FIRST LIGHT

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Growth remains resilient

SUMMARY

INDIA ECONOMICS: MONETARY POLICY REVIEW

MPC members for the 5th consecutive time kept policy rates on hold, by keeping repo rate unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. RBI also left its stance of "withdrawal of accommodation" unchanged with the vote of 5-1. Central bank reiterated its focus on bringing inflation down to 4% mark on a durable basis and vowed to maintain liquidity conditions in the system in alignment with its policy stance. GDP growth forecasts for FY24 were revised upward with RBI now expecting growth to clock 7%, supported by domestic consumption, manufacturing sector and investment. For first three quarters of FY25, RBI expects slight moderation in average growth to 6.5%. Inflation forecasts were retained and projections for first the quarters of FY25 shows that RBI expects inflation to hit 4% mark only briefly in Q2FY25. We foresee no change in stance in the next policy statement and no rate cut before Q2FY25.

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Daily macro indicators

Indicator	6-Dec	7-Dec	Chg (%)
US 10Y yield (%)	4.10	4.15	5bps
India 10Y yield (%)	7.25	7.24	(1bps)
USD/INR	83.33	83.36	0.0
Brent Crude (US$/bbl)	74.3	74.1	(0.3)
Dow	36,054	36,117	0.2
Hang Seng	16,463	16,346	(0.7)
Sensex	69,654	69,522	(0.2)
India FII (US$ mn)	**5-Dec**	**6-Dec**	**Chg ($ mn)**
FII-D	244.7	(143.4)	(388.1)
FII-E	694.9	24.0	(670.9)

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

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INDIA ECONOMICS: GOVERNMENT SUBSIDIES

In this note we have briefly analysed the trends seen in general government (centre and states) subsidies. Latest data for central government shows that subsidy levels (% of GDP) hover above pre-pandemic levels even until FY23. Major changes in pattern are visible over the past 10 years with food and fertilizer subsidies gaining more importance and petroleum subsidies being phased out. Within fertilizers too, shift towards nutrient based subsidies is visible. With PMGKAY scheme extended for another 5 years, we expect food subsidy bill and overall subsidy bill to breach projected target marginally in FY24. In case of states, the burden has remained range bound (between Rs 2-3 lakh crore) over the past 5 years. Lately, the subsidy bill has remained towards upper end of the bracket. Study of state budgets indicate that in FY24 as well, subsidy bill for major states and UTs collectively can range between Rs 2.6-3.1 lakh crore. Further, state-wise analysis shows that Punjab, Karnataka, Gujarat and Tamil Nadu are some of the states with higher subsidy per capita.

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INDIA ECONOMICS: MONTHLY CHARTBOOK

India’s growth has remained on firm footing with Q2 GDP holding strong. It received support from government’s capex and investment demand. Other high frequency indicators of growth are also relatively well positioned, with pick up visible in non-oil non gold and electronic imports, buoyant credit demand and robust auto sales. Company financials have also showed sector specific recovery. RBI’s recent policy has remained affirmative on growth, with growth forecast for FY24 being revised upwards. On inflation, however it remained vigilant, stressing on the fact that ‘monetary policy must continue to be actively disinflationary’. Fear of OMO sales have been temporarily ruled out, which will provide comfort to 10Y yield going forward. INR was weak compared to major global peers. However, in Dec’23 some correction was visible.

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MONETARY POLICY REVIEW

08 December 2023

RBI maintains status quo

Sonal Badhan
Economist

MPC members for the 5th consecutive time kept policy rates on hold, by keeping repo rate unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. RBI also left its stance of "withdrawal of accommodation" unchanged with the vote of 5-1. Central bank reiterated its focus on bringing inflation down to 4% mark on a durable basis and vowed to maintain liquidity conditions in the system in alignment with its policy stance. GDP growth forecasts for FY24 were revised upward with RBI now expecting growth to clock 7%, supported by domestic consumption, manufacturing sector and investment. For first three quarters of FY25, RBI expects slight moderation in average growth to 6.5%. Inflation forecasts were retained and projections for first the quarters of FY25 shows that RBI expects inflation to hit 4% mark only briefly in Q2FY25. We foresee no change in stance in the next policy statement and no rate cut before Q2FY25.

Balanced hold: In line with our expectation, RBI decided to remain on hold, and unanimously decided to keep the repo rate unchanged at 6.5%. Subsequently, SDF rate remains at 6.25% and MSF and Bank rate at 6.75%. Providing a dovish tint to the policy, Governor in his statement added that policy makers must remain "mindful of the risk of overtightening". This was balanced by adding that policymakers should also be mindful of "risk of being carried away by a few months of good data or by the fact that CPI inflation has come within the target range". The central bank has also reaffirmed that its target is to bring inflation below 4%, and therefore continued to retain its stance at "withdrawal of accommodation".

GDP growth hiked: RBI has upwardly revised its GDP growth forecast for FY24 to 7%, with Q3 growth projected at 6.5% (6% as per Aug'23 forecasts) and Q4 at 6% (5.7% earlier). Growth is then expected to rebound in Q1FY25 (6.7%), before easing again in Q2 (6.5%) and Q3 (6.4%). The upward revisions to overall FY24 number and Q3 and Q4 figures is account of resilience seen in high frequency data so far. The central bank has highlighted that manufacturing sector gathered momentum in Q3 (eight core and PMI) as price pressures declined. Service industry is also holding ground (e-way bills, toll collections, port cargo traffic, rail freight volume, diesel consumption, GST collections and PMI). On the demand side, urban demand is steady (air passenger traffic, PV sales, household credit) and rural demand is showing signs of recovery (sales figures of FMCG companies). Push from festive demand is also a positive. Investment demand is driven by public sector spending and progressive trends are emerging from improvement in fixed assets and capacity utilization of private manufacturing companies. However, we still believe that RBI estimates are slightly more on the optimistic side. Key downside risks are emerging from Rabi sowing, owing to impact of El Nino and thus possible faltering of agriculture growth in the coming quarters. This may the hurt rural demand.

बैंक ऑफ़ बड़ौदा
Bank of Baroda

GOVERNMENT SUBSIDIES

08 December 2023

Trends in general government subsidies

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In this note we have briefly analysed the trends seen in general government (centre and states) subsidies. Latest data for central government shows that subsidy levels (% of GDP) hover above pre-pandemic levels even until FY23. Major changes in pattern are visible over the past 10 years with food and fertilizer subsidies gaining more importance and petroleum subsidies being phased out. Within fertilizers too, shift towards nutrient based subsidies is visible. With PMGKAY scheme extended for another 5 years, we expect food subsidy bill and overall subsidy bill to breach projected target marginally in FY24. In case of states, the burden has remained range bound (between Rs 2-3 lakh crore) over the past 5 years. Lately, the subsidy bill has remained towards upper end of the bracket. Study of state budgets indicate that in FY24 as well, subsidy bill for major states and UTs collectively can range between Rs 2.6-3.1 lakh crore. Further, state-wise analysis shows that Punjab, Karnataka, Gujarat and Tamil Nadu are some of the states with higher subsidy per capita.

Centre's subsidy burden: Over the past 10 years, between FY14 and FY23, centre's overall subsidy bill has more than doubled from Rs 2.5 lakh crore (FY14) to estimated Rs 5.7 lakh crore in FY23. A part of this increase can be attributed to Covid-19 pandemic, when centre substantially increased its support for those in need. Between FY14 to FY16, subsidies were broadly stable around Rs 2.5-2.6 lakh crore, registering an average 0.9% growth. Beginning FY17, centre had started pruning its subsidy bill and had brought it down to Rs 2.2 lakh crore by the end of FY19, thus registering an average decline of 5.4% during the 3 year period. In FY20, as Covid-19 pandemic struck and government announced enhanced support for those affected, the bill shot up from Rs 2.6 lakh crore in FY20 to Rs 7.6 lakh crore by FY21. Subsequently steps were again taken to gradually bring down the subsidy level. However, the central government subsidy level continues to remain above pre-pandemic levels as the amount spent on subsidies is estimated to be around Rs 5.7 lakh crore in FY23, and is targeted to come down to Rs 4 lakh crore by FY24 (budget estimates). Even in terms of % of GDP, barring Covid impacted years (FY21 and FY22), subsidy-GDP ratio hovered at 1.7% since FY14. Only between FY17-20 was the ratio below average. For the last two years (FY22 and FY23) this ratio has remained at 2.1%, but is projected to come down to 1.3% by the end of FY24.

Major subsidies: In the past one decade, focus areas at which subsidies are targeted have changed. For instance, in FY14, fertilizer (26.4%), food (36.1%) and petroleum (33.5%), were three most important subsidies and accounted for 96% of the total subsidy bill. By FY23, food (47.7%) and fertilizer (44%) subsidies became the dominant ones and share of petroleum subsidy dwindled to 1.2%. One of the key reason behind this trend is deregulation of both petrol and diesel prices. With those prices now linked to market rates, Oil Marketing Companies (OMCs) are less dependent on government subsidies. Lately, another shift in pattern is seen in the "other subsidy" component.

Growth remains resilient

India's growth has remained on firm footing with Q2 GDP holding strong. It received support from government's capex and investment demand. Other high frequency indicators of growth are also relatively well positioned, with pick up visible in non-oil non gold and electronic imports, buoyant credit demand and robust auto sales. Company financials have also showed sector specific recovery. RBI's recent policy has remained affirmative on growth, with growth forecast for FY24 being revised upwards. On inflation, however it remained vigilant, stressing on the fact that 'monetary policy must continue to be actively disinflationary'. Fear of OMO sales have been temporarily ruled out, which will provide comfort to 10Y yield going forward. INR was weak compared to major global peers. However, in Dec'23 some correction was visible.

Domestic demand signalling resilience: Pick up in non-oil-non gold and electronic imports continues to show strengthening of consumption demand. Moreoever, automobile sales and steady uptick in credit growth have also provided much needed support. However, other high frequency indicators such as power demand, digital payments along with consumer durable and FMCG output has noted some softness. The recent release of PFCE growth for Q2 have also recorded moderation. On rural front, agriculture growth for Q2 slowed down sharply on the back of uneven monsoon activity. Growth is expected to moderate further in H2FY24 with concerns around rabi sowing, which needs careful monitoring.

Health of centre's finances: Fiscal deficit ratio (% of GDP, 12MMA basis) of the central government settled at 6.2% as of Oct'23 compared with 6.4% as of H1FY24, on account of slowdown in spending. In FYTD24 (Apr-Oct'23), centre's overall spending momentum eased to 11.7% versus 16.2% in H1FY24. This was mainly driven by slowdown in revenue spending (6.5% versus 10%). Capex also moderated (33.7% versus 43.1%). On the income side, centre's net revenue receipts rose by 16.1 %, compared with 19.5% growth seen in H1FY24. This was driven by softening in both direct (24.1% versus 25.4%) and indirect tax collections (3.7% versus 6.6%). Within direct taxes, corporate tax collections moderated, while income receipts were relatively stable. Within indirect taxes, customs and excise collections acted as a drag.

India's 10Y yield got some support: In Nov'23, India's 10Y yield fell in line with global yields, especially US 10Y yield guided the trajectory. However, much fall is arrested on account of tighter liquidity conditions. Going forward, India's 10Y yield is likely to be in the range of 7.25-7.35% in the current month. RBI's guidance ruling out any OMO sales at present will provide additional comfort. However, near term pressure on liquidity cannot be fully discounted, which will continue to exert pressure on the short end part of the curve. Apart from this, any upside surprise in inflation data will be a key risk. Longer end of the curve however, is unlikely to exhibit much volatilty.

INR at a record low: While most global currencies have gained from prospects of Fed rate cuts from early next year, the performance of INR has been underwhelming. INR fell to a record-low multiple times during Nov'23,despite lower oil prices and FPI inflows. Strong dollar demand from importers have been fueling the weakness in INR. However, INR has reversed some of its losses in Dec'23 and is trading marginally stronger this month. We expect INR to trade in the range of 83-83.5/$ in the near-term.

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

Economics Research Department
chief.economist@bankofbaroda.com

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**
SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**
Brand Name: **BOBCAPS**
Trade Name: **www.barodaetrade.com**
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