MONTHLY ECONOMIC BUFFET

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Economic Wrap: February 2022

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Last month saw multiple economic and political developments at domestic and global levels. On the domestic front, both fiscal and monetary policies focused on providing support to durable economic growth. Union Budget announced measures to revitalize investment, and RBI committed to maintaining accommodative policy stance to keep rates low. However, with escalating tensions around Russia-Ukraine war, there is pressure on oil prices, which impacts us in multiple ways.

Global tensions: With full scale military attack launched by Russia on Ukraine, global markets (equity/debt/currency) have been rattled. Major global economies (US, UK, European union) have also announced severe punitive sanctions on Russia, in order to deter it from taking further military actions. However, as the war lingers on, international oil prices have seen a significant jump. Prices have risen from US$ 95/bbl on 21 Feb 2022 to US$ 105/bbl as of 1 Mar 2022. This is expected to have considerable impact on the Indian economy on multiple fronts, including: trade, currency, inflation, RBI's policy and government's finances.

Domestic policies: To attain resilient GDP growth, both fiscal and monetary policies have extended support to revitalize the economy. While the Union Budget for 2022-23 was an investment centric budget, RBI also extended support by keeping policy rates unchanged for now. In the budget, specific thrust is given to infra for Rs 7.5 lakh crore, of which 65% is for roads, railways and defence. Measures have also been announced to boost segments like hospitality, housing, telecom, solar power, EVs etc. These measures should also help attract private investment.

Key macro data releases: Latest data shows that India's GDP growth is estimated at 8.9% in FY22 (-6.6% in FY21). For Q3FY22, growth is pegged at 5.4% from 8.5% in Q2FY22. With steady revival and resumption of economic activities post Omicron, we expect Q4FY22 growth between 4.8-5.3%. This will push GDP growth to 9.1% in FY22, higher than government estimates. Trade data also supports this analysis.

India's trade deficit in FYTD22 has surged to US$ 154.8bn from US$ 73.6bn in FYTD21. This has been due to higher imports led by revival in domestic activity and higher commodity prices. Exports too have remained buoyant at US$ 338bn in FYTD22, and are likely to exceed the government's target of US$ 400bn in FY22.

Inflation however remains a key concern, at both retail (CPI) and wholesale (WPI) level. CPI was up at 6% in Jan'22 from 5.7% in Dec'21, led by food inflation (5.4% versus 4%). Also, contrary to our expectations of 11.6% WPI in January, WPI has come in at 13%, which is only slightly lower than last month.

Global developments

Russia-Ukraine war

Tension between Russia and Ukraine was simmering in the last few months. The bone of contention was Russia's objection to including Ukraine in NATO. However, in an unexpected turn of events, Russia has invaded Ukraine, and has launched a full scale military offensive. Uncertainty over the crisis has roiled global markets.

Economic Sanctions are the global first response: Several developed countries including US, UK and European nations have imposed sanctions on Russia to deter further increase in hostilities by Russia. These have ranged from sanctions on banks as well as individuals and also export controls. US has been the forefront and announced sanctions on Russian banks (Sberbank- holds nearly one third of Russia's banking sector assets and VTB Bank- holds nearly one-fifth of Russia's banking sector assets), export control measures (which will more than halve Russia's high-tech imports) as well as sanctions on wealthy Russians and their families. Similar restrictions have been placed by the UK and European Union.

Impact on India: Economic impact of the Russia-Ukraine crisis is likely to be through higher oil prices. Since India is a large consumer of oil much of which is imported, the impact of higher oil prices is likely to be visible not only on trade deficit and currency but will also impact inflation and fiscal situation. It must be noted that both the Union Budget and RBI's monetary policy announcement came much before this crisis and did not factor in the impact of the crude price shock. Both the Budget and RBI hence took a conservative estimate of crude prices ~US$ 75/bbl which is likely to be a challenge going forward.

Trade: In FYTD22, we estimate oil imports at US$ 155.5bn. For the next year, oil imports are likely to be higher due to improvement in economic activity. We estimate a modest 5% increase in oil demand. Ceteris paribus, we assume trade deficit to increase to US$ 165bn. Further, a sustained increase in oil prices will push imports higher. We estimate that for every 10% increase in oil prices on a permanent basis, oil imports are likely to inch up by US$ 15bn or 0.4% of GDP. This will get reflected in higher current account deficit.

Currency: Higher oil prices lead to burgeoning trade deficit and hence adversely impact the external stability. This lead to currency depreciation. With uncertainty around the future course of the war, INR is likely to remain volatile. We expect INR to remain under pressure given the elevated level of crude prices and trade in the range of 75-77/$ in the next few months.

Inflation: Crude oil related products carry a weight of 7.3% in the WPI basket. Hence the direct impact of a 10% increase in oil prices is estimated be around ~0.7% on WPI. Adding the indirect impact, the overall effect can be around 1% increase in WPI.

We estimate that the direct impact of a 10% increase in oil prices is only ~0.15%. Higher oil prices will also feed into supply chains and push prices of other commodities and services upwards. The indirect impact of this pass-through is likely to be higher at about 0.25%-0.35%.

RBI Policy: Oil prices have inched up by 11.2% since 10 Feb 2022 (RBI policy meet) which is likely to push the inflation trajectory upwards. Hence, RBI might drop its accommodative stance in Apr'22. Further, the first policy of FY23 may also mark the start of policy normalisation by RBI through a change in reverse repo rate.

Policy developments

Union Budget 2022-23

Union budget for FY23 is an investment oriented budget, with focus on boosting government capex and reviving private sector spending. While the fiscal deficit target of 6.4% is higher than our expectation (6-6.25%), we still believe that government is on track to achieve its fiscal consolidation target by FY26. To boost consumption, few measures were announced and we this can impact prospects of growth. Steep rise in borrowings will also imply that 10Y yield will come under pressure this year (est.: ~7%).

FY22 fiscal deficit at 6.9%: In line with our view, the revised fiscal deficit target for FY22 is now at 6.9% (BoB est.: ~7%), higher than the budgeted estimate of 6.8%. This is mainly owing to higher than projected expenditure (7.4% in FY22 (RE) versus 1% rise projected in BE). This is driven by both revenue spending and capex. Robust revenue collections, supported by rebound in economic activity have allowed fiscal slippage to be minimal. Centre's tax revenues are expected to rise by 23.8% in RE to Rs 17.7tn from Rs 15.5 in BE. Non-tax revenues are also expected to overshoot the BE by Rs 700bn. Thus, net revenue collections are expected to come in Rs 2.9tn higher than the BE at Rs 20.8tn.

FY23 fiscal deficit at 6.4%: Fiscal deficit target for FY23 (BE) at 6.4% is higher than our expectations (6-6.25%). However, considering much of the fiscal space has been used to boost investments, we would term this fiscal deficit target as being more realistic. In terms of income, government expects normalisation of revenues, and projects tax revenues to increase by Rs 2.4tn to Rs 27.6tn (9.6%) in FY23 (BE). On the other hand, non-tax revenues are estimated to ease to Rs 2.7tn from Rs 3.1tn in FY22 (RE), as dividends and profit growth stabilizes. Disinvestment receipts are also more realistically targeted at Rs 650bn versus Rs 780bn in FY22 (RE). Centre's net revenue is projected to be up by 6% versus 27.2% in FY22

Key Takeaways:

1. We are on the fiscal path of prudence.

2. The borrowing programme will be large at Rs 14.95 lakh core. We can expect upward pressure on interest rates. 10 year bond ended at 6.82% today.

3. Specific thrust is given to infra for Rs 7.5 lakh crore of which 65% is for roads, railways and defence.

4. Measures to boost segments like hospitality, housing, telecom, solar power, EVs etc.

5. As secondary fallout, this should lead to increase in demand for credit.

6. No changes in direct taxes which means no boost for consumption. Consumption increase will be through secondary and tertiary effects of capex leading to higher job creation and income.

7. Disinvestment number for next year will be Rs 65,000 crore.
8. We will see a digital rupee next year with RBI taking the lead.
9. Sovereign green bonds to be issued. We need to watch for the modalities.
10. Subsidies to be reduced this year.
11. Average interest cost for FY23 will be at 6.5% compared with 6.1% in FY22.

This should help spur investment and hence growth and employment. Inflation will have to be watched for as crude price will hold the clue. With interest rates going up there will be a new cycle in the market and the days of easy money will be over.

Monetary policy

RBI has kept all policy rates unchanged. There has been focus on liquidity management. We believe the 4.5% inflation forecast for FY23, is on the lower side in the wake of crude running at US$ +90/bbl and high global commodity prices among others. Our forecast for CPI is ~5.5% in FY22 and at 5.0-5.5% in FY23. Growth forecast of RBI at 7.8% seems realistic. We expect RBI to remain on hold in the coming two policies as well.

Other key news

- Second Advance Estimates of production of major crops for the year 2021-22 have been released by the Ministry of Agriculture and Farmers Welfare. Record foodgrains production of 316.06 million tonnes is estimated. As per 2nd Advance Estimates for 2021-22, total **Foodgrains** production in the country is estimated at record 316.06 million tonnes which is higher by 5.32 million tonnes than the production of foodgrain during 2020-21. Further, the production during 2021-22 is higher by 25.35 million tonnes than the previous five years' (2016-17 to 2020-21) average production of foodgrains. Total production of Rice during 2021-22is estimated at record 127.93 million tonnes. It is higher by 11.49 million tonnes than the last five years' average production of 116.44 million tonnes. Production of Wheat during 2021-22is estimated at record 111.32 million tonnes. It is higher by 7.44 million tonnes than the average wheat production of 103.88 million tonnes.

- The Union Cabinet has approved the national roll-out of Central Sector Scheme, Ayushman Bharat Digital Mission (ABDM) of Ministry of Health and Family Welfare, Government of India, with a budget of Rs.1,600 crore for five years. The National Health Authority (NHA) will be the implementing agency of Ayushman Bharat Digital Mission (ABDM). Under the ABDM, citizens will be able to create their ABHA (Ayushman Bharat Health Account) numbers, to which their digital health records can be linked. This will enable creation of longitudinal health records for individuals across various healthcare providers, and improve clinical decision making by healthcare providers. The mission will improve equitable access to quality healthcare by encouraging use of technologies such as telemedicine and enabling national portability of health services.

- A target of all India coal production of 1.2 Billion Tonne up to the year 2023-24 has been fixed. Actions taken by the Government to further enhance the production of coal in the country include: Commercial Auction of coal on revenue share mechanism; Allowed sale of excess coal production; Rolling auction; and Single Window Clearance.

- After reviewing the cash position of the Central Government, the Government of India, in consultation with Reserve Bank of India, has decided to modify the amounts for the issuance of Treasury Bills in the remaining part of Quarter 4 of 2021-22. Centre will now borrow Rs 1.86tn compared with Rs 1.26tn planned earlier.

Data Releases

GDP: Q3FY22 GDP at 5.4%

India's GDP growth is estimated at 8.9% in FY22 (-6.6% in FY21). For Q3FY22, growth is pegged at 5.4% from 8.5% in Q2FY22. With steady revival and resumption of economic activities post Omicron, we expect Q4FY22 growth between 4.8-5.3%. This will push the GDP to grow by 9.1% in FY22, higher than government estimates. This will be on the back of muted impact of Omicron variant and state lifting lockdown restrictions. Resumption of economic activity at much faster pace than initially anticipated will push Q4FY22 growth higher. However, uncertainty due to escalation of geo-political risk (Russia and Ukraine crisis) might pose downside risk to these estimates.

For Q3FY22, GVA growth eased to 4.7% from 8.4% in Q2FY22. Moderation was noticed across all broad base components. Agriculture growth slowed to 2.6% in Q3FY22 from 3.7% in Q2FY22. Similar picture was seen with mining (8.8% in Q3 from 14.25 in Q2FY22), manufacturing (0.2% from 5.6% in Q2), trade (6.1% in Q3 from 9.5% in Q2FY22) and financial services (4.6% from 6.2% in Q2FY22). Even growth in public administration eased to 16.8% in Q3FY22 (19.5% in Q2FY22). Furthermore, contraction in construction sector at (-) 2.8% in Q3FY22 from an increase of 8.2% in Q2FY22 dragged down the overall growth.

Infrastructure industries

India's eight core industries slowed down marginally to 3.7% in Jan'22 from 4.1% in Dec'21, signalling muted impact of 3rd wave of Covid-19. This was led by moderation in output of refinery products (3.7% from 5.9% in Dec'21), natural gas (11.7% from 19.5% in Dec'21) and electricity (0.5% from 2.9% in Dec'21). Production of crude oil and fertilizer contracted by (-) 2.4% and (-) 2% added to the disappointment. Despite a broad based moderation, production of coal (8.2% from 5.2%) and steel (+2.8% from -0.7%) improved in Jan'22. On FYTD basis, eight core output improved by 11.6% for FYTD'22 compared with a contraction of (-) 8.6% in FYTD'21.

Fiscal health of Central government

Centre's fiscal deficit (gap between its income and expenditure), eased to 3.8% (of GDP) in Jan'22. This is much lower than government's revised estimates (RE) of 6.9%. Centre's net revenue has already exceeded government's RE for FY22. It is at Rs 18.4tn (RE: 17.7tn). Both tax and non-tax revenue are higher in terms of proportion of revised budget for FY22 this year compared with last year. However, total spending is behind target at Rs 28.1tn versus RE of 37.7tn. Total expenditure so far at 74.5% (% of RE) and is almost the same as last year when it was 73%. There is still Rs 1.6tn of capex and Rs 8tn of revenue expenditure that has to be incurred in the remaining two months (Feb-Mar'22).

Trade- Exports and imports moderated in Jan'22

India's trade deficit in FYTD22 has surged to US$ 154.8bn from US$ 73.6bn in FYTD21. This has been due to higher imports led by revival in domestic activity and higher commodity prices. Exports too have remained buoyant at US$ 338bn in FYTD22, and are likely to exceed the government's target of US$ 400bn in FY22. However, rising oil prices (above ~US$ 90/bbl currently) are likely to inflate the oil import bill. This will put pressure on trade deficit and INR. **We estimate that a US$ 10/bbl increase in oil prices will increase oil imports by ~US$ 2-3bn/month.**

India's exports moderated to US$ 34.5bn in Jan'22 (25.3% YoY) from a record-high of US$ 37.8bn in Dec'21 (38.9%). Oil exports moderated more than non-oil exports. In FYTD22 (Apr-Jan), India's exports have increased at a solid pace of 47.8% to US$ 338bn, compared with a decline of 13.4% in the same period last year. Improvement in global demand has contributed to the strong export performance.

Imports growth too moderated to an 11-month low of 23.6% in Jan'22 from 38.5% in Dec'21. While oil and gold imports dipped in Jan'22, non-oil-non-gold imports were broadly stable. On FYTD22 basis, imports have increased by 63% compared with a decline of 25.4% in FYTD21. In the same period, gold imports have increased by 94.1% versus a decline of 15.5% in FYTD21. It must be noted that gold prices declined by 1.9% in FYTD22 compared with an increase of 27.9% in FYTD21.

CPI touches 6%

CPI inflation rose to 6% in Jan'22 from 5.7% in Dec'21, led by food inflation (5.4% versus 4%). However, core inflation eased by 10bps to 6% due dip in prices under transport and communication, health and personal care items. Going forward, we expect core inflation to remain sticky due revival in domestic demand, and build of input price pressures as seen in WPI. We also expect inflation to overshoot RBI's estimates in FY22 and FY23. Despite this, we expect RBI to remain on hold for now, to support growth.

Food inflation was led by rebound in prices of vegetables (5.2% versus -3%). Vegetable prices also rose on wholesale basis with vegetable inflation (WPI) at 38.5% in Jan'22 versus 31.6% in Dec'21. Apart from this, in the CPI basket, prices of meat and fish (5.5% versus 4.6%), cereals (3.4% versus 2.6%), eggs (2.2% versus 1.5%), milk (4.1% versus 3.8%) and spices (4.7% versus 4%) also increased. Amongst these, similar trend was also seen in wholesale prices for cereals, pulses, eggs, meat and fish and milk.

Fuel inflation was a respite as fuel and light index eased to 9.3% in Jan'22 from 11% in Dec'21. On the wholesale level, fuel and power inflation has remained unchanged from last month at 32.3% in Jan'22. In the CPI basket, moderation was led by dip in prices of Kerosene (by PDS) to (-) 5.9% in Jan'22 from (-) 1.8% in Dec'21. Coal prices (-0.1% versus 1.3%) and other fuel items (-0.4% versus 0.8%) also fell.

WPI

WPI inflation is not an important in put for the MPC when it deliberates on policy. Yet, it is a very good indicator on what is happening on the producer side as it is broadly speaking a producers' price index. This index is dominated by manufactured products which have a weight of 64% in the index and are influenced by global factors. Hence the tendency of global prices increasing gets reflected more in the WPI than CPI. This number has been above 10% throughout the year and only part of the explanation is in the low base effect.

Contrary to our expectations of 11.6% WPI in January, WPI has come in at 13%, which is only slightly lower than last month. WPI inflation eased from 13.6% in Dec'21 to 13% in Jan'22, implying input price pressures continue to remain elevated. At 13% the number is still high and the disturbing part of the story is that the inflation of primary products has increased sharply. Only manufactured products inflation declined from 10.6% in Dec'21 to 9.4% in Jan'22. Fuel and power inflation remained unchanged at 32.3%. On the other hand, food inflation picked from 9.2% to 9.6%.

IIP- Industrial growth disappoints

IIP growth eased to 0.4% in Dec'21 from 1.3% in Nov'21 led by mining (2.6% from 4.9% in Nov'21) and manufacturing output (declined by -0.1% from an increase of 0.8%). Within manufacturing, output of furniture and electrical equipment disappointed the most. Capital goods output contracted to 11-month low of 4.6% in Dec'21. Notably, IIP growth over a 2-year basis (2.6% in Dec'21) is back up to pre-pandemic levels.

Sustainable recovery remains a challenge: During Apr-Dec'21, IIP rose by 15.2% compared with a decline of 13.3% in the same period over the previous year. The rapid spread of Omicron (Covid-19 variant) in Jan'21 had posed a challenge with surge in cases across the country resulting in state-wide restrictions. However, with cases now ebbing and states reopening the economy along with budget announcements, we expect improvement and revival to sustain in Q1FY23.

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