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Economic Round-up: August 2024

Markit global manufacturing PMI shows further contraction in global activity as the index slipped to 8-month low of 49.5 in Aug'24 from 49.7 in Jul'24. Of the 32 countries surveyed, 18 registered deteriorating conditions. New export orders declined the most, and employment also fell. Input prices rose at a slower rate, but output prices accelerated. Country-wise, US is showing signs of slowdown with labour market cooling (ADP employment, increase in continued jobless claims, drop in job openings) and drop in existing home sales and consumer survey also highlighting concerns around muted job prospects in the coming months. These factors, along with stable CPI trajectory is likely to allow the Fed to lower rates by 25bps in its Sep'24 meeting. Elsewhere, in Europe economic conditions still remain bleak with downturn worsening in Germany and France. Recovery in China is uneven, with retail sales doing well, but factory output and investment still showing sluggish growth, dragged by troubles in the real estate sector. In contrast, India remains a bright spot, as it maintains the title of fastest growing major economy in quarter ending Jun'24. High frequency indicators (rainfall, Kharif sowing, GST collections, air passenger traffic, and port cargo volumes) suggest that similar momentum is being maintained in Q2FY25 as well.

Global Central Banks: In Jul/Aug'24, in line with market expectations, major central banks (US Fed, ECB, BoE) kept their policy rates unchanged. However now in Sep'24, it is widely expected that both US Fed and ECB will lower their rates by 25bps each. In the Eurozone, while the decision is expected to be driven by weaknesses economic growth, in the US, cooling labour market and inflation scenario will help make FOMC the decision to cut rates. In case of US, analyst are pricing in 100bps rate cut in CY24. ECB is expected to lower rate only in Dec'24 after Sep'24. Bank of England (BoE) faces a dilemma with headline CPI falling as per projected trajectory, but services inflation and wage growth remaining sticky. Hence it is unlikely that BoE will cut rates in Sep'24. Earliest bet for BoJ hiking rates is in Oct'24.

Key macro data releases: GDP growth in Q1 moderated to 6.7% from 7.8% in Q4Y24 on a YoY basis. **GVA growth rose** by 6.8% in Q1FY25, up from 6.3% in Q4FY23. Most significant increase was noted in power and gas, construction and mining and quarrying. **Rainfall** is currently 8% above the LPA till 5 Sep 2024. There is also an improvement noted in the **sown area** (+1.9% YoY), with higher acreage of paddy, oilseeds, sugarcane and coarse cereals exceeding its normal sown area. INR depreciated by 0.2% in Aug'24 (-0.4% in Jul'24). This was despite weakening US$. W**e expect INR to trade in the range of 83.80-83.95/$** this month. India's 10Y yield softened in Aug'24 and we expect further moderation given the possibility of dip in inflation in the coming months as well as favourable liquidity conditions. Going forward, the **10Y yield is expected to trade in the range of 6.8%-6.9% in Sep'24**. **CPI inflation** eased to a 59-month low of 3.5% in Jul'24 from 5.1% in Jun'24, led by a favourable base. Food inflation eased on a YoY basis. Importantly, core inflation picked up to 3.4% in Jul'24 due to the hike in telecom tariffs. Our **estimate for headline CPI stands at 4% for Aug'24**.

Macro developments

Global growth: Soft landing in US; China recovery still unclear

Following better than expected GDP growth in Q2CY25 (3.1% versus 2.8% estimated earlier and 1.4% in Q1), some signs of slowdown are beginning to show up in Q3 (Jul/Aug'24). For instance, job openings in Jul'24 have fallen to 3.5 year low of 7.67mn from 7.9mn in Jun'24. Continuing claims jobless claims rose by 13k to 1.87mn for the week ending 24 Aug. The ISM manufacturing PMI contracted for the 5th consecutive time in Aug'24 as the index was at 47.2 compared with 46.8 in Jul'24. New orders, particularly new export orders continue to decline. Conference board consumer confidence survey stated that "consumers' assessments of the current labour situation, while still positive, continued to weaken, and assessments of the labour market going forward were more pessimistic". As a result, US Fed is expected to begin its rate cutting cycle from this month.

In case of Europe, the economic condition remains much weaker. Latest manufacturing PMI data shows that significant weakness persists in German and French manufacturing sectors, as both indices declined further in Aug'24. In France, new orders fell at the steepest pace since May'20, while in Germany they were at their weakest since Nov'23. German economy is also seeing pressure on the services sector as the activity slowed in Aug'24, with PMI moderating to 51.2 from 52.5 in Jul'24, driven by slowdown in new export orders. Germany's IFO business climate index also noted weakening sentiment with index dropping to 86.6 in Aug'24 from 87 in Jul'24, driven by considerable drop in manufacturing and services sector. The IFO institute has also lowered its growth projections for Germany for CY24 to 0% from earlier projected 0.4%.

China's economy on the other hand gave mixed signals, with retail sales and CPI picking up pace, while industrial production, FAI, home prices, and PMI indices noting a dip. Retail sales rose by 2.7% in Jul'24 versus est.: 2.6%. Excluding cars, the jump in sales was even sharper at 3.6% from 3% in Jun'24. However, real estate sector related home appliances and furniture sales continue to remain weak. Home prices were down by 7.6% on MoM basis in Jul'24, sales were down by 18.6% on CYTD basis (Jan-Jul'24), following 19% decline in H1. Industrial production moderated to 5.1% in Jul'24 from 5.3% from Jun'24. FAI growth has also slowed on YTD basis till Jul'24 to 3.6% (est.: 3.9%) from 3.9% in H1. This was dragged by slowdown in fixed investment in the real estate sector (-10.2% versus -10.1% in H1).

India's growth: Momentum maintained

India's Q1FY25 (Apr-Jun) GDP growth slowed a tad to 6.7% from 7.8% in Q1. This was due to moderation in government spending, but private consumption and investment improved significantly, indicating that fundamentals still remain strong. In nominal terms, private consumption rose by 12.4% in Q1FY25 compared with 8.1% in Q4. GFCF was up by 9.1%, following 8.6% growth in quarter ending Mar'24. High frequency indicators are showing that momentum is continued even in Q2 so far (Jul-Aug). Rainfall is currently 8% above the LPA till 5 Sep 2024. Supported by higher than normal rainfall, there has been continued improvement in the sown area (+1.9% YoY), with acreage of, paddy, oilseeds, sugarcane and coarse cereals exceeding its normal sown area. GST collection till Aug'24 are higher at Rs 3.6 lakh crore versus Rs 3.2 lakh crore. Air passenger traffic is also on the higher side with 64mn passengers flown between Jul-Aug'24 compared with 61mn during the same period last year. Port cargo volumes have also picked up pace with Jul-Aug average at 6.4% versus 4.2% last year. We are thus more optimistic than RBI on FY25 growth.

Central bank actions

RBI delivered no major surprise in the latest monetary policy in Jul'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 came at a time when food inflation was registering double digit growth, and this was coupled with upward revisions to the inflation projections for the next 2 quarters, suggesting that the possibility of a rate cut now seems most likely only in Dec'24 or even later. This signals that the RBI does not expect inflation to subside materially in the next few months. The key risk to the inflation trajectory stems from food inflation. However, now with higher than normal monsoon and improvement in Kharif sowing, we expect these risks to have subsided. The RBI remained positive on the growth outlook and kept its projection for GDP growth unchanged at 7.2% for FY25. We believe growth will be slightly higher (7.3-7.4%) than RBI's estimates.

US Fed kept its policy rates unchanged at 5.25-5.5% for the 8th consecutive time in Jul'24 meeting. However, the Fed Chair acknowledged that recent macro prints are pointing towards a soft landing. These include trends in labour market, real estate, and manufacturing sector. In addition, inflation moving in line with Fed's trajectory is also seen as a big positive, allowing the FOMC to indicate that there might be rate cuts soon. Based on this narrative, as per CME FedWatchTool, majority of the investors are now expecting 3 rate cuts this year (25bps each), starting Sep'24.

Bank of England (BoE) in Jul'24 announced its first rate cut in more than four years. The decision was a close call as it was voted by 5-4 in favour of 25bps rate cut. The policy rate now stands at 5%. This was considered to be a more hawkish rate cut, as the Governor clarified in his statement that the Central Bank will not cut rates too soon, and its decision will be data dependent. Investors have now reduced the possibility of 2 more rate cuts this year. This in line with BoE's expectation of CPI averaging 2.3% in Q3, before rising again to 2.7% in Q4.

In line with expectations, **ECB** held rates unchanged in its Jul'24 meeting at 3.75%. The ECB President highlighted that inflation still remains elevated and pressure persists in case of services inflation. The Central Bank also stated it will require more macro evidence before cutting any more rates. There is now a high probability that rates will be cut in the Sep'24 meeting, as GDP growth in Eurozone's largest economy (Germany) continues to falter, and manufacturing sector remains in deep downturn.

Data Releases

Currency outlook

INR depreciated by 0.2% in Aug'24 (-0.4% in Jul'24) to currently trade at 83.87/$, close to its lifetime low of 83.97/$. This was despite weakening US$. The factors that impacted Rupee include: slowdown in FPI inflows (mainly equity segment), and increased dollar demand by importers. However, the decline was not as steep as it was in case of other currencies, mainly due relatively steady FPI inflows in the debt segment and lower oil prices. As a result, INR traded in the range of 83.72-83.97/$. In the next fortnight, we expect movement in INR to remain range bound. Domestic currency is expected to benefit from possibility of renewed FPI inflows in the equity segment (due to changes announced in the MSCI index) and moderation in oil prices. However, pressure may arise as DXY is beginning to regain ground as investors scale back their expectation of a large rate cut by Fed in Sep'24. Further, any escalation in geo-political tensions in the Middle East will also increase the demand for safe haven currencies, thus adversely impacting INR. We thus expect INR to trade in the range of 83.8-83.9/$.

Bond Market Round-up

Most of global yields eased in Aug'24. US 10Y yield softened further hinting rate cuts are incoming. US Fed minutes and Fed Chair Powell had signalled the same in the recent commentary amidst the moderation in inflation, reflected with the recent PCE data which is inching closer to the target mark along with signs of weakness in labour market. The only uncertainty lies over the quantum of rate cuts, it could vary between 25-50bps with the market pricing increased likelihood of at least 3-cuts this year, followed by more cuts in CY25. On the domestic front, India's 10Y yield too softened and we expect further moderation given the possibility of further dip in inflation in the coming months as well as favourable liquidity conditions. Higher FPI-inflows in debt segment with the bond index inclusion also bodes well for the bond market. Going forward, the 10Y yield is expected to trade in the range of 6.8%-6.9% in Sep'24, with risk evenly balanced.

Update on corporate results

India Inc.'s performance in Q1 FY25 was sombre, with the sequential moderation in profit growth becoming much more pronounced. Sales growth continued to trail in single digits, even though it is higher than last year. Seasonal patterns and elections were the major drivers of corporate performance, having an overall dampening impact on demand. On the positive side, green shoots were visible in rural demand with FMCG, 2-wheeler and tractor sales picking up. A normal monsoon will further aid this recovery. Traction was also seen in industries such as textiles, chemicals and paper products. On the other hand, crude oil, cement and iron and steel industries were a major drag on the overall performance.

Monsoon and sowing update

Rainfall is currently 8% above the LPA till 2 Sep 2024. Momentum remains stable, with cumulative rainfall at 66.6mm between 27 Aug and 2 Sep 2024, compared with 70.1mm between 20 and 26 Aug. Between 1 Jun and 2 Sep 2024, out of 36 sub-divisions, 31 (85% of the country) have received normal or above normal rainfall so far and 8 states are in the deficient zone. Region-wise, except East & North East (-13%) which continues to report deficient rainfall, all others have received higher than normal rainfall so far. Southern peninsula (+25%) and Central region (+17%) continue to record excess rainfall. Supported by higher than normal rainfall, there has been continued improvement in the sown area (+1.9% YoY), with acreage of, paddy, oilseeds, sugarcane and coarse cereals exceeding its normal sown area. Latest data shows, that when compared with normal area of last year, this year ~99% of sowing has been completed so far. As sowing is almost complete, harvesting of crops will be critical. Excess/large excess of rainfall or deficient rainfall can be damaging for sown crops.

India's Foreign Trade: Q1-FY25

India's merchandise trade deficit was higher, as imports have risen at a sharper pace than exports (both on sequential and cumulative basis). The sequential increase in imports is attributable to non-oil non-gold imports, signalling resilient domestic demand. However, the cumulative picture gives a better picture. The increase in imports on a cumulative basis is led by oil imports, as prices have increased during the same period and Apr-Jun data also suggests lower discount from Russia. Going forward, we expect some correction in the trade deficit as some revival in the export cycle cannot be ruled out. Easier monetary conditions are expected to boost demand conditions globally. On capital account as well, comfort is already seen in FDI and FII flows. A favourable interest rate differential for India and comparatively better growth dynamics than major EMs will help in maintaining a stable external position. Overall, we expect CAD to be in the range of 1-1.5% in FY25. INR will remain range bound and with Fed's rate cut cycle, some appreciation bias will prevail.

Core sector growth

Eight core industry growth rose to 6.1% in Jul'24 from 5.1% in Jun'24. This was driven by rebound in output of refinery, steel, fertilizer and cement. Revival in government spending, particularly capex has supported steel and cement sector growth. Fertilizer output has been helped by continuous improvement in Kharif sowing. Refinery production is also up, as prospects of global demand have improved (US and China). On the other hand, electricity output moderated, as progress of monsoon cooled climatic conditions and reduced demand. Other sectors which noted a decline in Jul'24 were crude oil and natural gas. Coal output also eased. On FYTD basis (Apr-Jul), core sector output registered marginal slowdown (6.1% versus 6.6% last year), largely driven by moderation in output of crude oil, fertilizer, steel and cement. Given the latest trend in core sector growth, we expect ~6% IIP growth in Jul'24.

GDP growth in Q1

GDP growth in Q1 moderated to 6.7% from 7.8% in Q4Y24 on a YoY basis. This was lower than our expectation of 7.3%. The slower than expected growth was attributed to lower government spending, which declined down to (-) 0.2% after increasing by 0.9% in Q4FY24 given the curtailment of spending due to elections. On the other hand, investment picked up and registered a solid growth of 7.5% from 6.5% in Q4FY24. Both exports and consumption spending also recorded solid growth of 8.7% (8.1% in Q4) and 7.4% (4% in Q4) respectively. Imports recorded a sluggish growth of 4.4% (8.3% in Q4) on account of growing geo political tensions.

WPI inflation eases

WPI inflation moderated to a 3-month low of 2% in Jul'24 compared with 3.4% in Jun'24, supported by softening of both food and fuel & power inflation. Our forecast for headline WPI inflation was 2.2%. A sharp drop in tomato prices dragged down the vegetables prices and resulted in deflation in Jul'24. Despite this, prices of potato continued to accelerate further. For cereal inflation both paddy and wheat continue to register an uptick. Fuel and power inflation surged to 1.7%, despite a dip in global oil prices. Manufactured products inflation edged up to 1.6% in Jul'24 from 1.4% in Jun'24. Against this back drop, we expect WPI to ease in the coming months. So far, the Kharif acreage has been better than last year and monsoon has been well distributed and 5% above LPA (1 Jun-13 Aug). Given the gradual transition from El Nino to La Nina is favourable for South West monsoon, it remains positive for the food inflation.

CPI inflation

CPI inflation eased to a 59-month low of 3.5% in Jul'24 from 5.1% in Jun'24, led by a favorable base. Food inflation eased on a YoY basis, even as the sequential momentum was upwards. Importantly, after witnessing a downward trend for the past few months, core inflation picked up to 3.4% in Jul'24 due to the hike in telecom tariffs. The outlook for food inflation is positive due to a pickup in rainfall activity across the country. High-frequency price data indicates a softening momentum in prices in Aug'24. Core inflation should also remain subdued given that global commodity prices have remained muted. Risks however remain from an un-anchoring of household's inflation expectations. Overall, we continue to expect inflation in the range of 4.5%-5% in FY25. RBI is likely to be cautious and any move on rates will only be possible once it is sure that inflation has eased on a durable basis. We hence expect a rate cut only in Dec'24.

Growth in Industrial Production

IIP growth for Jun'24 came in at 4.2% versus BoB estimate of 4.5%, from an upwardly revised 6.2% in May'24. Barring mining (10.3% in Jun'24 versus 6.6% in May'24), growth in output of both manufacturing (2.6% versus 5%) and electricity (8.6% versus 13.7%) eased. In case of electricity production, early onset of monsoon in certain parts of the country, impacted demand. This implies, in quarterly terms, in Q1FY25, IIP growth was at 5.2% versus 5.1% in Q4FY24 and 4.7% in Q1FY24. Manufacturing sector output slowed and registered 3.8% growth in Q1 this year (5.1% last year), versus 4.8% in Q4. Mining sector growth (7.9%) on the other hand improved, compared with both Q4 (5.1%) and Q1 (6.3%) of last year. With record heat-wave conditions persisting during AprJun'24 period, electricity output jumped sharply by 10.9%, in comparison with 7.3% increase in Q4 and 1.3% in Q1FY24.

Even as demand side pressures impacted production of non-durables, we expect this trend to reverse in the coming months. Higher than normal monsoon and improvement in Kharif sowing is expected to revive rural demand. Cooling down of inflation will also help spur urban demand. Solid improvement in services sector activity is also a reflection of this. We also expect growth to pick up again ahead of the festive season demand and also due to increase in government spending.

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