continue to borrow from banks, though the debt market may provide a cheaper alternative to the best rated companies. Overall growth in credit this year may be expected to be around 11%.

With deposit rates going up along with the repo rate, savings will be rechannelled to banks. We do not expect the deposit rates to go up commensurately with the repo rate hikes as there is still surplus liquidity in the system. Further, volatility will continue in the capital market thus making banks deposits more attractive in relative terms. Debt funds which offered better returns so far will now reverse such benefits in a rising interest rate scenario. Other alternatives too like crypto will be less attractive given not just the state of the market but also the tax laws. This will be beneficial for the banking system which has been at a disadvantage in the low interest rate regime.

Table 13: Bank deposits and credit growth

	FY18	FY19	FY20	FY21	FY22	FY23E
Bank deposits growth	6.2	10.0	7.9	11.4	8.9	11-12
Bank credit growth	10	13.3	6.1	5.6	8.6	10-11

Source: CEIC, Bank of Baroda Research I E: Bank of Baroda Estimates

Bond yields to rise

Bond yields have been driven by not just the repo rate but also market factors. First, the size of the government borrowing programme as well as the progress on the fiscal side tend to influence these yields. Every time there are announcements made on the supplementary budget, yields can go up due to the expected higher fiscal deficit. Second, the inflation rate and perspectives of the same have a bearing on the bond market which tend to be forward looking. Third, the developments on the global front cannot be missed out. These include both what the Fed does or is likely to do as well as well as bond yield movements in these markets. Fourth, the developments in the currency market also have their role to play on the bond yields. Fifth, the state of the liquidity in the system is critical too as any contraction can lead to higher yields.

The ultimate movement in yields will be due to a combination of these factors and hence the prevalence of surplus liquidity will not ensure that yields remain low. Surplus liquidity has come down in the last few weeks due to a combination of the CRR hike invoked by the RBI as well as normal course of banking business.

For the year, the government borrowing programme at Rs 16 lakh crore is large and inflation is expected to reign at a high level with the repo rate being increased to at least 5.40-5.65%. Global rates will be elevated with the Fed likely to increase its rate to the range of 3-3.5%. There will be question marks on the fiscal deficit as expenditure on good and fertilizers subsidy will increase given the state of affairs today. The states too will be pressurized though going by the past the deficits are unlikely to be exceeded as they tend to cut back on expenditure to rein in the deficits and hence borrowings.

Under these conditions we expect the 10-year bond yield to reach the range of 7.75-8% by the end of the year.

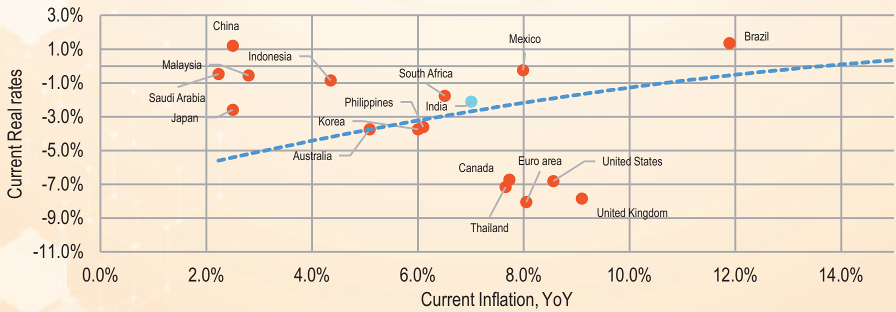
Table 14: 10Y G-Sec yield to remain elevated

	FY18	FY19	FY20	FY21	FY22	FY23E
India's 10Y yield (average)	6.93	7.7	6.7	6.0	6.3	7.75-8

Source: Bloomberg, Bank of Baroda Research I E: Bank of Baroda Estimates

Another argument which can be put forth is that India still has a very high negative real rates. This leaves RBI with more option to maneuverer the policy rate (in terms of raising rates), so that the negative real rates actually don't dent savers and in turn investors and have a second round downward impact on growth.

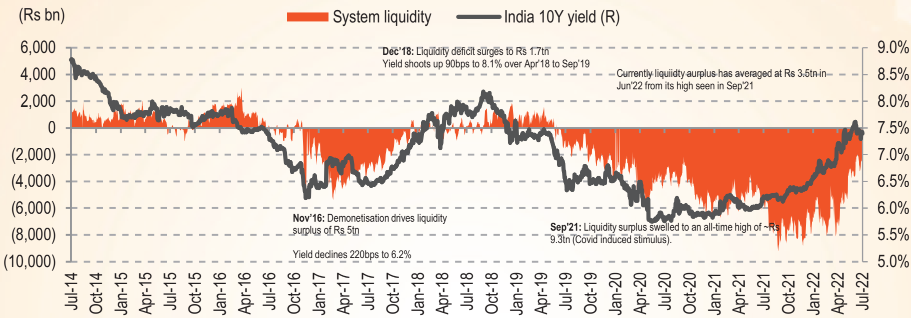
Figure 7: India still has a very high negative real rates



Source: BIS, Bank of Baroda Research

Historically, as seen in the fig 8 below, with withdrawal of liquidity support from RBI, yields also inch up. Liquidity surplus has averaged to Rs 2.9tn in Jun'22 which is far lower compared to Rs 4.3tn in May'22 and Rs 6.5tn in Apr'22. This might also put pressure on yields.

Figure 8: Liquidity normalisation is clearly visible with withdrawal of surplus liquidity, thus yields will rise



Source: RBI, Bloomberg, Bank of Baroda Research, Data till 13 Jul 2022

Fiscal scene to be tenuous all the time

The government has shown resolve in controlling the fiscal deficit even below (6.7%) the targeted level of 6.9% for FY22. This was notwithstanding the additional expenditure that had to be incurred due to the relief measures announced during the course of the year. Consolidation was supported by buoyant revenue growth and upward revision in nominal GDP.

For FY23, the factors working in favour of the fiscal balances being maintained are the following:

- Revenue collections have been good in April and May'22 and the compliance rate has improved leading to better tax collections. Given that growth in real GDP will be ~7.2% this year amounting to 15% in nominal terms, tax buoyancy will be retained and there could be higher collections too. This however, may not be ideal way of growth taking place as there should be a higher share of real GDP growth in this number.
- It may be pointed out that high inflation has pushed up the nominal GDP growth rate in FY22 and will also do so this year which will be beneficial for tax collections.

- Revenue collections will also be supported by high inflation resulting into buoyant indirect tax collections, and custom duty collections due to elevated global commodity prices.
- The disinvestment programme of LIC has been completed. There is less pressure now and the government could roll out plans for the other companies to ensure that we are closer to the target of Rs 65,000crore.

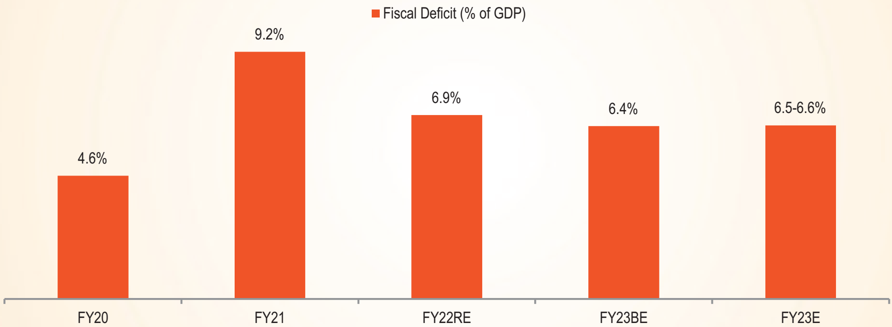
On the other side, there are pressures that can come in the way of achieving the target of 6.4% fiscal deficit.

- The RBI transfer of Rs 30,307 crore is much lower than that last year. This will mean higher contributions have to come from other PSU financial institutions.
- The government has extended the free food relief scheme till Sep'22, which will involve higher outflows. As per centre's own estimates, this will cost the ex-chequer ~Rs 80,000 crore.
- In addition, government has also announced slew of measures to tame inflation and lower the price burden on consumers. These measures include: Rs 8/lt cut in additional excise duty on petrol; Rs 6/lt cut in additional excise duty on diesel; additional; Rs 1.1 lakh crore fertilizer subsidy (over and above Rs 1.05 lakh crore budgeted for FY23); Rs 200 subsidy per gas cylinder (upto 12 cylinders) to ~9 crore beneficiaries of PM Ujjwala Yojna; reduction in customs duty on raw materials and intermediaries for plastics products, and iron and steel. Export duty has been levied on some steel products (up 15%) and iron ore (up to 50% from 30% earlier). Import duty on ferronickel, coking coal, PCI coal has been cut from 2.5% to 0%, while the duty on coke and semi-coke has been cut from 5% to 0%. Import duty on Naphtha has been reduced to 1% from 2.5%, and on PVC to 7.5% from 10%. These measures are expected to reduce the cost of final products.
- Reduction in additional excise duty on petrol and diesel will solely impact revenues of the Centre, as that duty is not shared with states. Government revenues will suffer a loss of Rs 1 lakh crore due to this. In addition, additional fertilizer subsidy will push the overall subsidy bill up to Rs 4.3 lakh crore from the budgeted Rs 3.2 lakh crore. Fertilizer subsidy will now stand at Rs 2.15 lakh crore. Cost of providing subsidy on gas cylinders will also cost the exchequer Rs 6,100 crore.
- The increase in MSPs will also mean that the food subsidy bill will be under pressure as there will also be aggressive buying to ensure that the old situation is reached.

- Interest cost on borrowings would go up as the repo rate is increased and bond yields increase. Based on the budgetary calculation of total outstanding liabilities and interest payment, interest rate was coming around 6.5% in FY23. If we assume interest rate to be elevated at 7.5%, which is about 100 bps higher, interest payment of the centre will increase by ~Rs 15,000 crore from Rs 9.4 lakh crore estimated for FY23 in the budget documents.

The benefit on the fiscal side will however be the higher base of GDP growth due to higher inflation. This will allow fiscal slippage to be range bound and not exceed 6.6%. However, in case of even higher nominal GDP, or cuts in expenditure, government might be able to meet its target of 6.4% fiscal deficit in FY23.

Figure 10: Fiscal deficit as % of GDP



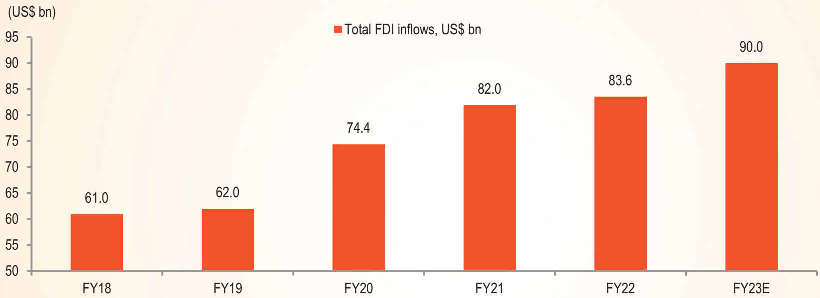
Source: CEIC, Bank of Baroda Research I E: Bank of Baroda Estimates

Foreign investment

Foreign investment has played a very important part in stabilizing our balance of payments especially when the current account deficit was high. For the last couple of years however, the CAD has not been an issue with a surplus being witnessed in FY21. However, with conditions changing and the CAD expected to be at 3% of GDP, there will be reliance on capital flows to steady the boat. The forex reserves have already fallen to less than US$ 600bn. There have been expectations of the ECB market providing support. More recently RBI increased the ECB limit under the automatic route to US$ 1.5bn from US$ 750mn earlier. However, with interest rates rising overseas and the rupee being volatile, the impact of these measures may be muted. In this context foreign investment will be looked at closely.

FDI has touched a record US$ 83bn in FY22, and with positive policies being pursued by the government, we may expect an increase to US$ 90bn this year. There will be challenges of fewer funds flowing across the globe due to quantitative tightening searching for various markets to invest. We do believe that given the significant upward direction in investment by foreign players, India is still seen as a very rich place to invest. With government policies being progressively pro-business and significant lacuna in various sectors for funds especially infrastructure, these flows will remain steady in a similar range. However, this said, the upside may be limited to another US$ 5-10bn, taking the total investment flows to the region of ~US$ 90bn.

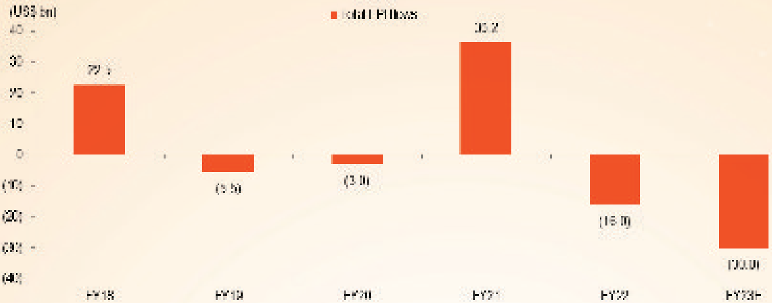
Figure 11: FDI inflows into India have remained buoyant



Source: DIPP, Bank of Baroda Research I E: Bank of Baroda Estimates

The global markets have been volatile this year and will continue to be for the rest of the months. Portfolio investors will be continuously evaluating alternatives and hence will tend to be whimsical. While higher interest rates in the West can divert funds into the debt segments (sovereign and private), the QE programme of the Fed will reduce the quantum of investible funds. Both this will combine to make emerging markets compete harder for funds. FPIs will also consider the currency strengths of various countries as expected depreciation will lower real returns on investment. Under these conditions FPIs cannot be relied upon significantly to provide support to the balance of payments this year. FPI has been whimsical in the past, turning negative in 3 of the last 5 years. This cannot be relied upon to steady the BOP. In FY23 so far, FPI have pulled out net US$ 14.9bn from the Indian markets so far (upto 11 July 2022). To counter this and support the exchange rate, RBI recently announced measures to spur FPI flows in the debt segment. However, with a global risk-off sentiment amidst fears of a global recession, FPIs are likely to shun riskier EM assets. In FY23, we expect FPI outflows to be around ~US$ 30bn, assuming investor sentiment picks up in the latter part of the year.

Figure 12: FPI inflows muted



Source: DIPP, Bank of Baroda Research I E: Bank of Baroda Estimates

Foreign trade

India's exports remained buoyant in FY22 on the back of a recovery in global growth and touched a record high of US$ 419.7bn. For FY23, we expect export growth to be steady and a lot will depend on how the global economy fares in the year. With China slowing down, overall flows would tend to slow down. Also the policies followed by various central banks can slow down the pace of economic growth, affecting foreign trade.

Table 15: Trade deficit to surge further

US$ bn	FY18	FY19	FY20	FY21	FY22	FY23E
Exports	303.5	330.1	313.4	291.8	419.7	450.0
Imports	465.6	514.1	474.4	394.4	611.9	700.0
-Oil	108.7	140.9	130.6	82.7	161.1	190.0
Trade Deficit	(162.1)	(184.0)	(161.4)	(102.6)	(192.2)	(250.0)

Source: CEIC, Bank of Baroda Research I E: Bank of Baroda Estimates

India may look at opportunities in the following sectors to push exports. Agricultural exports have remained buoyant and with the space created by the Russia-Ukraine war, India can look at filling some of the gap created. Textiles and footwear exports too offer a lot of potential. For the year we expect 8% growth in exports.

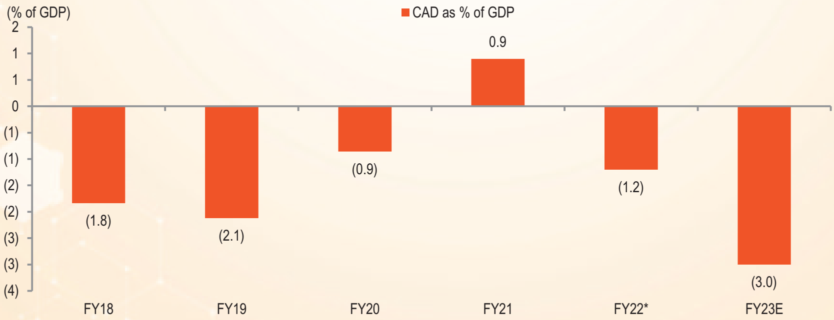
India's imports too expanded swiftly to US$ 612bn in FY22 amidst a pickup in domestic economic activity as well as higher commodity prices. In FY23 as well, imports would tend to rise swiftly. In Q1FY23, imports have risen sharply to US$ 187.4bn compared with US$ 127bn in Q1FY22. This has been led by oil imports, which have almost doubled from US$ 30.9bn in Q1FY22 to US$ 60.1bn this year as oil prices have risen sharply. Even non-oil-non-gold imports have noted an uptick. There has been some softening in global commodity prices lately amidst fears of a global recession, which will be positive for India. Oil prices too have softened to below US$ 100/bbl. Further, government's recent move to hike import duty on gold should help deter gold imports which have been surging in recent times. However, with the economy picking up steam, there will increase in demand for inputs and capital goods. Coal imports have been increasing despite higher global prices, amidst a shortage in domestic coal production due to an increase in power demand. Overall, we expect imports to grow by 15% this year.

As imports rise faster than exports, trade deficit is likely to inch up further in FY23. Overall, we expect trade deficit at a record high of ~US$ 250bn, or 7.3% of GDP.

Current account balance

With trade deficit at a historic high, invisibles are likely to offer some support to the CAD. Invisible receipts particularly software receipts and remittances are likely to remain buoyant. Overall invisibles balance is expected at US$ 150bn. This implies a CAD of ~US$ 100bn or around 3% of GDP this year.

Figure 13: CAD at 3% of GDP in FY23



*Source: RBI, Bank of Baroda Research I * Data upto Dec'21, E: Bank of Baroda Estimates*

Overall, with a current account deficit of ~US$ 100bn and capital account offering a surplus of ~US$ 60-65bn only, forex reserves may see a depletion of ~US$ 35-40bn. It must be noted that this is based on the assumption that FPI outflows will be contained at US$ 30bn in FY23. However, as has been seen in the past, FPI flows tend to be volatile, and hence can affect these projections.

Currency

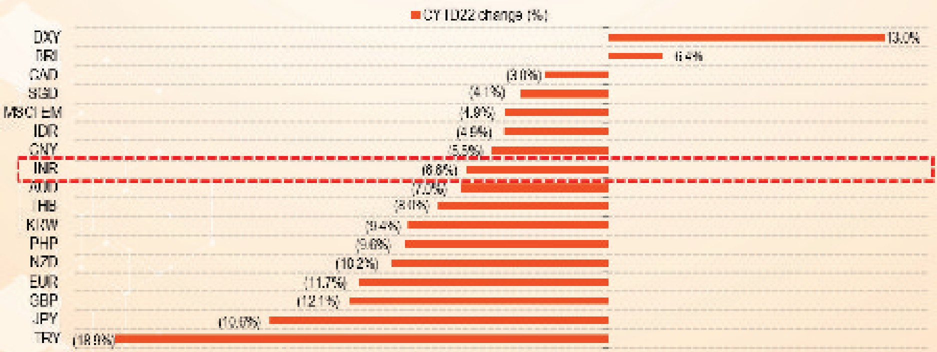
INR depreciated to a record low of 79.6/$ on 12 July 2022 as expectations of a faster pace of monetary tightening by Fed and rising US 10Y yield pushed dollar to a 20-year high. US dollar has also found support on safe-haven demand as fears of a global recession have magnified recently.

On the domestic side, higher inflation, persistent FPI outflows and elevated trade deficit will continue to weigh on INR. Apart from its intervention in the forex market to prevent any sharp movements in the exchange rate, RBI also announced measures to boost capital inflows to counter the increase in CAD. However, with strong global headwinds and weak domestic macros, INR is likely to remain under pressure.

The rupee has been affected by both fundamentals as well as external forces. The latter includes the Fed action and the strengthening of the dollar against other currencies. It has been observed that as the dollar strengthens in the global market all other currencies tend to decline and hence the rupee has also moved in the similar direction. However, it can be seen that the performance of the rupee has been steady with the depreciation being at almost the median level for the range of major currencies.

RBI's foreign exchange reserves at US$ 588.3bn (as of 1 July 2022) give it ample room for the same. For FY23, we expect INR in the range of 78-80/$.

Figure 14: Global currencies movement



*Source: Bloomberg, Bank of Baroda Research I * Data up to 12 July 2022*

Concluding remarks

FY23 will be year of consolidation for the economy. The progress made in FY22 was significant from the point of view of the economy recovering to the pre-pandemic level after having two setbacks during the year in the form of Covid-19 attacks and responses from the government in terms of restrictions on economic activity. The current year hopefully will not witness a lockdown even in case of a Covid-19 attack. However, the war has been the extraneous event that has disrupted the global economy and has led to high inflation which governments and central banks are combating. Therefore the high pace growth which was expected at the time of drawing up the Budget has been tempered today with these shocks manifesting in the financial indicators. The approach is hence more cautious when making forecasts and is susceptible to change depending on the evolving conditions.

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