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FIRST LIGHT

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RESEARCH

BOB Economics Research | Monthly Chartbook

Outlook improving, inflation remains a worry

SUMMARY

India Economics: Monthly Chartbook

India's economic outlook seems to be improving with rising vaccinations, falling Covid-19 cases and improvement in corporate profitability. Government's tax collections are increasing and so is capex. Indian corporates are looking fresh investments in cement, steel, renewables and PLI linked sectors. Export demand—goods and services—has never been better. However, inflation is a cause of concern with RBI revising its FY22 inflation forecast to 5.7% (5.1% earlier). RBI is likely to start policy normalisation in Q4FY22. An improving growth outlook and high forex reserves imply RBI has time to rein in surplus liquidity, reduce the wedge between repo and reverse repo rate and raise repo rate in FY23.

Click here for the full report.

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.32	3bps	(4bps)	75bps
India 10Y yield (%)	6.22	(1bps)	4bps	37bps
USD/INR	74.27	(0.2)	0.5	0.8
Brent Crude (US$/bbl)	69.04	(2.3)	(8.6)	53.5
Dow	35,102	(0.3)	0.7	26.3
Shanghai	3,495	1.1	(0.8)	3.4
Sensex	54,403	0.2	3.8	42.5
India FII (US$ mn)	**06-Aug**	**MTD**	**CYTD**	**FYTD**
FII-D	6.0	25.1	(3,228.0)	(1,200.8)
FII-E	21.3	498.0	6,876.2	(450.1)

Source: Bank of Baroda Economics Research

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India's economic outlook seems to be improving with rising vaccinations, falling Covid-19 cases and improvement in corporate profitability. Government's tax collections are increasing and so is capex. Indian corporates are looking fresh investments in cement, steel, renewables and PLI linked sectors. Export demand—goods and services—has never been better. However, inflation is a cause of concern with RBI revising its FY22 inflation forecast to 5.7% (5.1% earlier). RBI is likely to start policy normalisation in Q4FY22. An improving growth outlook and high forex reserves imply RBI has time to rein in surplus liquidity, reduce the wedge between repo and reverse repo rate and raise repo rate in FY23.

Vaccination gaing pace; covid cases drop: India's Covid-19 graph is looking better with sero surveys showing 67% of population with antibodies. Vaccination is ramping up with daily doses at 5mn. Incremental Covid-19 cases are falling and states are easing restrictions.

Outlook improving: Growth commentary from RBI was encouraging. While current consumer confidence is weak, 1-year ahead outlook has seen significant improvement. Exports are seeing a sustained upturn not seen in many years with non-oil exports up by 30% over a 2-year horizon. Government tax collections are buoyant led by corporate tax. Corporates have deleveraged and looking at investments in cement, steel, renewables, EVs and PLI linked sectors. Rural demand is likely to sustain with another good monsoon. Urban consumption will improve with a lag once economy is back to full potential.

Centre's revenue growth solid so far: Centre's gross tax collections rose to Rs 5.3tn (+97%) in Q1FY22, from Rs 2.7tn in FY21 and Rs 4tn in FY20. Both direct and indirect tax collections are buoyant at Rs 2.5tn and Rs 2.9tn versus Rs 1.7tn to Rs 2.3tn, respectively in FYTD20. CGST collections are back to pre-pandemic levels (Rs 1.7tn). Centre's capex has also improved significantly from Rs 630bn in Q1FY20 to Rs 1.1tn in Q1FY22. In case of states, while tax receipts are yet to pick-up, capex is back at last year's level, supported by market borrowings (Rs 1.5tn in Q1FY22 versus Rs 815bn in Q1FY20).

Inflation a cause of concern: In Jul'21, India's new benchmark yield shot up by 15bps in contrast with other global yields which declined following Fed and ECB's dovish comments and rising Covid-19 cases globally. In Aug'21 as well, India's 10Y yield rose by 4bps following RBI's upward revision of inflation forecast by 60bps to 5.7% in FY22. Even in Q1FY23, the trajectory is at 5.1%, above MPC's 4% target. Five MPC members voted to continue accommodative stance for as long as necessary to revive and sustain growth. RBI also increased absoption under variable rate reverse repos (VRRR) to Rs 4tn in Sep'21. While lower commodity prices on the back of rising Covd-19 cases may give near-term relief, higher inflation implies RBI will start normalisation in Q4.

INR to remain range-bound: After depreciating sharply by 2.3% in Jun'21, INR stabilised and fell by only 0.1% in Jul'21. Despite higher oil prices and FII outflows (US$ 1.8bn in Jul'21 compared with inflows of US$ 0.9bn in Jun'21), a weaker dollar supported INR. While imports are likely to be higher on the back of rising oil prices and resumption in domestic economic activity, resilient exports (record-high in Jul'21) will likely keep trade deficit contained. Hence we expect CAD to remain contained at ~1% of GDP in FY22. This should support INR in 73-75/$ in the near term. Higher oil prices and another Covid-19 wave are key risks to our view.

Note: The source for all exhibits is 'CEIC and Bank of Baroda' unless otherwise specified

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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