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Economic Wrap: March 2022

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With continuing war between Russia and Ukraine, commodity prices remain elevated. Global markets are analysing the impact of this on global inflation and trajectory of growth. Rise in Covid-19 cases in China have posed another downside risk to economic recovery. On the domestic front, Rs 6.4/lt rise in retail fuel prices this month added to inflation burden on consumers. We expect RBI to take note of this and consider changing its accommodative stance in the upcoming Apr'22 meet.

War continues: Full scale war between Russia and Ukraine continues to dominate global markets. As a result of the war and stiff economic sanctions imposed on Russia, global commodity prices have increased hsarply. In particular, international crude price is hovering above US$ 110/bbl with 9% (MoM) increase since the war started. Gold is also up by 2%. Prices of food commodities too remain elevated. The impact of this is also visible in domestic fuel prices, which have gone up by Rs 6.4/lt since 22 Mar 2022. However, with rise in new Covid-19 cases in China and announcement of stringent lockdown restrictions, pose downside risk to oil and other commodity prices. It also poses downside risk to global economic recovery.

Global Central Banks on the move: US Fed has begun its rate hike cycle with 25bps increase in its Mar'22 policy meeting. More aggressive rate hikes (~50bps) are expected in the upcoming meetings to tame rising inflation. BoE has also hiked rate (by 25bps) for the third consecutive time now On the other hand, BoJ remains on hold and continues to keep its policy accommodative to support 10Y yield.

Key macro data releases: Latest data shows that India's eight core industries continued its upward momentum as it rose to a 4-month high of 5.8% in Feb'22 compared with a growth of 4% in Jan'22. Separately, India's current account deficit (CAD) widened to a 13-quarter high of 2.7% in Q3FY22 (US$ 23bn) compared with 1.3% of GDP in Q2FY22 (US$ 9.9bn). Trade deficit rose by US$ 16bn led by sharp jump in both oil and non-oil imports.

Centre has also announced its borrowing calendar for H1FY23, pegging borrowing at Rs 8.45tn (59% of total). Net borrowing in H1 is estimated at Rs 6.18tn (Rs 5.35tn last year). However, borrowing through T-bills will be slightly lower in H1 at Rs 4.32tn compared with Rs 4.68tn last year.

CPI inflation rose to 6.1% in Feb'22 against market consensus of 6%. Notably, inflation surpassed its Jan'22 level which was supposed to be the peak as said in the RBI's policy statement. Going forward, we expect CPI to be ~5.5-6% in FY23. Upside risks persist and all eyes are now on RBI's policy decision due next week.

Global developments

Russia-Ukraine war

Tensions between Russia and Ukraine continue to effect global markets (equities/commodities/debt/currency). Post the announcement of war, prices of major commodities have risen sharply. Commodities where Russia and Ukraine have a comparative advantage have been impacted significantly. Crude prices rose by 9% post war. Prices of Palladium which is used by automakers for catalytic converters to curb emissions shot up to its 7-month high, in Mar'22. Russia is the biggest producer of palladium (91MT in 2020 compared to 80MT in 2015) and control's 40% of global production. This is an important commodity as the world is focusing on ESG goals. Aluminium prices also hovered at a near record high level in Mar'22. Edible oil prices are also likely to go up. Notably, edible oils have a share of 2.9% in CPI and 1.1% in the WPI basket respectively.

Sovereign bond yields (10Y) too have inched up sharply on the back of expectation of elevated inflation and aggressive rate hiked by global Central Banks. US and Germany's 10Y yields have gone up by 37bps and 38bps, respectively, since the war started. In case of UK, yield was up by 16bps. India too has witnessed 8bps rise in 10Y yield.

Central Bank decisions

Globally, central banks (except Japan) remained hawkish on account of inflationary concerns following increase in commodity prices (especially crude). US Fed raised its federal fund rate for the first time since CY18 by 25bps. FOMC members expect around 6-7 rate hikes in CY22. As per their projections, median fund rate is likely to be 1.9% in CY22 (0.9% projected in its earlier meeting) and 2.8% in CY23 (1.6% projected earlier). Inflation projections at 4.3% for CY22, is far higher than its targeted 2%.

Bank of England also raised rates in Mar'22 by 25bps, its third consecutive rate hike. It expects inflation to reach 8% in Q2CY22 (earlier it was expecting peak of 7.25% in Apr'22).

On the other hand, Bank of Japan continues to provide monetary stimulus through unlimited bond buying, to keep interest rates low and to support growth.

Where are commodity prices headed?

The escalating geopolitical tension between Russia and Ukraine have impacted rather rattled commodity prices to the full extent. Since 24 Feb 2022, when the first fiery speech of Russian President came up, international oil prices shot up by ~21%. In absolute terms, crude prices went up by US$ 20/bbl to its current trading level of US$ 116/bbl.

Not only oil, other commodities also faced the brunt of it. Wheat prices are currently at its 14-year high. Aluminium prices also rose to its record high levels. Notably, in 2014, when Russia annexed Crimea, then a Ukrainian territory with majority of Russian population, international oil prices (20 Feb 2014), were trading at US$ 110/bbl.

What Russia and Ukraine's trade basket says?

Further, we have looked closely at the exports basket of Russia and Ukraine, to understand which commodities will be impacted the most in the near term. Evidently, crude oil has the major share followed by petroleum products and natural gas. Other than that, Russia also exports coal, metals, petrochemicals and fertilizer. Notably, Russian high-quality exports meet 10% of European coal-fired plant demand.

OPEC has already signalled that it would not ramp up production to lower prices. Thus, oil would continue to see fairly volatile prices till the war ends and be in the range of $ 100-120/barrel.

Another important commodity which is worth speaking of is Palladium. It is used by automakers for catalytic converters to curb emissions. Russia is the biggest producer of palladium (91 metric tons in 2020 compared to 80 metric tons in 2015). This is an important commodity as the world is focusing on ESG goals.

Speaking of Ukraine, cereals has the major share in export basket followed by iron and steel and animal or vegetable fats. Within cereals, corn, wheat, rapeseed and soybeans constitute the major share. Agri Index (Roger) thus increased by 4%, post the announcement of war.

We believe the uptrend in commodity prices are likely to persist until some dialogue of diplomacy is forthcoming.

Special studies

Does FPI drive the Markets?

Amongst emerging countries, India has remained a bright spot for foreign investors. The long term relation between FPI (equity) and Equity markets is positive based on monthly data. However, based on daily data the relation is weak. These are some of the results that come from the regression analysis of stock market movements on flow of FPIs. Similar analysis was conducted on Mutual Funds and results reflect that they are not a significant driver of equity indices like Sensex.

What is the role of institutions in driving stock markets? There are two sets of institutions that are large investors in the market and could be driving the same- FPIs and mutual funds. In recent months, global markets have been volatile due to escalated geo political tensions between Russia and Ukraine. The impact of the same can be seen across different asset classes. Indian markets have ended in the red in the recent past with volatile FPI (equity) flows. Mutual funds also have a role to play in the market being large investors in the equity space. Their actions at times have countered those of FPIs.

While analysing the dataset it has been seen that relation between FPI and equity markets has largely been a positive one especially for a longer time span. Over the last 8 years there has been a strong positive correlation (0.6) between the FPI equity flow and returns on Sensex. Notably, there is direct relation between the two. Previously, in the year 2015 it was seen that FPI (equity) investment had dropped to US$ 3.3bn in 2015 from US$ 16.2bn and the return in domestic market was down by (-) 5% in 2015 compared with an increase of 30% in 2014. Different global factors were at play during this period including Fed beginning the rate hike cycle in 2015 after holding rates for a decade.

The Mutual fund (equity) flows tends to a draw negative correlation with capital markets at (-) 0.5. Thereby implying that mutual fund flows cannot be reliable driver of capital markets, even the regression results for the same reflect the same with much lower variations (R Square).

What does interest cover of industries indicate?

A quick indicator of solvency of companies is the interest cover. It indicates whether the company has the ability to service the interest component of its debt from the profits earned in a particular period. We e examined the results of 1789 companies excluding financial units and traced the trend of PBDIT/Interest expense, to analyze whether they are in a position service the interest component of debt obligation.

FY20- The ratio fell for 72% (1281 out of 1789) of companies. (Table 1) Sectors such as communication, mining, auto ancillaries, rubber products and roads noted considerable decline. Notably, for communications industry the ratio was -0.6 in Mar'20 as the telecom sector grappled with issues related to AGR dues. Only cement, electricity, drugs and pharma and edible oils and vanaspati witnessed increase in the interest cover ratio.

FY21- Recovery is visible: 46% (827 out of 1789) of companies noted improvement in the PBDIT/Interest expense ratio. Among them, the notable ones are from sectors such as communication, cement, drugs and pharma, metals and products, rubber and wood products. However, for gems and jewellery, edible oils and vanaspati and hotels and tourism, the ratio noted considerable deterioration.

9Month FY22- 51% (921 out of 1789) have noted a deterioration in the interest cover. Among them, communication, gems and jewellery, sugar, paper and textiles are the notable ones.

Economics of edible oils

After crude oil, edible oil had raised concern considering that we import 60% of our requirements and sunflower oil, which comes almost wholly from Ukraine constitutes around 14% of import. Edible oil prices have already been rising and have fed their way through the food processing industry with prices of bakery products, processed foods going up besides restaurant bills. This is a serious issue as it has also been responsible for keeping CPI inflation elevated.

While there has been a lot of focus on the rising crude oil price with Brent crossing $ 120/barrel once again, which is not good news for India as the retail prices of petrol and diesel have also been increased, another concern is on the edible oils front. India imports around 60% of vegetable oil requirements and their prices have been increasing since 2021. This has contributed significantly to food inflation with CPI inflation for oils and fats being 16.4% for February and WPI inflation for vegetable and animal fats being 14.9%.

With Ukraine being an important producer of sunflower oil, disruptions in production has already had an impact on prices as dealers work on substituting with other oils. High inflation in edible oils has potential to have a secondary impact on the user industries. Most of the user industries have already had one round of price increases due to rising prices of wheat, oils, sugar, spices, etc. they would have to go in for a second round of price increase if this situation persists for a longer period of time.

State of DISCOMs

The recently concluded state Elections had one thing in common when it came to manifestoes which is that free power would be provided to farmers. This issue as a standalone promise is not really amiss provided the subsidy is given to the DISCOMs from the Budget. But this does not happen. There have been several attempts made to address the issue of debt of DISCOMs with UDAY being the most aggressive scheme. However, the performance of DISCOMs in various states is still far from satisfactory.

Our analysis of UDAY data shows that most of the states are still reporting high transmission losses and are also under financial stress with ACS-ARR gap far above the targeted level of “zero”. In light of this, we believe that Central government’s RDS scheme may have set ambitious target for FY25 (ACS-ARR gap to 0).

On a national level, government data shows that average ACS-ARR gap (Rs per unit) is 0.25/unit. Average AT & C losses are 18.77%. Of the 28 states for which data is available, 15 states have losses above 0.25/unit. Only 7 states make profit. In terms of transmission losses, out of 29 states, 17 states have reported losses above the national average.

UDAY data shows that the 7 states where DISCOMS are making profits include: Gujarat, Rajasthan, Punjab, Kerala, Himachal Pradesh, Uttarakhand, and Dadra and Nagar Haveli. Amongst these, only 4 states have transmission losses less than 15% (Gujarat, Kerala, Himachal Pradesh and Dadra and Nagar Haveli). Rajasthan and Punjab have transmission losses at 28.1% and 20.6% respectively. Uttarakhand’s AT & C losses are at whooping 96.43%.

The low performing states in terms of financial losses (ACS-ARR gap) include: Sikkim, Arunachal Pradesh, J&K, Madhya Pradesh, Manipur, Telangana and Bihar. Amongst these, except Madhya Pradesh and Telangana, AT& C losses for other states range between 35-64%.

Key policy announcements

- Cabinet approves extension of Pradhan Mantri Garib Kalyan Anna Yojana (PM-GKAY) for another 6 months (April-September, 2022). The Phase-V of PM-GKAY scheme was to end in March 2022. It may be recalled that the PM-GKAY has been under implementation since April 2020, as the largest food security program in the world. The Government has spent approximately Rs 2.60 Lakh Crore so far and another Rs 80,000 Crore will be spent over the next 6 months till September 2022 taking the total expenditure under PM-GKAY to nearly Rs 3.40 Lakh Crore. This will cover nearly 80 crore beneficiaries across India and like before would be fully funded by the Government of India.

- The Cabinet Committee on Economic Affairs approved the Minimum Support Price (MSP) for Raw Jute for 2022-23 season. The MSP of Raw Jute (TDN3 equivalent to TD5 grade) has been fixed at Rs 4,750/- per quintal for 2022-23 season with an increase of Rs 250/- over the previous year. This would ensure a return of 60.53% over all India weighted average cost of production. It assures a minimum of 50% as margin of profit. It is one of the important and progressive steps towards ensuring better remunerative returns to the jute growers and to incentivize quality jute fibre.
- Merchandise exports from India have crossed US$ 400 billion in the current financial year, 9 days ahead of schedule. This is far higher than the previous record of US$ 330 billion achieved in 2018-19.
- A quantity of 741.62 LMT of Paddy has been procured in KMS 2021-22 upto 27.03.2022 in the procuring States/UTs of Chandigarh, Gujarat, Assam, Haryana, Himachal Pradesh, Jammu & Kashmir, Jharkhand, Punjab, Uttar Pradesh, Uttrakhand, Telangana, Rajasthan, Kerala, Tamil Nadu, Karnataka, West Bengal, NEF (Tripura), Bihar, Odisha, Maharashtra, Puducherry, Chhattisgarh, Andhra Pradesh and Madhya Pradesh. Till now about 105.14 Lakh farmers have been benefitted with MSP value of Rs. 1,45,358.13 crore.

Data Releases

Centre’s H1 borrowing calendar

Central government expects to borrow Rs 14.31tn from the markets in FY23, compared with Rs 14.91tn announced in the budget for FY23. The difference is on account of switching operations conducted on 28 Jan 2022. Out of this Rs 14.31tn, centre will borrow Rs 8.45tn (59% of the total) in H1FY23. This implies, H2 gross borrowing will be at Rs 5.86tn. In terms of proportion of aggregate borrowing, it is almost the same as the last 3 years. It was 60% in FY20, 54% in FY21 and 60% in FY22. This was also largely in accordance with market expectations as it was expected that the government would frontload its borrowing in the first half given that there is surplus liquidity which will be rolled back indirectly during the course of the year. Net borrowing in H1 is estimated at Rs 6.18tn compared with Rs 5.32tn last year.

Maturity wise, issuance for 10 years and above (10-40years) remained at 63% of total issuances in H1FY23, much in line with H1FY22 where it was at 68.6%. For tenor between 2-7 years (7-years to be newly traded), issuances are at 30.8% in H1FY23. We may expect stability in the bond market though there will be some tense moments on inflation worries and hence oil prices will dominate sentiment until the RBI policy.

Apart from dated securities, issuance of treasury bills will be slightly lower this half at Rs 4.32tn compared with Rs 4.68tn last year. Also, the WMA limit for the centre has been increased to Rs 1.5tn against Rs 1.2tn.

IIP- Industrial growth disappoints

IIP growth rose to 1.3% in Jan’22 from 0.7% in Dec’21 led by manufacturing (1.1% from 0.2% in Dec’21) and mining output (2.8% from 2.6% in Dec’21). Within manufacturing, output of apparels and printing and pharma products registered the most improvement. Infra and FMCG output rose to 5.4% and 2.3% respectively in Jan’22. Recovery in global economy remains at risk with deepening crisis between Russia and Ukraine, with commodity prices soaring ahead.

Manufacturing output climbed to a 3-month high of 1.1% in Jan’22 compared with 0.2% growth in Dec’21. Apparels (21.8% from 6.15 in Dec’21), printing products (13% from 0.2% in Dec’22) and Pharma products (increase of 7% from contraction of 1.8% in Dec’22) registered the most improvements in Jan’22. Mining sector too registered an improvement at 2.8% in Jan’22 (2.6% in Dec’21). However, electricity output moderated by 0.9% from 2.8% in Dec’21. Notably, over a 2-year horizon, IIP index is 0.7% above the pre-pandemic level.

Within use-based classification, there has been a broad based improvement across sectors. Infra goods output has grown to a 3-month high of 5.4% in Jan’22 compared with 2.1% in Dec’22. FMCG goods rose to a 5-month high of 2.3% in Jan’22 after contracting by 0.1% in Dec’21. Capital goods output contracted at much slower pace of (-) 1.4% in Jan’22 (-3.8% in Dec’21).

Core industries performance

India's eight core industries continued its upward momentum as it rose to a 4-month high of 5.8% in Feb'22 compared with a growth of 4% in Jan'22. However, the expansion needs to be seen with caution as it comes on the back of a much lower base (-3.3% in Feb'21). Output of petroleum refinery rose at a much faster pace by 8.8% in Feb'22 from 3.7% in Jan'22. This was driven by both domestic and export demand. Output of both steel and electricity expanded by 5.7% (3.7% in Jan'22) and 4% (0.9% in Jan'22) respectively in Feb'22. Cement growth at 5% was over a marginal increase of 0.2% last year. Production of natural gas continued to clock double digit growth at 12.5% in Feb'22 compared with a growth of 11.7% in Jan'22. Notably, production of crude oil contracted at a much slower pace by (-) 2.2% in Feb'22 from (-) 2.4% in Jan'22.

Fiscal health of Central government

Centre’s fiscal deficit (gap between its income and expenditure), rose to 3.9% (of GDP) in Feb’22. This is much lower than government’s revised estimates (RE) of 6.9%. In terms of meeting the revised budget targets (RE) for FY22, Centre’s gross tax revenue is at Rs 22.7tn (91% of RE) as of Feb’22 (FYTD basis), while net revenue is at Rs 17.9tn (86% of RE). Within tax revenues, direct tax collections have reached 89% (Rs 11.1tn) of the targeted level and indirect tax collections are at 93% (Rs 11.7tn). Non-tax revenues have broadly met the target at Rs 3.1tn (99%). In case of spending, overall expenditure till Feb’22 was at 83% of RE (Rs 31.4tn), with capex at 80% (Rs 4.9tn) and revenue spending at 84% (Rs 26.6tn). This implies, in order to meet the targets, government should have spent Rs 1.2tn on capex, and Rs 5.1tn as revenue expenditure in Mar’22.

India's CAD widens

India's current account deficit widened to a 13-quarter high of 2.7% in Q3FY22 (US$ 23bn) compared with 1.3% of GDP in Q2FY22 (US$ 9.9bn). Trade deficit rose by US$ 16bn led by a sharp jump in both oil and non-oil imports. On the invisibles side, services receipts improved from US$ 25.6bn in Q2 to US$ 27.8bn in Q3, led by software receipts. Transfer receipts too were higher. On an FYTD basis, CAD has expanded to 1.2% of GDP, compared with a surplus of 1.7% of GDP in FYTD21. For Q4FY22, we estimate CAD at ~3.5% of GDP. This implies, CAD at ~1.5-2% of GDP in FY22.

From US$ 40.1bn in Q2, capital account surplus narrowed to US$ 23.3bn Q3. Both FDI and FPI inflows dried up. On the other hand, banking capital inflows improved to US$ 8.2bn from US$ 0.4bn in Q2. Even short-term credit picked up. As a result, overall there was a net accretion of US$ 0.5bn in the forex reserves in Q3 compared with US$ 31.2bn in Q2. Overall, we expect India's trade deficit to remain elevated in FY23 as well. This is on the back of higher commodity prices, particularly oil. On the whole, we expect CAD at 2.5% of GDP in FY23 assuming oil prices remain at ~US$ 110/bbl.

Forex update: What the war has meant?

The Ukraine war tended to cast a shadow on the forex market and the tendency was for currencies to depreciate against the dollar. The rupee was under pressure during the first part of the fortnight but recovered with the RBI swap of sell-buy of US$ 5bn was completed. The rupee has ranged between Rs 76-77/$ and would tend to be in this bracket till the month end. The decline in oil prices will help to assuage the currency.

Trade- Exports stable; Imports rebound in Feb'22

India's trade deficit in Feb'22 widened to 3-month high of US$ 20.9bn from US$ 17.4bn in Jan'22. Sequentially, imports (+US$ 3.5bn) rose faster than exports (+US$ 0.1bn). Except gold imports, both oil and non-oil-non-gold imports picked up pace. Apart from recovery in domestic demand, higher commodity prices are also inflating the import bill. Exports at US$ 374bn in FYTD22, are closer to exceeding government's target of US$ 400bn in FY22. Continuous rise in oil prices has put downward pressure on INR.

India's export growth was broadly stable in Feb'22 at 25.1% (US$ 34.6bn) compared with 25.3% (US$ 34.5bn) in Jan'22. Amongst the major commodities, exports of only engineering goods (32% versus 24.1%) and gems & jewellery (18% versus 13.6%) accelerated. Import growth rebounded to 36.1% in Feb'22, following moderation in Jan'22 (23.5%). While gold imports dipped in Feb'22, oil imports picked up sharply. Non-oil-non-gold imports too accelerated. Within non-oil imports, coal (117% versus 39.5%), project goods (83% versus 11%), pearls & precious metals (32.9% versus 6%) and ores and mineral (103.1% versus 91.1%) imports rose the most.

CPI Inflation remains a concern

CPI inflation rose to 6.1% in Feb'22 against market consensus of 6%. Notably, inflation surpassed its Jan'22 level which was supposed to be the peak as said in the RBI's policy statement. Going forward, we expect CPI to be ~5.5-6% in FY23. Upside risks persist with regard to elevated commodity prices and its laggard pass through.

Food inflation in Feb'22 inched up at the retail level, driven by vegetables, cereals and meat and fish. Notably, food inflation was at its highest since Nov'20. 5 out of 12 food items noted considerable increase in inflation namely cereals (4% in Feb'22 versus 3.5% in Jan'22), meat and fish (7.4% versus 5.5%), vegetables (6.1% versus 5.1%) and spices (6.1% versus 4.7%). Even for items such as oil and fats (16.4%), pulses (3%) and sugar (5.4%), stickiness in inflation is observed.

Even core inflation remained sticky at 6% in Feb'22. Clothing and footwear (8.9% in Feb'22 versus 8.8% in Jan'22), housing (3.6% versus 3.5%), household goods and services (7.2% versus 7.1%), education (3.6% versus 3.3%) and personal care and effects (5.4% versus 3.5%). Notably, the sharp jump in personal care and effects has been due to increase in gold prices on an average by 6.2% in Feb'22 against 1.3% in Jan'22.

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