1 Oct 2024

Sonal Badhan
Economist

Economic Round-up: September 2024

Markit manufacturing PMI shows that activity in major European economies (Germany/France) remains in severe stress, and activity in Japan is also now beginning to deteriorate. As per flash PMIs, the story is similar in case of US as well. In the US, other macro indicators for Aug'24 are also pointing towards a soft landing. Retail sales and new home sales have weakened, and unsold inventory is on the rise. Non-farm payrolls also rose less than expected. Private consumption expenditure growth was revised lower in the final estimates for Q2CY24 GDP growth. In view of steady inflation, Fed delivered a super-sized rate cut (50bps) in its Sep'24 meeting, and the dot plot indicates another 50bps cut can be expected over the next 2 meetings. Another concern for global growth is coming from muted growth in China. Retail sales, industrial production, industrial profits, FAI growth noted slowdown in Aug'24. However, some recovery was visible in the manufacturing sector in Sep'24, as official PMI index rose to 50.4 from 49.8 in Aug'24. PBOC has also announced a slew of measures to revive growth (RRR cut, LPR cut, lower minimum down payment required for 2nd home loan, aligning rate of interest for existing home loans with new home loans). The impact of these measures is expected to be only limited.

Global Central Banks: In Aug/Sep'24, in line with market expectations, major central banks (US Fed, ECB) lowered their policy rates. US Fed delivered an outsized rate cut of 50bps, keeping in view softening labour market conditions and steady inflation trajectory. Dot plot shows possibility of another 50bps cut this year and another 100bps cut in CY25. ECB lowered its policy rate by 25bps, in the wake of deteriorating economic conditions. Bank of England (BoE) on the other hand, held its rates unchanged and is expected to deliver least aggressive rate cuts this year, with only 1 more rate cut expected in the remainder of the year, as it faces a dilemma with services inflation remaining elevated. BoJ has also continued to maintain is dovish stance, leading to rise in uncertainty about the timing of next rate hike. PBOC lowered its RRR rate and 7-day LPR as part of the stimulus measures announced to revive economic growth.

Key macro data releases: India's current account deficit was recorded at 1.1% of GDP in Q1FY25, compared with a surplus of 0.5% of GDP in Q4 FY24. This was led primarily by a pickup in merchandise deficit. **Rainfall** is currently 8% above the LPA till 30 Sep 2024, and the monsoon has begun retreating. There is also an improvement noted in the **sown area** (+1.5% YoY), with higher acreage of paddy, oilseeds, sugarcane and coarse cereals exceeding its normal sown area. **Centre's H2FY25 gross borrowings** have been pegged at Rs 6.61 lakh crore, implying that the FY25 borrowing target has been maintained at Rs 14.01 lakh crore. In terms of maturity pattern, approximately 77% of the issuances are concentrated in the 10Y or higher tenor. **CPI inflation** inched up marginally to 3.7% from a 59-month low of 3.5% in Jul'24. Food inflation picked up on a YoY basis led by vegetables. Core inflation remained stable at 3.4%, as lower inflation in personal care and effects category offset the marginal increase seen in other categories.

Macro developments

Global growth: slowdown imminent

Final estimates for US GDP in Q2CY24 showed that the economy expanded by 3% (unchanged from 2nd estimate). While the headline number was left unrevised, private consumption growth was revised lower to 2.8% from 2.9% as per 2nd estimates, dragged by services. In contrast, private investment growth was revised sharply higher to 8.3% from 7.5% earlier. In Q3, growth is expected to have slowed. Retail sales growth in Aug'24 moderated to 0.1% (MoM) from 1.1% in Jul'24. US conference board consumer confidence index surprisingly fell to 98.7 in Sep'24 (lowest since Aug'21) from 105.6 in Aug'24, as consumers become less certain about job market scenario. New home sales fell by (-) 4.7% (MoM) in Aug'24, following 10.7% increase in Jul'24. Notably, during the same period, the inventory ratio rose to 7.8 months from 7.3 months. Fed has already embarked upon the rate cutting cycle and will continue to do so until next year at least.

In case of Europe, the economic conditions are much bleaker. Latest manufacturing PMI data shows that significant weakness persists in German and French manufacturing sectors, as both indices declined further in Sep'24. In France, purchasing activity, in response to lower sales, fell at the steepest pace since Mar'20. In Germany, PMI index fell to 12-month low of 40.6 (42.4 in Aug'24), dragged by decline in new orders and reduction in backlogs of work. Germany's IFO business climate index also fell in Sep '24, noting deteriorating sentiment, with index dropping to 85.4 from 86.6 in Aug'24. Amongst major sectors, index turned more negative for manufacturing, services and trade. ECB in its latest forecasts has lowered its projections for GDP growth in Euro Area to 0.8% in CY24 (0.9% earlier) and 1.3% in CY25 (1.4% earlier).

China's economy is also showing signs of stress as retail sales, industrial production, industrial profits, FAI growth noted slowdown in Aug'24. The situation seems to have improved in Sep'24 as Markit flash manufacturing PMI bounced back into the expansionary territory as it rose to 50.4 from 49.8 in Jul'24, driven by higher new orders. Retail sales in Aug'24 had slowed to 2.1% (est.: 2.5%) from 2.7% in Jul'24, while industrial production growth eased to 4.5% (est.: 4.8%) from 5.1% in Jul'24. FAI growth, on CYTD basis (Jan-Aug) slowed to 3.4% compared with estimated 3.5%. Industrial profit fell sharply in Aug'24 (-17.8% YoY) following 4.1% increase in Jul'24, bringing the CYTD growth down to 0.5% from 3.6% during Jan-Jul period.

India's growth: Momentum maintained

Major international organisations announced their India GDP outlook recently. Moody's revised its projection upward to 7.2% for the current fiscal year from 6.8% estimated earlier. It also pushed the FY26 estimate higher to 6.6% from 6.4% earlier. ADB retained its growth estimate for the current fiscal year at 7% and 7.2% for next year. S&P too maintained its growth projections, at 6.8% for FY25 and 6.9% for FY26. Government of India, in its monthly economic update also mentioned that in view of the progress seen in high frequency indicators, it continues to expect 6.5-7% growth this year. High frequency indicators such GST collections have maintained a healthy run rate of Rs 1.83 lakh crore in FYTD25 (Apr-Aug) so far, compared with Rs 1.66 lakh crore last year during the same period, indicating sustained domestic demand. Apart from this, higher than normal monsoon (+6% as of 26 Sep 2024) and increase in Kharif sowing (+1.5% as of 23 Sep 2024) also implies improved prospects rural demand in the coming months. Festive demand will also help sustain the current momentum. Urban demand, reflective in air passenger movement (~97.5mn in Q2FY25 versus 99.8mn in Q1) and services PMI (60 in Q2 versus 60.5 in Q1) are also holding ground. We are thus more optimistic than most organisations on FY25 growth (7.3-7.4%).

Central bank actions

RBI delivered no major surprise in its latest monetary policy in Aug'24. Both the repo rate and stance were kept unchanged by a 4-2 vote. However, the statement by the RBI Governor had a marginal hawkish tilt as he underlined the risks that prolonged and elevated food inflation could have on headline inflation. The cautionary tone by the Governor and upward revisions to the inflation projections for the next 2 quarters suggest that the possibility of a rate cut now seems most likely only in Dec'24 or even later.

US Fed decided to lower the policy rate by 50bps in its latest meeting in Sep'24, thus bringing the policy rate down to 4.75-5%. This is the first rate cut since CY20. The FOMC highlighted that "in light of the progress on inflation and the balance of risks, the Committee decided to lower the target range for the federal funds rate". Economic projections were also tweaked, and the central bank now expects GDP growth at 2% in CY24, down from 2.1% estimated in Jun'24. Unemployment rate projection was significantly revised upward from 4% in Jun'24 to 4.4%. Both headline and core PCE inflation projections were lowered to 2.3% (2.6% in Jun'24) and 2.6% (2.8%) respectively. Fed Chair Powell in the press conference acknowledged that if inflation report was available at the time of Jul'24 policy then Fed might have opted for a rate cut at that time only. Another reason for a super-sized rate cut was that the central bank didn't want to lag behind the curve. The dot plot shows another 50bps cumulative rate cut in CY24 and 100bps in CY25.

In a close call, **Bank of England (BoE)** in its Sep'24 meeting, held the policy rate unchanged at 5%, with a vote of 8-1. The pause comes after 25bps rate cut announced in Aug'24, a first in more than four years. The policy statement was more hawkish than expected as the central bank clarified that "monetary policy will need to continue to remain restrictive for sufficiently long until the risks to inflation returning sustainably to the 2% target in the medium term have dissipated further". Cautionary bells were also sounded regarding services inflation being at elevated levels. The next rate cut is almost fully priced in for the Nov'24 meeting, while a cut in Dec'24 remains a close call for now.

In line with expectations, **ECB** lowered its policy rates by 25bps, bringing the deposit rate to 3.5% from 3.75% earlier. This decision took into account faltering economic growth in the Euro Area and stabilizing inflation. This is supported by the economic projections provided by the bank. As per Sep'24 estimates, real GDP growth for CY24 is estimated at 0.8%, down from 0.9% estimated in Jun'24 and for CY25 it is estimated at 1.3% (1.4% in Jun'24). Inflation is expected to follow the same path, as the projection for CY24 was left unrevised for both CY24 (2.5%) and CY25 (2.2%). As more signals appear of deepening economic downturn in the Euro Area, there remains 50-60% probability of another 25bps rate cut in Oct'24 meeting.

PBOC in Sep'24 had announced a slew of measures to support the faltering economic growth. These measures included: lowering the minimum down payment for 2nd home loan to 15% from 25% earlier; guiding commercial banks to readjust interest rates charged on existing mortgages to align with interest rates on newly issued home loans; reduction in 7-D loan prime rates (LPR) by 20bps to 1.5%; reduction in RRR by 50bps (excluding institution which have already been allowed to maintain 5% reserve ratio), freeing up liquidity to the tune of 1tn Yuan ($140bn) and bringing the weighted average reserve requirement for financial institutions to ~6.6%.

Data Releases

Currency outlook

INR appreciated by 0.1% in Sep'24 against a depreciation of -0.2% seen in Aug'24. This was supported by a weaker dollar. Apart from this, increased quantum of FPI flows (record high equity inflows), range bound commodity prices and the narrative of easier liquidity conditions amidst global monetary policy easing, have lend comfort. However, in terms of gains observed in major EM peers, INR was largely capped. This may be attributable to quarter end phenomenon and higher dollar demand from importers and banks. In the near term, macro conditions remain favourable of INR. DXY is expected to trade with a downward bias as disinflation is underway in the region and consumption demand is softening. FPI flows will further gain strength as index inclusion becomes broad based with increased weightage which in turn will attract security specific flows. On external front, enough cushioning in terms of adequate forex reserves along with timely intervention of RBI will ensure volatility of rupee to be largely contained. We expect INR to trade in the range of 83.7-83.8/USD in Oct'24, with an appreciating bias.

Bond Market Round-up

Global yields largely softened in Sep'24. US 10Y yield eased after Fed unveiled the rate cuts and signalled the possibility of additional cuts this year and this will be followed in CY25. Moderation in the recent PCE data adding to the Fed's conviction of abating price pressure, with inflation inching closer to the target mark. Incoming US jobs data will add further clarity to Fed's guidance on rate outlook. On the domestic front, given the moderation in inflation and favourable liquidity conditions, India's 10Y yield eased. Going forward, the 10Y yield is expected to trade in the range of 6.68%-6.75% in Oct'24, with risk evenly balanced. On policy rate, we anticipate RBI will wait and watch before taking any action in Dec'24 given the moderation in headline inflation.

Monsoon and sowing update

As the monsoon has begun retreating, we look at how rainfall fared this season. Rainfall was 8% above the LPA till 30 Sep 2024. Momentum was maintained until the first fortnight of Sep'24 with total rainfall at 111.1mm versus 78.1mm. Between 1 Jun and 30 Sep 2024, out of 33 sub-divisions, (89% of the country) received normal or above normal rainfall so far and 5 states were in the deficient zone. Region-wise, except East & North East (-14%) which continues to report deficient rainfall, all others have received higher than normal rainfall during this period. Central region (+19%) and Southern peninsula (+14%) recorded significant excess rainfall. Following the regional trend in rainfall, overall reservoir storage levels was at comfortable level of 87% as of 26 Sep 2024, compared with 71% last year. Only northern region has storage levels (68%) lower than last year (86%), due to below normal levels seen in reservoirs in Punjab and HP. Apart from these two states and Goa (at normal level), reservoir levels across other states have recorded levels above normal this season. Sown area data showed that as of 23 Sep, Kharif sowing was 1.5% higher than last year and had even crossed the normal area level. Acreage of, paddy, oilseeds, sugarcane and coarse cereals has already exceeded its normal sown area.

India's CAD at comfortable level

India's current account deficit was recorded at 1.1% of GDP in Q1FY25, compared with a surplus of 0.5% of GDP in Q4 FY24. This was led primarily by a pickup in merchandise deficit. Services receipts and remittance inflows also slowed marginally. There was a perceptible slowdown in the capital account surplus, led by a sharp moderation in FPI inflows, even as FDI inflows saw a much-needed revival. As a result, there was a marked reduction in BoP surplus, to US$ 5.2bn compared with US$ 30.8bn in Q4. The outlook for India's balance of payment position remains positive, led by lower commodity prices and an expected recovery in merchandise exports. Services receipts and remittances too are expected to be higher, as the global monetary policy cycle turns favourable. Overall, we expect CAD at 1-1.2% of GDP in FY25.

Core sector growth

Core sector growth fell by (-) 1.8% in Aug'24, following 6.1% rise in Jul'24, largely due to base effect On FYTD basis (Apr-Aug) core sector output has eased further, as it rose by 4.6%, compared with 8% growth registered last year during the same period. Output of refinery products fell by (-) 1% after registering 6.6% in Jul'24. Uncertainty around global demand for oil, following signs of weakening economic activity in US and China could be a reason. International oil prices have also a taken a hit. Output of steel industry also slowed in Aug'24 (4.5% versus 6.4%). Modest growth in total auto sales, as visible in the FADA data, could be a major drag. Continuity of heavy rains in Aug'24, along with moderation in output in major core industries, led to reduced peak demand for electricity. Growth of these sectors was also impacted partly due to base effect. Amongst other major sectors, industries which noted a decline in output in Aug'24 were coal, crude oil, natural gas and cement. Fertilizer sector growth also moderated, as we reach the end of the sowing season. Given the weakness in the eight core industries in Aug'24, and considering the impact of unfavourable base, we expect IIP growth at ~0.5% in Aug'24.

Update on H2 borrowing calendar

Centre's H2FY25 gross borrowings have been pegged at Rs 6.61 lakh crore, implying that the FY25 borrowing target has been maintained at Rs 14.01 lakh crore. In terms of maturity pattern, approximately 77% of the issuances are concentrated in the 10Y or higher tenor. Yields in this bracket have seen a significant moderation in H1 FY25, due to significant inflows from FPIs. Given the favourable global and domestic backdrop, we expect a further downward bias in domestic yields, particularly in the short-end side, leading to a steepening bias in the yield curve. This will be further supported by RBI rate cuts, which is expected to start from Dec'24. The above backdrop suggests that the actual interest cost for the government is likely to be lower.

WPI inflation eases

WPI inflation moderates to a 4-month low of 1.3% in Aug'24 compared with 2% in Jul'24 supported by softening of both food and fuel & power inflation. Our forecast for headline WPI inflation was at 1.6%. Lower prices of both onion and tomato has dragged down the vegetables inflation. Under food grains, prices of pulses and paddy eased further. Fuel and power inflation slipped in to contraction at 0.7% amidst a dip in global oil prices. Manufactured products inflation edged down to 1.2% in Aug'24 from 1.6% in Jul'24. Against this back drop, we expect WPI to ease further in the coming months. Softening of global commodity prices bodes well for this outlook. So far, the Kharif acreage has been better than last year and monsoon has been 8% above LPA (1 Jun-16 Sep).

CPI inflation

CPI inflation inched up marginally to 3.7% from a 59-month low of 3.5% in Jul'24. Food inflation picked up on a YoY basis led by vegetables. However, sequentially there was a significant moderation in food inflation due to lower vegetable prices. Core inflation remained stable at 3.4%, as lower inflation in personal care and effects category offset the marginal increase seen in other categories. The outlook for food inflation is positive as the progress of monsoon has been adequate. Soft global commodity prices will also impart a sobering effect on core inflation which is likely to remain at comfortable levels. Overall, we continue to expect inflation in the range of 4.5%-5% in FY25. RBI is likely to be cautious and wait for a durable moderation in inflation before cutting rates. We see the possibility of rate cut only in Dec'24 provided the durability of low inflation is established by data.

Growth in Industrial Production

IIP growth rose a tad to 4.8% in Jul'24 from 4.7% in Jun'24, supported by jump in manufacturing sector. Mining and electricity output eased in Jul'24, due to monsoon activity. On FYTD basis as well, growth remains stable at 5.2% so far (Apr-Jul'24). Within manufacturing, boost has been provided by industries like refinery products, machinery, and other transport equipment. In terms of use-based classification, only capital goods and intermediate goods recorded an improvement in Jul'24, while other sectors continued to register a slowdown. Going forward, as monsoon activity was strong in Aug'24 as well, we expect some softening in electricity output. However, as government spending has seen picking up pace (capex for centre and revenue for states), we expect revival in construction activity and thus increase in output of related products. Improvement in Kharif sowing is also expected to boost rural demand.

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

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