3 February 2023

**Sonal Badhan**
**Economist**

# Economic Round-up: January 2023

**At the beginning of 2023, while there is hope that global economy will slow down less than previously anticipated, however uncertainties still remain. While impact of China's re-opening is visible in improvement of manufacturing and services PMI in China and Europe, macro data points in the US are still muted. With the beginning of moderation in the pace of rate hike by Fed, it is expected that growth will get support. For the time being, inflationary pressures have been cooling down across countries, however upside risks persists. If Chinese economy rebounds more sharply than expected then it will build pressure on commodity prices and reignite price pressures. Impact of re-opening on Chinese and global economy will have to be closely watched to gauge the risks.**

**Global growth:** Global economy is giving mixed signals at the start of CY23. In the US, majority of macro data (home sales, manufacturing activity, retail sales, and consumer confidence) is showing slowdown, while labour market still remains tight. On the other hand, activity in Eurozone is seen improving (Germany Ifo, PMIs) and CPI is expected to have peaked last year. In China, following government's decision to re-open the economy, both manufacturing and services activity has rebounded, with services sector being the major beneficiary. Taking into account these new developments, IMF has upwardly revised its CY23 global growth forecast to 2.9% (2.7% estimated earlier). However, it has slightly lowered CY24 forecast to 3.1% from 3.2%.

**Global Central Banks:** In the latest policy meetings of US Fed, ECB and BoE, all three banks decided to raise their key policy rates. While Fed slowed its pace of increase to 25bps, both BoE and ECB maintained their pace and rose rates by 50bps. In terms of future guidance, Fed has maintained that it is unlikely to cut rates in CY23 as labour market still remains tight and can act as upside pressure on CPI, which has recently begun to cool down. BoE sounded more dovish and believes that it does not expect economy to slowdown as much as anticipated earlier. ECB too has vowed to continue hiking rates until CPI is substantially brought down. BoJ on the other hand has reaffirmed that it will maintain its ultra-loose monetary policy stance as it expects inflation to fall below the targeted 2% by mid of fiscal year 2023.

**Key macro data releases:** With data on the fiscal state of the government coming in till Dec'22, fiscal deficit has reached 59.8% of the targeted level, compared with 50.4% during the same period last year. Capex remains the bright spot, with spending spearing ahead and revenue expenditure also at par with last year. On the income side, net revenue witnessed further slowdown on account of moderation in both direct and indirect tax receipts.

On the industrial production side, core sector growth for December has come in at 7.4% thus taking the cumulative number to 8% for the first 3 quarters. With the exception of crude oil all segments witnessed positive growth.

CPI inflation eased to a 13-month low of 5.7% in Dec'22 from 5.9% in Nov'22. This was on account of favourable base (5.7% in Dec'21 from 4.9% in Nov'21) and 50bps decline in food inflation. CPI food index moderated to 4.2% in Dec'22 from 4.7% in Nov'22. Core CPI (excl. food and fuel) remained sticky at 6% in Dec'22 as well. The major driver had been increase in personal care and items inflation to 8.1% in Dec'21 from 7% in Nov'22.

# Global developments

## Global growth-not as bad as expected

IMF in its latest world economic outlook has revised its global growth forecasts for both CY23 and CY24. Upward revision has been made to CY23 forecast while CY24 forecast has been revised downward compared with outlook in Oct'22. ***In CY23, global growth is expected to come in at 2.9% versus 2.7% estimated earlier, while in CY23, growth will be rebound to 3.1% versus 3.2% estimated in Oct'22.*** CY23 growth forecasts for almost all economies have been revised upwards/left unchanged except for Saudi Arabia (-1.1 percent change from Oct'22) and UK (-0.9 percent change from Oct'22). On the other hand, most significant upward revisions have been made for Russia (+2.6 percent change from Oct'22), China, Italy (+0.8 percent change from Oct'22) and Germany and US (+0.4 percent change from Oct'22). Re-opening of Chinese economy, normalising of supply chains, and cooling commodity prices have given hope that CY23 may not be as bad as expected. However, prolonged effect of slowdown in growth in will be seen in CY24 as well, wherein growth forecasts for advanced and emerging market economies has been revised lower. Significant reductions have been made to growth forecasts of Italy, Japan, Brazil (-0.4 percent change from Oct'22), followed by US, Euro Area, Spain (-0.2 percent change from Oct'22) and Germany (-0.1 percent change from Oct'22).

US economy is showing signs of slowdown, which has also pushed Fed to hike rates by a smaller quantum this time. US existing home sales fell by (-) 1.5% (MoM) in Dec'22 to ~4mn units—lowest level since Nov'10. Elevated mortgage costs is deeply impacting the housing sector. However, mortgage rates have begun to inch down following Fed's indication of adopting a less aggressive monetary policy stance. The 30-year fixed mortgage rate has fallen to 6.09% (as of 2 Feb 2023)—lowest level since mid-Sep'22. Despite this, consumer confidence remains low, with conference board index slipping to 107.1 in Jan'23 from 109 from Dec'22. US retail sales have also taken a hit with sales down by (-) 1.1% in Dec'22 following (-) 1% decline in Nov'22. On the production side as well, manufacturing output fell by 1.3% in Dec'22 versus (-) 1.1% decline in Nov'22. Manufacturing ISM index also shows that weakness in activity remains in Jan'23 as well, with index down to 47.4 from 48.4 in Dec'22. On the other hand, a key concern for US Fed also, is the tightness in labour market. The 4-week moving average for initial jobless claims was down by ~6k to ~192k for the week ending 28 Jan 2023, compared with ~198k in the week before.

In Eurozone (EZ), while economic activity still remains muted, the weakness is reducing. EZ's final manufacturing PMI came in at 48.8 in Jan'23, up from 47.8 in Dec'22. In Germany too, pace of contraction of manufacturing activity eased with index improving to 47.3 in Jan'23 from 47.1 in the previous month. In case of France, activity moved into expansion zone with PMI settling at 50.5 from 49.2 in Dec'22. Prices too seem to have peaked with CPI cooling off to 8.5% in Jan'23 from 9.2% in Dec'22. Germany's business morale is also up, following news of re-opening of China's economy, with Ifo index improving to 90.2 in Jan'23 from 88.6 in Dec'22. GDP data for Q4CY22 also came in much better than expected at +0.1% versus estimated decline of (-) 0.1%, though it was still lower than Q3's print of +0.3%. ECB considers current inflation level as elevated and has hence wowed to keep hiking rates until it brought down to target levels.

While China's decision to re-open its economy has offered a glimmer of hope to the global growth, so far the signs of revival are mixed. While China's official manufacturing PMI index rebounded to 50.1 in Jan'23 from 47 in Dec'22, the Markit manufacturing PMI (survey covering smaller Chinese firms) still remains in contraction with index at 49.2 versus 49 in Dec'22. However, 12-month forward looking optimism was at its highest for smaller firms in Jan'23. On the other hand, services activity showed much sharper improvement, also supported by Chinese New Year celebrations. While the official non-manufacturing PMI index jumped to 54.4 in Jan'23 (41.6 in Dec'22), Markit services PMI was up at 52.9 (48 in Dec'22). Retail sales in Dec'22 contracted less sharply by (-) 1.8% compared with (-) 5.9% decline in Nov'22. In Q1CY23, it is estimated that retail sales growth would rebound to 6%. High frequency indicators indicate that passenger mobility has revived to near pre-pandemic levels. Property sector indicators are also pointing towards a recovery. However, profit margins of firms still remain tight. Official Jan-Feb'23 data for industrial production, retail sales and FAI will be keenly eyed to gauge the actual impact made following re-opening of the economy.

## Global central bank decisions

***In line with market expectations, US Fed raised its key policy rate by 25bps to 4.5-4.75%,*** slowing down the pace of rate hike from 50bps in the previous months. The easing was done acknowledging that inflation is beginning to cool down. However, it maintained its stance that no rate cuts can be expected this year, as inflation still remains at elevated levels and the bank is committed to bring it down to 2%. It also highlighted that labour market remains tight and wage pressures pose upside risk to inflation outlook.

***ECB too raised its key policy rate by 50bps versus 75bps hike in the previous month***. The smaller rate hike was delivered keeping in view that inflation might have peaked last year and energy prices are beginning to come down. However, going forward, upside pressures on inflation may emerge from: pull back in government provided energy subsides; stickiness in wage rates; and delayed effect of easing supply chain bottlenecks. Central Bank thus re-affirmed and vowed to continue hiking rates to manage inflation expectations and bring inflation level down to its medium-term target.

In line with other major central banks, ***Bank of England (BoE) too raised its policy rate, by 50bps, taking its key lending rate to 14-year high of 4% in Feb'23***. The pace of rate hike was unchanged from Dec'22 (+50bps), when it was slowed from +75bps in Nov'22. BoE's statement was more dovish than anticipated as it hinted at slowdown in the pace of rate hikes in the coming meetings on account of inflation cooling off. The bank also expects economy to contract less sharply in CY23 than earlier anticipated. In Q1CY23 it expects output to contract by (-) 0.3% compared with (-) 0.6% estimated earlier. For Q1CY24, growth is now estimated at (-) 0.7% versus (-) 2% earlier.

BoJ in its Jan'23 meeting decided to keep its rates and stance unchanged. In the policy statement the bank highlighted while inflation remained elevated at the moment, it is expected to cool off in the coming months as international oil prices have dipped. As a result, it expects inflation to fall below the target 2% mark by mid of fiscal year 2023. It has thus vowed to maintain its ultra-loose policy stance even its Mar'23 policy meeting.

# Special studies

## Budget 2023-24: Reinvigorating growth through investment

Union Budget for FY24 was a continuation of the ideology displayed in earlier budgets and it hence tread on similar lines. Focus was on tuning spending towards capital expenditure to create a multiplier effect on growth by crowding in private investment. From inflation standpoint as well, budget gave a relief by raising rebate limit under personal income tax from existing Rs 5 lakh to Rs 7 lakh (new regime). Other estimates such as tax revenue collection in line with slightly downward bias for GDP growth in FY24 seem feasible. From market standpoint as well, budget gave a cheer by not inflating the gross borrowing numbers which led to dip in 10Y yields. Sector wise, MSMEs was in focus, whether be it providing digi-locker facility to them, integrating them in the value chain or revamping the credit guarantee scheme by providing a corpus of Rs 9,000 crore.

**Tax Revenue to get a hit in FY24:** Though FY23 has been a year of good revenue collections (both corporate and income tax is expected to grow by 17.3% and 17.1% respectively), the hit is likely to be in FY24. This will be in line with slowing GDP growth. Both corporate and income tax are expected to grow by 10.5% each to Rs 9.2 lakh crore and Rs 9 lakh crore respectively. Indirect taxes are likely to be buoyant at Rs 15.3 lakh crore as per FY24BE from Rs 13.3 lakh crore in FY23RE. This would be supported by robust GST collections of Rs 9.6 lakh crore in FY24 from Rs 8.5 lakh crore in FY23RE. Total tax revenue is expected to increase by 10.4% to Rs 33.6 lakh crore in FY24BE from Rs 30.4 lakh crore in FY23RE.

**Non tax revenue** is expected to increase to Rs 3 lakh crore in FY24BE from Rs 2.6 lakh crore in FY23RE. This would be supported by better dividends from PSUs and Banks estimated at Rs 91,000 crore from Rs 83,953crore in FY23RE. This is on the back of better financial results of corporates and Banks.

**Fiscal deficit** target for FY24 (BE) at 5.9% is in line with our estimate of 5.75-6%. FM has repeatedly mentioned in her statement that objective would be in restoring the fiscal glide path of less than 4.5% by FY26.

**Focus on capex continued:** Centre's capex spending is expected to increase by 37.4% in FY24BE to Rs 10 lakh crore against 22.8% increase seen in FY23RE. Ministry wise, capital outlay for road transport and highways has increased 1.3times to Rs 2.6 lakh crore in FY24BE compared to Rs 1.9 lakh crore in FY23BE. For defense as well, the capital outlay increased to Rs 1.6 lakh crore in FY24BE compared to Rs 2.7 lakh crore in FY23RE. For telecom, it increased to Rs 61,692 crore from Rs 54,150crore in FY23RE. Other than this, capital outlay for Petroleum and Natural Gas have showed a sharp increase to Rs 35,509 crore in FY24BE from Rs 600 crore in FY23RE. States transfer (as 50-year interest free loan to be spend as capex), have been higher at Rs 1.37 lakh crore in FY24BE which was Rs 1.1 lakh crore in FY23RE.

**Revenue spending pruned down:** Revenue spending is expected to ease, noting only 1.2% increase in FY24BE to Rs 35 lakh crore compared with 8.1% increase (Rs 34.6 lakh crore) seen in FY23RE.

**Disinvestment receipts** have been pegged slightly higher at Rs 51,000crore in FY24BE from Rs 50,000crore in FY23RE.

**Reasonable borrowing numbers to comfort yields:** In FY24BE, gross borrowing is estimated at Rs 15.43 lakh crore against Rs 14.21 lakh crore in FY23RE. Repayments are likely to be higher at Rs 4.4 lakh crore against Rs 3.1 lakh crore in FY23RE. Thus, net borrowing amounts to Rs 11.8 lakh crore, slightly higher compared to Rs 11.1 lakh crore in FY23RE. Interest cost is also likely to be at Rs 10.8 lakh crore in FY24BE against Rs 9.4 lakh crore in FY23RE. Outstanding liabilities of the government would rise to Rs 169.5 lakh crore against Rs 152.6 lakh crore in FY23RE. This tantamount to an effective interest rate (Interest payment/Average outstanding liabilities) of 6.7% in FY24BE which is only slightly higher compared to 6.5% in FY23RE. Net securities against small savings is expected to increase to Rs 4.7 lakh crore in FY24BE compared to Rs 4.4 lakh crore in FY23RE. This is assumed on the back of higher rates on these instruments.

## Economic Survey 2022-23

This year Economic Survey presented a holistic picture of the impact of government policies on growth and quality of living and also outlined the path to achieve sustainable 7-8% growth per annum over the medium term. While on one hand, this year's survey highlighted progress made in social sector (improvement in enrolment ratios, health and social sector spending, decline in mortality ratios, increased access to cooking fuel, affordable housing, water, sanitation and electricity, and all weather roads), on the other hand it noted strength on the external front (forex reserves, remittances, and import cover). Robustness of the financial intermediaries and, fiscal position of the government were pointed as pillars on which India's growth will leap forward in the medium-term. Further push is expected to be provided by enhancing the physical and digital infrastructure of the country, which has already changed our way of living and has helped us cope with the effects of Covid-19 pandemic faster.

**GDP growth:** Economic Survey expects Indian economy to do better than pre-pandemic year as the health and economic shocks of pandemic and spike in commodity price wear off. The economy is pegged to grow by 7% in FY23 and by 6.5% (6.0-6.8%) in FY24 as global environment remains rife with uncertainty. In the medium term, potential GDP growth of the country is likely to rise to 7-8% per annum.

**Physical and Digital Infrastructure:** Economic Survey acknowledges Infrastructure offers multiplier effected in the economy and thus the government had adopted the forward looking approach towards infra. Under National Infrastructure pipeline (NIP) over 89,151 projects worth Rs 141.4 lakh are under various stages of implementations. The role of digital infrastructure in socio-economic development has expanded and have gathered increased importance. The focus of digital India programme rests on providing high speed internet as a core utility to citizens for delivering services, creating unique digital identity, providing shareable private space on public cloud (digitally store certificate and documents). Favourable demographics, digital behaviour pattern and middle class expansion are growth drivers for India's digital infrastructure.

**Agriculture and Food management:** Private investment in agriculture sector has increased by 9.3% in FY21 (7% in FY20). Institutional credit in agriculture sector has grown by as much as Rs 18.6 lakh crore in FY22 from Rs 15.8 lakh crore in FY21. Initiatives such as PM-KSIAN, PM-Fasal Bima yojana and forming agriculture infrastructure fund has provided much needed support to the sector. Formation of e-NAM with 1.74 crore farmers and 2.39 lakh traders has aided the sector further.

**"Revenue Relish":** In the current fiscal year, government is likely to reap benefits of "sustained revenue buoyancy" with FYTD (Apr-Nov'22) growth in revenue collections breaching the long-term average (LTA) trends. For instance, gross tax revenues so far are up by 15.5% versus LTA of 13.9%. This has allowed the government to improve the quality of spending with capex now contributing to 19% (FY23BE) of the total expenditure versus 12% in FY18. Road transport & highways, railways and defence services have been the biggest beneficiaries.

**All under a "Big Tent":** The survey highlights, that government reforms apart from focusing on high growth, also ensured that growth remains inclusive and improves the quality of life of general public. To achieve this, social sector spending of the government increased more than 2X to Rs 21.3 lakh crore by FY23 (BE) from Rs 9.1 lakh crore in FY16. Further, health budget of both central and state governments rose to 2.2% of GDP (FY22RE) from 1.6% in FY21, and remained above 2% in FY23 (BE) as well (2.1%).

**Financial intermediaries:** It was noted in the economic survey that following boom and bust cycle experienced by the financial sector in the first 2 decades of this millennium, the financial sector is now back on track. While the recovery was somewhat delayed owing to the Covid-19 pandemic, banks now have much cleaner balance sheet, GNPA ratio of SCBs has fallen to a 7-year low of 5.0% as of Sep'22; CRAR remains healthy at 16.0%; and the recovery rate for the SCBs through IBC was the highest in FY22 compared to other channels. Going forward, supported by strong balance sheets, growth in credit offtake is likely to sustain, and with revival in private capex, India will witness a virtuous investment cycle.

**External stability:** Highlighting the strength of our fundamentals, the survey notes that our forex reserves remain sufficient at US$ 563bn (as of Dec'22) and can cover up to 9.3 months of our imports. Foreign exchange reserves as a % of total debt also stands at whooping 97%. India remains one of the top remittance recipient of the world (according to World Bank report) with US$ 100bn estimated in receipts for 2022. Going forward, the survey expects CAD to remain within sustainable limits, assuming easing of crude oil prices, resilience of net services exports and inflow of remittances. However, risks to this outlook may emerge from pick up in oil prices and commodity prices (in case global recovery fastens) increasing our import bill.

## States' capital spending: An update

RBI data shows that in terms of capital expenditure, both central and state governments are broadly equal partners. Thus, at a time when we are looking at the central government to give public investment a nudge, performance of state governments should also be keenly watched.

RBI study on state finances shows that total capital expenditure in FY23 (BE) for all the states and UTs put together had been pegged at Rs 7.54 lakh crore, up from Rs 6.34 lakh crore last year (FY22RE) and Rs 4.18 lakh crore during pre-pandemic period (FY20). This is in line with union government's target of Rs 7.50 lakh crore for FY23 (BE), Rs 6.03 lakh crore for FY22 (RE) and Rs 3.36 crore in FY20. Thus, implying that states have a marginally higher share in driving public sector investment growth.

For the purpose of this study, we analysed state-wise capex data for 24 states and UTs and excluded Manipur, Meghalaya and Mizoram, Goa, J&K, Delhi and Puducherry from our sample due unavailability of latest data. Total capital outlay for these 24 states was budgeted at Rs 6.85 lakh crore for FY23 (BE) versus Rs 5.75 lakh crore as per FY22RE. This is 90% of the total amount budgeted by states. The total projected expenditure on capital for FY23 for this set of states is just tad lower than that of the centre which is Rs 7.5 lakh crore (which also includes Rs 1.40 lakh crore of loans to be given to states). If the loan part is excluded then it would mean that the states are targeting to spend higher than centre in terms of capex.

The centre for the first 8 months of the year has spent Rs 4.5 lakh crore which is 60% of the budgeted amount. The states on the other hand have been slower with just 39% of the budgeted amount being spent so far which is Rs 2.7 lakh crore. Hence, there is considerable slack here which needs to be made up during the course of the remaining 4 months of the year. If that is not the case, then we can expect downward revision in the capex print when revised estimates (RE) for FY23 are published.

Of the Rs 6.85 lakh crore, 5 major states alone contribute to 47% of the total capex. These include Uttar Pradesh (Rs 1.2 lakh crore), Maharashtra (Rs 65,000 crore), Madhya Pradesh (Rs 46,000 crore), Karnataka (Rs 44,000 crore) and Tamil Nadu (Rs 43,000 crore). If we add other major states to the list which have share more than 4% (Odisha, Gujarat, Rajasthan, W. Bengal, Andhra Pradesh, Bihar and Telangana) then share of these 12 states jumps to 81%. Thus, tracking the performance of these states can help us estimate if target for this year will be met or not.

So far, these 12 major states have spent Rs 2.12 lakh crore only, and amongst these, only Gujarat and Karnataka have spent more than 50% of the budgeted amount. There are smaller states like HP, Kerala also which have spent more than 50% so far. Amongst the top 5 states, which contribute to 47% of the budgeted amount, both Uttar Pradesh (29% of BE) and Maharashtra (30% of BE) are lagging much the target. In comparison to this, Karnataka (52% of BE), Tamil Nadu (49% of BE), and Madhya Pradesh (49% of BE) have made better progress till date.

This shows that there does seem a long distance to be covered for states. They have been going slow ostensibly because of caution being exercised to ensure that the fiscal targets are not breached. Hence there could be some push given in the last two months of the year. This has been a challenge as well as a pattern followed by states spending on capex where cuts are invoked at the end to meet the fiscal deficit target. Therefore while budgeted numbers for capex are indicative of intention, the final numbers reveal the capacity to go through with these plans.

## Disinvestment is more a case of misses

Prior to the presentation of the Union Budget there were many conjectures about the disinvestment figure of capital receipts. Be it unfavourable macros to raise capital, procedural hurdles or pricing issue, we have seen that disinvestment has been more of a miss rather than a hit in the past. Against this backdrop, we traced the disinvestment scenario since FY92, when the idea was first floated. We ventured into different routes through which disinvestment is carried out and through which route maximum receipts are garnered. Next, we evaluated how BSE CPSE had fared in terms of returns compared with the Sensex. We then delved into the financials of CPSEs to get an idea where the green and red flags exist.

Some observations here stated below:

- Historically only in FY08, the receipts have been higher than previous periods. This is on account of disinvestment of small portion of government equity in Rural Electrification Corporation (REC), Power Grid Corporation Limited (PGCIL) and National Hydroelectric Power Corporation (NHPC). During this period as well, National Investment Fund (NIF) was in its initial years and proceeds from disinvestment were meant to be channelized through this fund.
- From FY14 onwards, disinvestment receipts picked pace through the route of public offer, exchange traded funds (ETFs) and CPSE to CPSE sale. Several regulatory initiatives in terms of raising minimum public shareholding to 25% from 10% earlier for listed CPSEs, making buyback compulsory for certain CPSEs, introducing IBC code, launching Bharat 22 ETF New Fund Offer and also approving asset monetisation policy, proved to be helpful.
- FY18, FY19 and FY22 have been remarkable years. In FY18, NTPC and GIC garnered maximum receipts through OFS and IPO route respectively. In FY19, Bharat 22 ETF and Coal India bagged major receipts. In FY22, sale of Axis Bank Strategic holding of SUUTI, NMDC and Air India have been the major ones.
- There are various routes through which disinvestment is carried on such as 1) Initial/ Further Public Offer (IPO/ FPO) where an unlisted company makes a fresh issue of shares, for FPO an already listed company makes either a fresh issue or an offer for sale 2) Exchange Traded Fund (ETF) is a basket of stocks reflecting an index deriving value from underlying stocks 3) Offer for Sale (OFS) is share sale through the exchange platform for listed companies 4) Buyback (BB) of shares is repurchase by a

company of its shares from its existing shareholders and 5) Strategic sale of CPSEs is sale of a substantial portion of the government shareholding of up to 50% or higher.

- Historically between FY99-FY00, maximum disinvestment receipts have been routed through strategic sale followed by public offer. In the next phase that is between FY00-FY14, CPSE to CPSE sale, ETFs and buyback gained prominence.
- From FY16 onwards where maximum disinvestment receipts were garnered, it was seen that public offer dominated the space. Lower interest rate regime (as it was an accommodative policy space barring the recent hike cycle which commenced on May'22), surplus liquidity, better corporate performance and favourable cost of capital, contributed towards the same.
- Historically disinvestment has been more of misses rather than hits. Out of 32 occasions, in only 8 occasions, disinvestment receipts have surpassed their target.

## Highlights of RBI's FSR

- Despite an uncertain global macros, FSR highlighted that Indian economy has remained fairly resilient. However, downside risks to growth cannot be ruled out. As per Systemic Risk Survey of RBI, almost all surveyed respondents expect medium to very high probability of a global recession in 2023.
- Within macroeconomic risks, RBI has flagged that corporate sector risk, pace of infrastructure development and risks to real estate prices have increased. Risk to domestic inflation on the other hand has declined.
- What has been a respite is that banking system has remained resilient with adequate capital buffers and moderate levels of non-performing loans.
- Not only this, stronger capital levels of NBFCs, robust growth in AUMs of domestic mutual funds also point towards stability of overall financial system. Another important development has been that the GNPA ratio of large borrowers has improved significantly to 6.4% in Sep'22 from over 10% in Mar'21. Almost all the profitability indicators of SCBs have improved in Sep'22 compared to Mar'22.
- Stress test results also indicated that Indian banks are well capitalized and are in a well-equipped position to absorb any macroeconomic shocks. Capital levels are well above requirement even during severe stress period. Under baseline scenario, GNPA ratio of SCBs is likely to improve to 4.9% in Sep'23 from 5% in Sep'22.
- A broad based increase in credit has been seen across sectors, population groups, geography, type of accounts and bank groups. PVBs have registered higher credit growth than PSBs. Within total advances the share of services and personal loans have moved up. Credit growth has also expanded for agriculture and industry sector.
- The slippage ratio which has been on the uptrend since Dec'21 has cooled off in Q2FY23. PSBs have registered the most improvement during this period.
- On the other hand, provision coverage ratio has been rising at a steady pace since Mar'21 and has edged up to 71.5% in Sep'22. The ratio has exceeded beyond 75% for both Private Banks and Foreign banks.

- After declining continuously for the last two years, the cost of funds increased slightly to 4.2 in Sep'22 from 4.1 in Mar'22.
- The capital to risk weighted assets ratio (CRAR) of SCBs declined by 77 bps from March 2022 level on account of increase in risk weighted assets (RWAs) as lending activity picked up. From 16.7% in Mar'22 it went down to 16% in Sep'22. For PSBs, the ratio was marginally lower at 14.5% in Sep'22 from 14.6% in Mar'22. For PVBs, the ratio went down to 17.2% from 18.8% in the same period.
- Credit flow to MSME by PVBs have registered a strong growth. However, lending by PSBs have moderated for the same period. Broad based recovery in domestic demand, higher working capital requirement along with the ECLGS scheme has played a pivotal role in sustained credit growth.
- Overall GNPA ratio (PSBs and PVBs) in MSME has fallen to 7.7% in Sep'22 (9.3% in Mar'22). However, the distress continues in MSME with 1/6th of the accounts availing ECLGS falling in to NPA.
- Delinquency levels which shows impairment in consumer credit, measured in terms of the proportion of the portfolio at 90 days past due or beyond, have improved across all bank groups. For PSBs, it improved to 4.3 in Sep'22 from 4.5 in Mar'22.
- Another risk which is flagged in the FSR regarding consumer credit is that inquiry volumes for loan demand from prime and below prime consumers have increased at a faster pace than that from higher rated consumers.
- Credit has expanded at a faster pace in NBFCs with aggregate o/s amount at Rs 31.5 lakh cr. The GNPA ratio of NBFCs (5.9% against 7.2%) has moderated from its peak levels seen in pandemic period.
- GNPA ratio of SCBs is likely to be 4.9% in Sep'23 under baseline scenario from the existing level of 5% in Sep'22. However, under medium and severe stress, it is likely to deteriorate to 5.8% and 7.8% respectively.
- For PSBs, the GNPA ratio would be 6.4% in baseline scenario from 6.5% in Sep'22 and under medium and severe stress, it would deteriorate to 7.4% and 9.4% respectively.

## Is Investment set to pick up?

The New Year started with positive news emerging on the investment side. This was reflected in the CMIE data on new investment announcements made by firms for Q3FY23, which may be interpreted as investment intentions by firms, and could possibly reflect pick up in investment activity.

New investment announced accelerated sharply to Rs 7.8 lakh cr in the December quarter of 2019. However with onset of Covid-19 pandemic and lockdown restrictions imposed across the country, investment took a back seat as has been visible with moderate pace of new investment till Dec'21. With reopening of economy gradual pickup in economic activity, new investment announced peaked at Rs 8.6 lakh cr in Mar'22. Since then, in Q1FY23 and Q2FY23 a dip in new announcements was noticed. However, things are now beginning to look optimistic. As of Dec'22, there has been as steady pick up in new announcements and stands at around Rs 6.1 lakh cr compared with Rs 3.7 lakh cr in Sep'22 and Rs 4.2 lakh cr in Dec'21.

On a cumulative basis, total investment announced has grown by over 36% in Apr-Dec'22 compared with last year. It is Rs 15 lakh crore for the 9-month period compared with Rs 11 lakh core last year. In fact the Rs 15 lakh crore of announcements made in FY23 so far is the highest in the last 5 years.

Important takeaways sectors that have shown interest in investment with their announcements for the cumulative period of Apr-Dec'22 are as follows:

- Chemicals and related products along with machinery accounted for 54.1% share of total new announcements made.
- The chemical and related sector has witnessed an uptrend in terms of new announcements, its share had been relatively lower previously.
- For power sector, the share of new announcements has been growing at a healthy pace in Apr-Dec'22 (27.4%).
- Share of new announcements in metal sector has registered dip in Apr-Dec'22 period compared with last year for the same period.
- Transport services (mainly airlines) used to account a bigger share of pie in terms of new announcements. However, its share of new announcements has declined the most for Apr-Dec'22, if compared with last 3-years.
- Construction and real estate sector has been disappointing too as the share of new investment projects have dwindled this time. Thus signaling not many new projects have not been launched.

It has also been seen that while investment announcement are made, they do not necessarily materialize as can be seen from the gross fixed capital formation rate which has been stagnant in the region of 27-29% in the last 5 years. In this context it was relevant to look at the funding side where banks are important players.

The latest sector-wise data on banking business showed that non-food credit rose by 8.9% on a year to date basis ending November 18 2022. The figure for last year was 1.8%. (Data up to December 16 suggests growth increased further to 10.6% as against 3.3% last year).

The pattern of growth for November was interesting as the growth rate in all the four segments was higher than that of last year, which was encouraging. A revival in growth in credit to large industry showed a reversal and needs to be monitored closely as growth of 4.3% comes over a negative growth last year.

The picture emerging is that the new announcements made by companies does reflect optimism and the various policies that have been introduced has had the preliminary effect. However, the fructification of the same would need to be monitored.

Concomitantly looking at the funding side, growth in credit has, till November, been lower than aggregate credit for industry giving the sense that while there are intentions to invest, the plans may not yet be in place for implementation. Within industry however, the chemicals and metals sectors have witnessed traction in terms of growth in credit which can be corroborated with the investment announcements too. The same trend is evident even when the corporate bond issuances are looked at.

The power sector has a high share in new investment announcements. However, the growth in credit has been rather low at 2.1%. This can be an area for banks to expect further traction especially in the renewables space.

# Data Releases

## Currency outlook: INR to remain steady

A changing Fed narrative as well as a global risk-on sentiment explain the rally in global currencies in 2023. Dollar has weakened as markets continue to expect Fed terminal rate to peak lower than the Central Bank expectations. There is also a renewed optimism over global economy with reopening in China and growth resilience in Europe. Consequently, global currencies including INR, have regained some of the losses incurred last year. The gains have differed, and INR has remained an underperformer. FPI outflows as well as concerns over elevated external deficits have limited the gains in INR. The outlook remain uncertain with several conflicting factors at play. Weaker dollar and benign oil prices are likely to support INR, even as FPI flows may still remain elusive. On balance, we expect INR to trade in the range of 81.5-82.5/$ in the short-term, while ruling out any sharp swings on either side.

## Bond Market Round-up

Global bond yields edged down as markets are now expecting that Fed is probably nearing its terminal rate, as it got breather from softening of core PCE data. Macro prints in the US still remained weaker, thus the timing of pause remains crucial from the perspective of soft/hard landing. OIS rate are pricing in another 50bps hike in the current cycle. On domestic front, India's 10Y yield inched up ahead of the Union Budget. We expect pressure on long end yields to continue as centre is expected to borrow above Rs 16.5-17 lakh crore. Apart from this, repayment pressure of Rs 4.5 lakh crore is also there in FY24. Any demand side measure to be announced in the budget will also be cautionary call for inflation, as core still remains elevated. We expect India's 10Y yield to remain in the range of 7.3-7.4% in the current month. We also expect some correction in short end yields as RBI is approaching end of its rate hike cycle, post the Feb'22 policy. System Liquidity is likely to remain under pressure as currency in circulation would pick up both in Q4 and FY24 ahead of the general election and widening of credit-deposit gap would persist on account of relatively stable domestic demand conditions.

## Core industries

Core sector growth for December has come in at 7.4% thus taking the cumulative number to 8% for the first 3 quarters. With the exception of crude oil all segments witnessed positive growth. Crude oil production has been affected due to volatile prices as well as limited investment in new fields. Fertilizers production has grown by 7.3% on top of 3.5% last year and is part of restocking being done by companies. Steel and cement have grown by 9% which signals strong infra activity as well as private construction. The former is more in the government domain. Electricity and coal have both registered over 10% which goes along with robust economic activity this month. With 7.4% growth in core industries which have a share of around 40% in the IIP, the latter may be expected to increase by 4-5% this month.

## Central government finances

Central government's fiscal data shows that on FYTD basis (Apr-Dec) fiscal deficit reached 59.8% of the targeted level versus 58.9% as of Nov'22 and 50.4% as of FYTD22. In terms of spending, capex spending by the government continues to be the bright spot, with 65.4% of the budgeted target utilized as of Dec'22 (FYTD basis) compared with 59.6% spent as of Nov'22. Revenue spending remains at par (72.9% as of Dec'22) with last year

(72.7% as of Dec'21). On the income side, government has seen 12.5% jump in gross tax revenues uptil Dec'22, down from 15.5% growth recorded till Nov'22. Indirect tax collections have witnessed a greater slowdown (7.1% as of Dec'22 versus 8.5% as of Nov'22), compared with direct tax collections (18% versus 23.9%). Within direct taxes, both income tax (19.2% versus 26.7%) and corporate tax collections have moderated (16.9% versus 21.1%). Within indirect taxes, the softening was mainly on account of continued contraction in union excise collections (-19.9% versus -20.9%). Overall, centre's net revenue eased, as it was up by 2.1% compared with 4.8% as of Nov'22.

## CPI inflation cools further

CPI inflation eased to a 13-month low of 5.7% in Dec'22 from 5.9% in Nov'22. This was on account of favourable base (5.7% in Dec'21 from 4.9% in Nov'21) and 50bps decline in food inflation. CPI food index moderated to 4.2% in Dec'22 from 4.7% in Nov'22. This is led by sharp fall in vegetable prices by 15% in Dec'22 from 8.1% decline in Nov'22. Even fruit prices moderated to 2% from 2.7% in Nov'22. Other items of food inflation however noted an upsurge on YoY basis. These were, egg inflation (6.9% from 4.9% in Nov'22), meat and fish (5.1% from 3.9%) and cereal products (13.8% from 13%). To avoid the base, the sequential picture gives a better understanding. Thus on MoM basis, vegetables, pulses, oils and fat, milk, sugar and cereals all have shown moderation in Dec'22.

Core CPI (excl. food and fuel) remained sticky at 6% in Dec'22 as well. The major driver had been increase in personal care and items inflation to 8.1% in Dec'21 from 7% in Nov'22. This was on account of 3.1% MoM increase in gold prices in Dec'22. Apart from this, even health inflation rose to 6.2% from 5.8%. Other item such as transport and communication showed some moderation to 4.9% from 5.3%. On sequential basis, barring household goods and services all items of core inflation inched up in Dec'22, signifying demand holds buoyant.

## WPI moderating

Headline WPI eases to almost 2-year low of 5% (BoB est.: 5.6%) in Dec'22 from 5.8% in Nov'22. Food inflation in Dec'22 edged lower (0.7% from 2.2% in Nov'22) on the back of contraction in fruits and vegetable inflation (-23.6% against 13.8% in Nov'22). Vegetable prices declined for the second straight month by (-) 36% compared with (-) 20.1% in Nov'22. Tomato prices plummeted down to 4-year low of (-) 65% in Dec'22 (-52.5% in Nov'22) as supply expanded. Onion prices too followed suit and declined further by (-) 26% from (-) 19.2% in Nov'22. Cereal inflation has edged up to 9-year high of 14% (12.8% in Nov'22) led by higher wheat (20.7% from 18.1% in Nov'22) and paddy (6.8% from 6.4%) prices. Pulses inflation has also inched up to 1.5% (0.6% in Nov'22).

Fuel and power inflation in Dec'22 moved up to 18.1% from 17.4% in Nov'22, owing to sharp increase in electricity index to 16.6% from 9.5% in Nov'22. However, coal and mineral oil prices moderated down to 2.6% (3% in Nov'22) and 22.7% (23.8% in Nov'22) respectively in Dec'22. The dip in mineral oil index is in line with the trend seen in international oil prices, which has moderated down to 8.7% (YoY) in Dec'22. Within mineral oil, the prices of LPG registered a decline for the 2nd straight month. However, prices of kerosene and petrol edged upwards.

Core inflation continued to ease further to 2-year low of 3.2% in Dec'22 from 3.5% in Nov'22. Manufactured products inflation dropped down to 3.4% in Dec'22 from 3.6% in Nov'22. Of the 22 commodity sub-indices, 10 indices rose at a slower pace in Dec'22 than Nov'22 led by paper products, chemicals, furniture, leather products, fabricated metals and motor vehicles. Prices of basic metals moved up to 0.8% in Dec'22 after contracting by (-) 0.1% in Nov'22. On the global front, prices of copper (-12.3% from -17.3% in Nov'22), zinc (-7.9% against -11.2%)

and lead (-3.7% against -9.9%) have contracted at a much slower pace. However, aluminum and iron ore prices declined further by (-) 10.9% (-10.8% in Nov’22) and (-) 4.4% (-3% in Nov’22) respectively in Dec’22.

## IIP jumps sharply

IIP growth came in way above our expectation (2.8%) at 7.1% in Nov’22 from 4.2% decline in Oct’22. A favourable base indeed provided the support. Mining index rose by 9.7% in Nov’22 from 2.5% in Oct’22, manufacturing was also buoyant at 6.1% compared to 5.9% decline in Nov’22. Electricity production grew at double digit pace of 12.7% from 1.2% in Nov’22.

**Drivers of manufacturing production:** Sharp increase was noticed for wearing apparel, leather products, wood products, pharma, transport equipment, machinery and electrical equipment.

**Use based data:** Capital goods production rose at a sharp pace of 20.7% from 1.7% decline in Oct’22. Infrastructure and construction goods also rose at a double digit pace of 12.8% from 1.1%. Both consumer durables and FMCG segment remained buoyant.

## 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