Monthly Economic Update – January 2024

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22 January, 2024

Summary

- **Growth:** The domestic growth story remains largely driven by investment, propelled by government's thrust on capital expenditure that is providing impetus to construction and manufacturing sectors. Private consumption remains relatively weak.
- **Inflation:** Food prices continue to impart volatility to headline consumer inflation, though to a lesser degree in recent months. Core inflation continues to moderate.
- **Liquidity:** Banking system liquidity remains in deficit due to weak deposit growth and build-up of government cash balances. The central bank also been injecting liquidity via VRR to lift the pressure off the weighted average call rate.

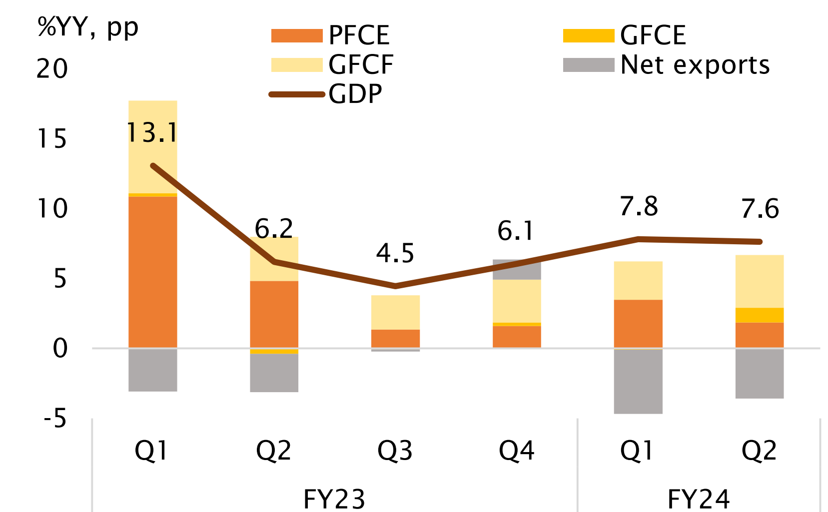
Factors supporting domestic economy	Risks to domestic economy
Robust growth driven by investment	Slowdown in private consumption
Moderating core inflation	Volatility in food prices, agriculture output
Lower uncertainty around national elections	Global growth slowdown
China+1 strategy; EM bond index inclusion	

Factors supporting global economy	Risks to global economy
Monetary policy easing expected in 2024	Slowdown in China, Europe, and the US
Moderation in commodity prices	Impact of geopolitical tensions on global trade, crude oil prices
	High levels of debt
	Policy uncertainty ahead of US elections

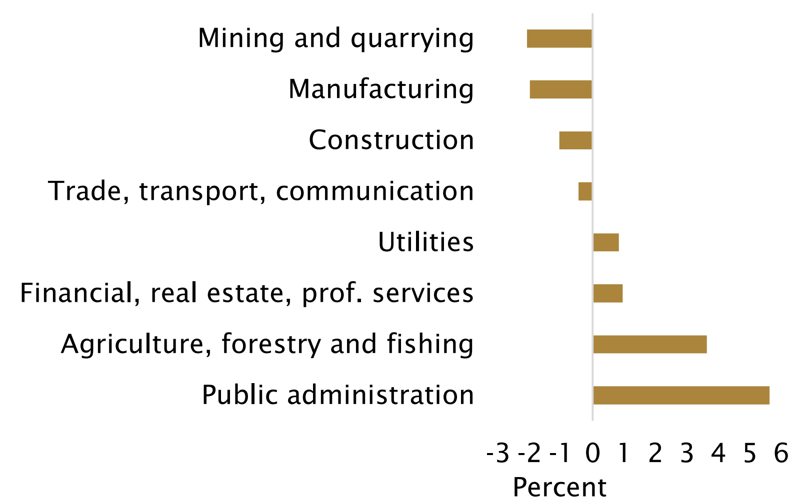
NSO pegs FY24 real GDP growth at 7.3%YY

- **Real GDP grew 7.6%YY in Q2-FY24, defying expectations of a slowdown from 7.8% growth in Q1 and exceeding RBI's estimate of 6.5%.**
  - On the expenditure side, investment (GFCF) added the most to growth, while private consumption (PFCE) slowed. Public consumption (GFCE) rose ahead of the polls this year, while the external sector remained a drag.
  - By industry, manufacturing and construction sectors were the bright spots amid growth moderation in some services sub-sectors. Agriculture growth was weak.
- **In its first advance estimate, NSO has pegged real GDP growth of 7.3% for FY24, (RBI estimate: 7.0%YY) partly aided by deflation in input costs for some sectors.**
  - NSO's nominal GDP growth estimate of 8.9% for FY24 is lower than Union Government budget estimate of 10.8%, posing a statistical upside risk to fiscal deficit.

Real GDP growth (%YY), contribution of components (pp)



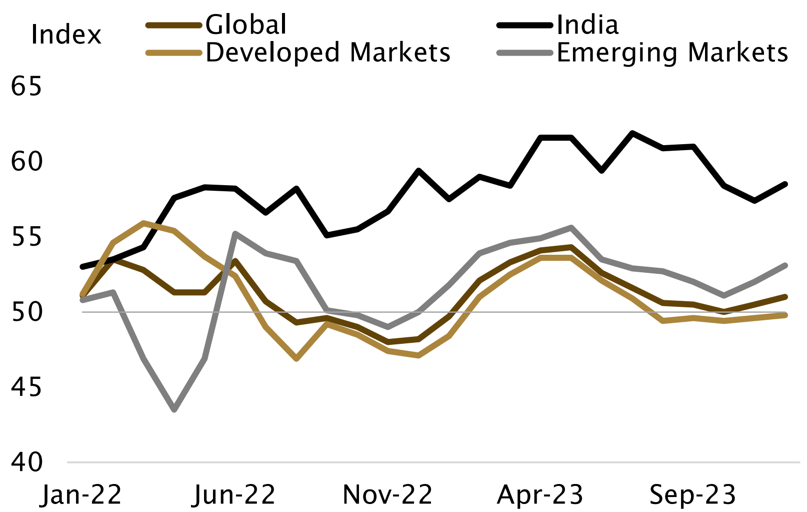
Implied sectoral deflators in FY24 (%)



India to remain one of the fastest growing major economies

- In its latest note on global economic prospects, the **World Bank has forecasted global growth to decelerate for the third consecutive year in 2024 to 2.4% from 2.6% in 2023** due to the impact of tight monetary policies, restrictive credit conditions, and weak global trade and investment.
- The Bank expects **emerging market economies to perform better relative to developed economies**, though common risks remain – escalation of the recent conflict in the Middle East, financial stress due to elevated debt levels amid high interest rates, persistent inflation, trade fragmentation, and climate-related disasters.
- **India is anticipated to maintain the fastest growth rate among the world's largest economies, largely driven by robust investment and services.** However, the World Bank expects India's post-pandemic recovery to slow, with estimated growth of 6.3% in FY24, and then gradually rise to 6.4% in FY25 and 6.5% in FY26.

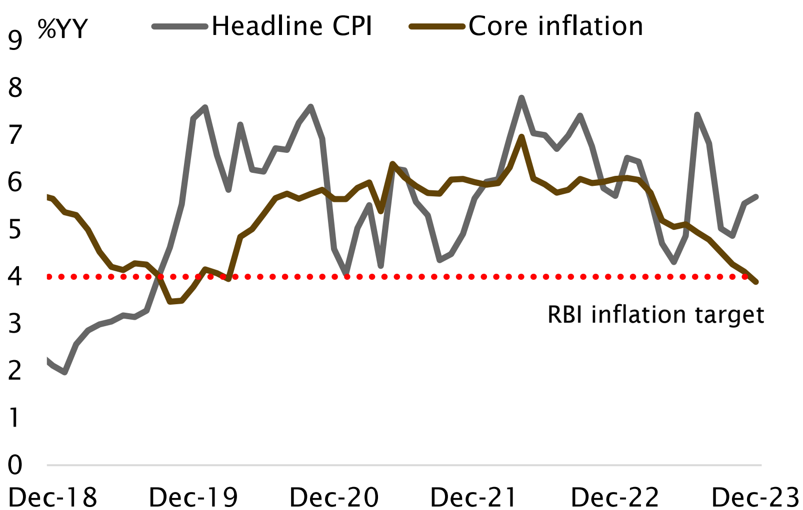
Composite PMI (Diffusion index, 50+=expansion)



World Bank, Global Economic Prospects, January 2024				
Real GDP (%YY)	2022	2023	2024	2025
World	3.0	2.6	2.4	2.7
Advanced economies	2.5	1.5	1.2	1.6
US	1.9	2.5	1.6	1.7
Euro area	3.4	0.4	0.7	1.6
Japan	1.0	1.8	0.9	0.8
Emerging economies	3.7	4.0	3.9	4.0
Brazil	2.9	3.1	1.5	2.2
Russia	-2.1	2.6	1.3	0.9
India	7.2	6.3	6.4	6.5
China	3.0	5.2	4.5	4.3
South Africa	1.9	0.7	1.3	1.5

Core inflation moderated further in December

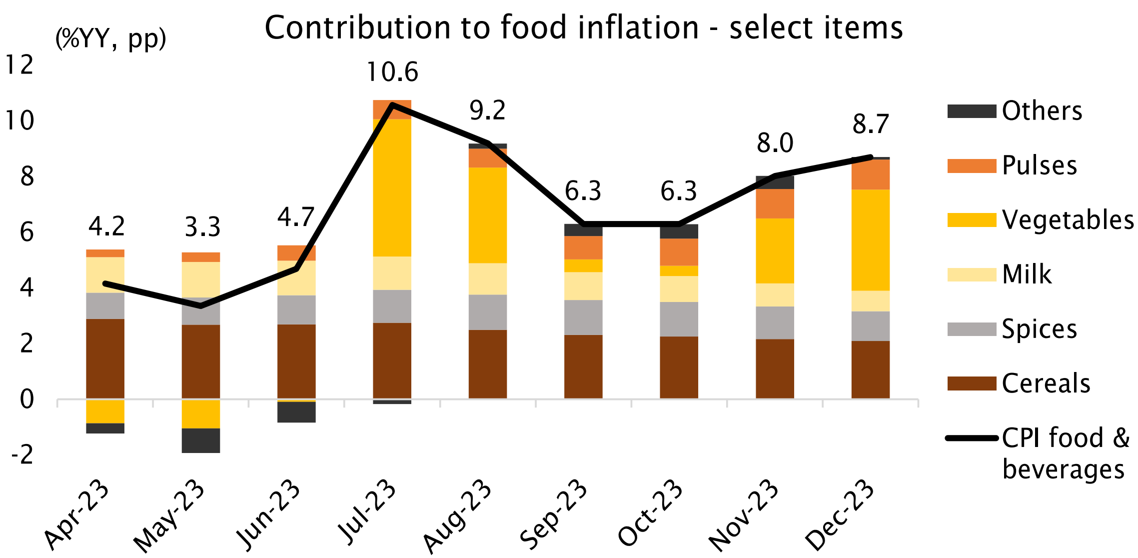
- **Headline inflation rose slightly to 5.7%YY in December from 5.6% in November, taking the Q3-FY24 average to 5.4%, lower than the RBI's forecast of 5.6%.**
- **Core inflation (ex-food and fuel) eased to 3.9% from 4.1% in the previous month**, with core services inflation continuing to stay below core goods inflation.
    - Within core, inflation moderated across most major categories, except for housing where there was a marginal uptick.
- Food inflation continued to impart volatility to the headline print in the months of November and December, which was in line with expectations. On the bright side, **the extent of food price shock was lower than anticipated.**
- Fuel prices remained in deflation for the fourth consecutive month, aided by double-digit deflation in LPG prices and kerosene (PDS prices), though electricity inflation remained in double digits..



India headline CPI and main sub-indices				
%YY	Weight	Oct-23	Nov-23	Dec-23
Headline CPI	100.0	4.87	5.55	5.69
Food	45.9	6.29	8.02	8.70
Intoxicants, etc.	2.4	3.87	3.81	3.65
Clothing	6.5	4.31	3.90	3.61
Housing	10.1	3.80	3.55	3.63
Fuel and light	6.8	-0.39	-0.77	-0.99
Miscellaneous	28.3	4.46	4.38	4.07
Note: Color code is based on %3m3m, SAAR data				

Food prices continue to roil headline CPI; though to a lower extent

- The volatility in food prices in FY24 is largely being driven by vegetables, though the double-digit inflation in spices, pulses and cereals is also keeping inflation elevated.
- Food inflation rose to 8.7%YY in December from 8.0% in November. **Vegetable prices contributed the most to food inflation**, particularly onions and tomatoes.
- Over the past couple of months, prices of fruits and sugar have also been rising.
- The **outlook for food prices remains clouded by the impact of uneven monsoon this year, aggravated by the El Nino conditions, which are expected to remain in H1-2024.** The initial Kharif output estimates were lower than expected. Both reservoir levels and cumulative winter rainfall remain below long term average.
- However, **Rabi sowing has progressed in recent weeks and active government intervention is proving effective to curb food price pressures**.
- Latest high frequency data indicates elevated inflation in case of rice, pulses; and moderation in case of wheat, sugar, onions, and tomatoes.



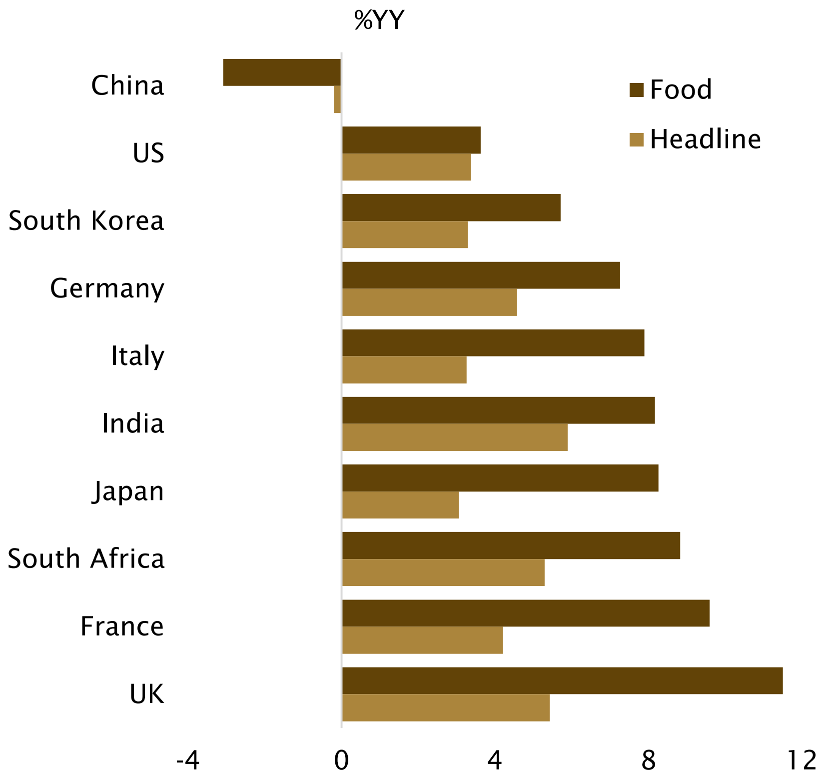
Rabi sowing (as on 12-Jan)	Percent change over last year	Percent of full normal year
Total crops	-0.7	104
of which		
Wheat	0.4	110
Rice	-4.7	45
Pulses	-4.9	100
Coarse cereals	5.1	101
Oil seeds	0.5	129

Food inflation woes across economies, despite benign global prices

- India is not an exception when it comes to food price shocks hindering the central bank’s disinflation process.

- **Even as global food prices remain muted, many major economies continue to grapple with high domestic food inflation.**

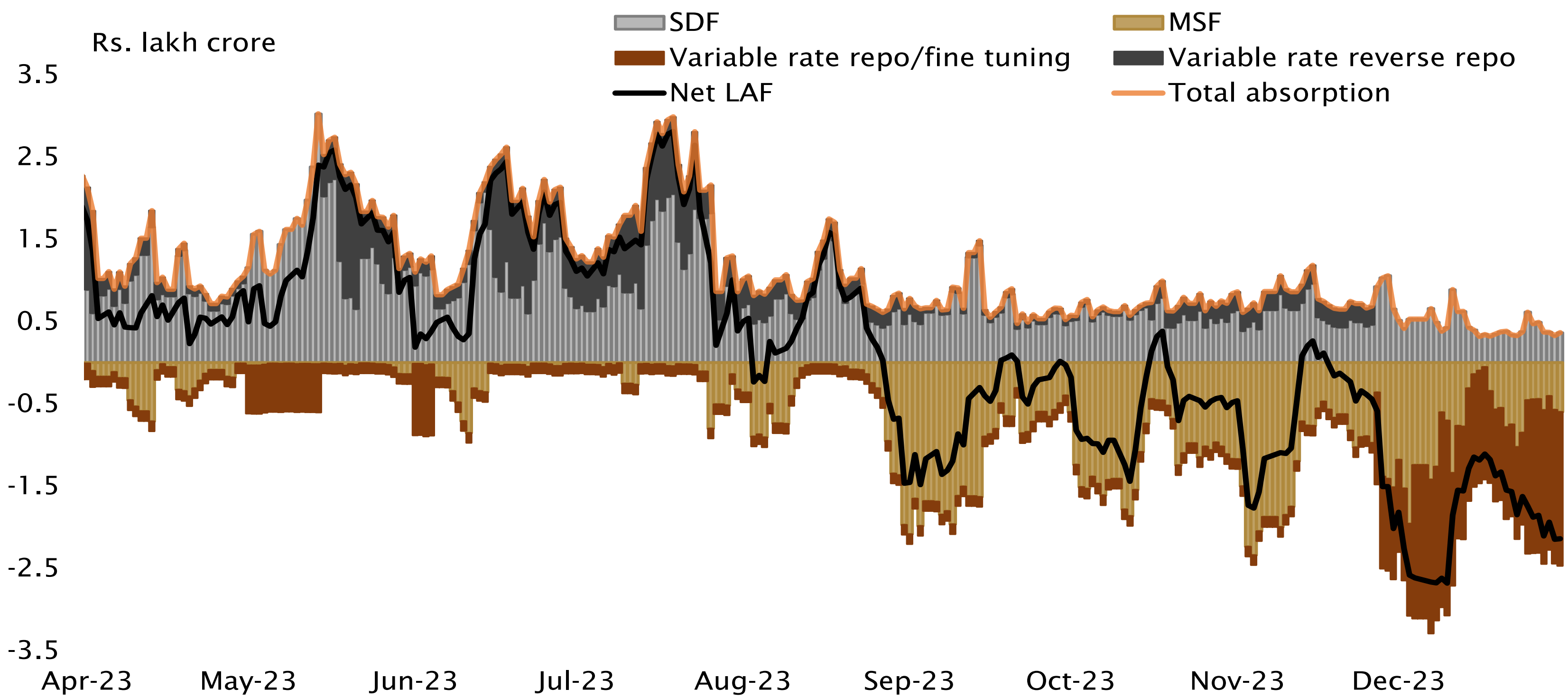
Inflation across select economies, H2-FY24



UN FAO Food Price Index (Real)

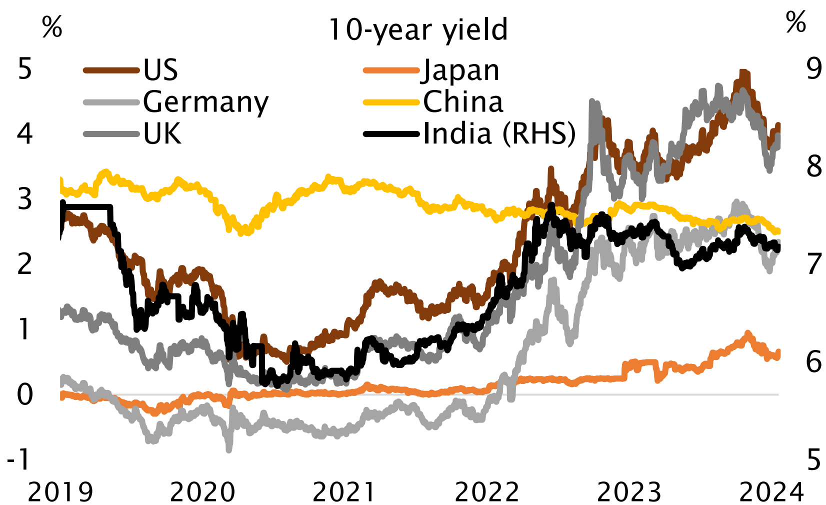
Liquidity in deficit on weak deposit growth, lower govt. spending

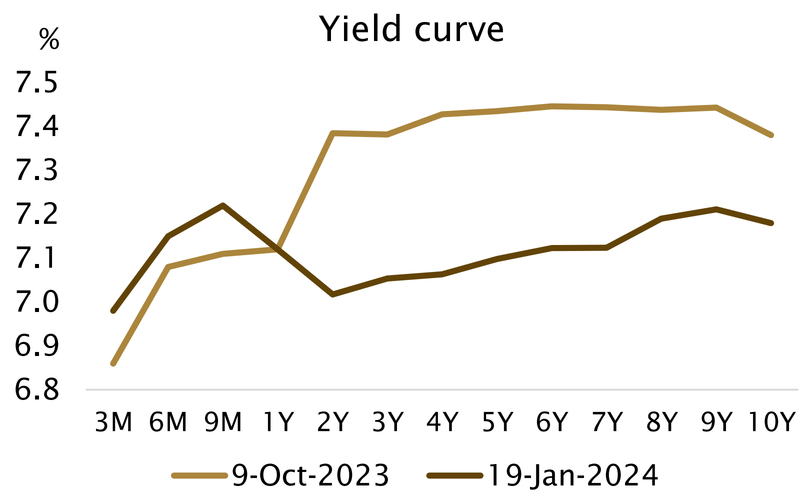
- **Net banking liquidity remains in deficit to the tune of over Rs. 2 lakh crore**, mainly due to weak deposit growth and build-up of government cash balances.
- The liquidity deficit has kept the weighted average call rate near the upper end of the LAF corridor since the last policy meeting, with multiple instances of the call rate breaching the SDF rate.
- **To easy liquidity conditions, the central bank has conducted multiple variable rate repo auctions starting mid-December** (after a gap of almost six months), with six fine-tuning operations (2-7 days maturity) amounting to Rs. 6 lakh crore and one main operation (13 days) amounting to Rs. 1.75 lakh crore.



Expectations of policy stance shift at Feb/Apr RBI MPC meeting

- **Global bond yields have come off their 2023 peaks, but remain sensitive to incoming economic data** and tend to rise when strong prints push away the expectations of policy rate cuts further into 2024 and beyond.
- Mirroring global dynamics, **while rates have softened at the long end of the curve in India, short-term interest rates have increased since the last RBI MPC meeting, probably reflecting the liquidity deficit in the system**. In mid-January, the 10-year benchmark yield hit a 6-month low aided by, among other factors – lower-than-expected CPI inflation for December, lower borrowing by state governments for two consecutive weeks, and strong foreign portfolio flows.
- **In addition to the lower-than-expected CPI inflation** in Q3-FY24 (5.4%YY vs RBI forecast of 5.6%), **the central bank's resumption of variable repo rate auctions to infuse liquidity has prompted some market participants to anticipate change in RBI's policy stance to neutral as early as at its February MPC meeting.**

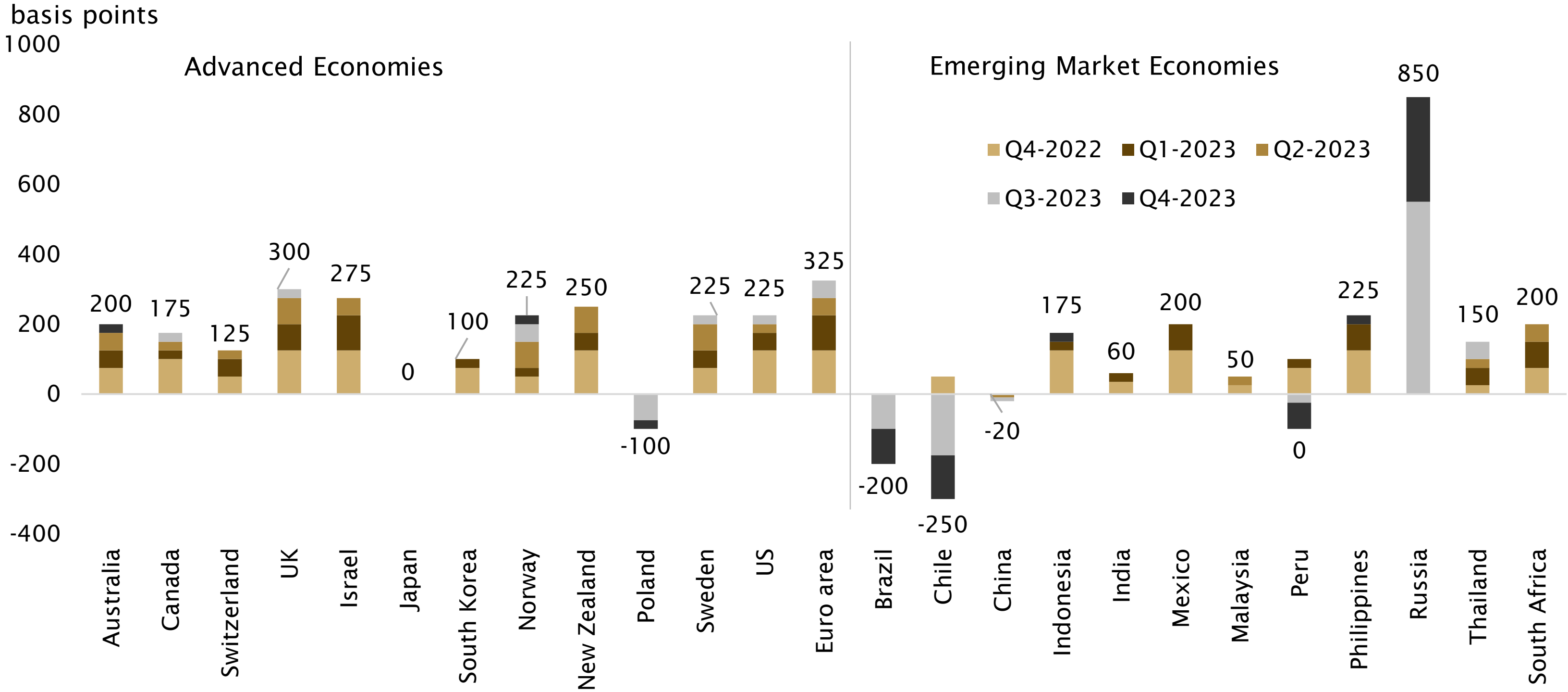




Monetary policy divergence across economies

- The COVID-19 pandemic induced a synchronous monetary policy easing by central banks to support economies. However, in recent quarters, **the divergence in growth and inflation outcomes has led to differences in policy paths.**

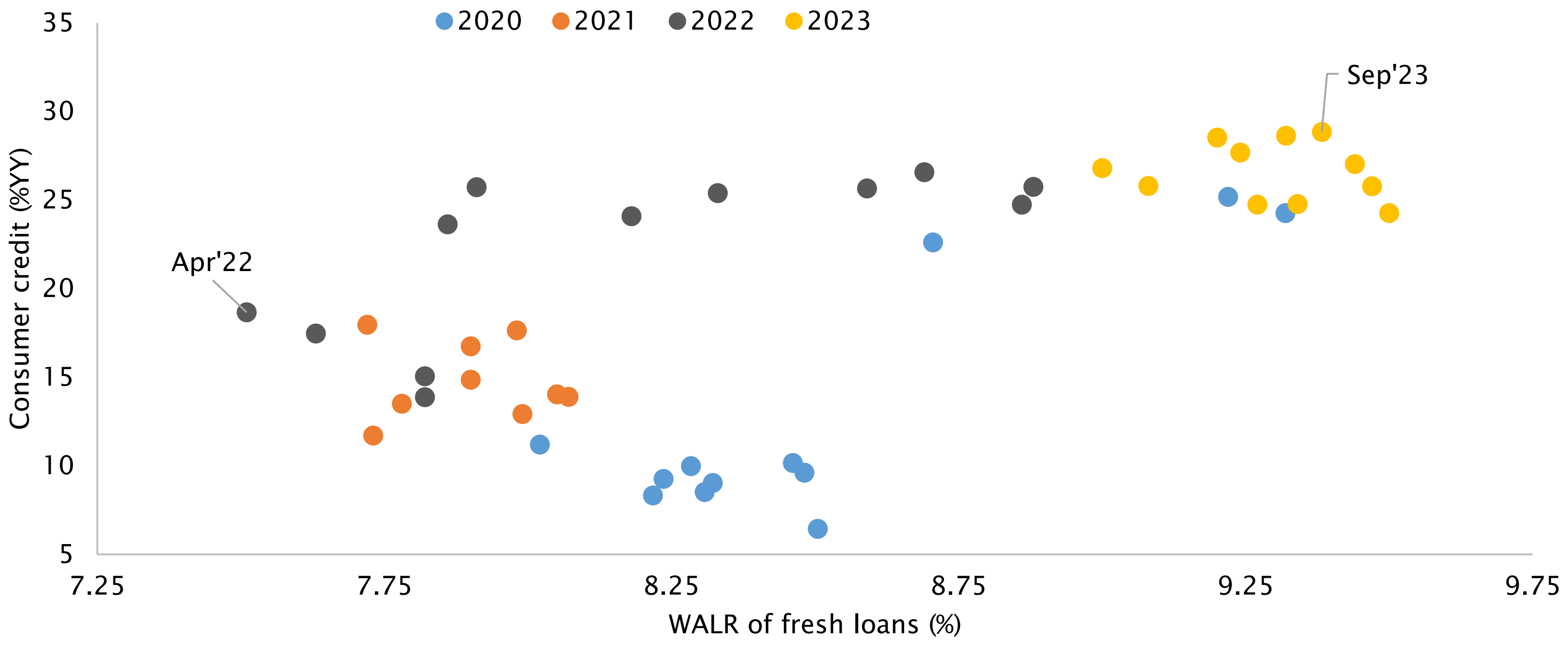
- **While central banks in most advanced economies have held rates constant in recent months, the outcomes in emerging market economies have varied.**
  - Latin American economies such as Brazil, Chile and Peru have already started policy easing by cutting rates, even as Asian economies such as Indonesia and Philippines continued to tighten even in Q4-2023.



Recent domestic regulatory steps announced for financial stability

- **Increase in risk weights on consumer credit:** In November, the RBI raised the risk weights on consumer credit exposure of commercial banks and NBFCs, and also on bank credit to NBFCs. The risk weights on credit card receivables of SCBs and NBFCs have also been increased, in addition to strengthening of credit standards in respect of various sub-segments under consumer credit.

- Despite no imminent signs of stress in the retail credit segment, its **rapid growth amidst the disinflationary monetary policy stance raised concerns** in terms of pro-cyclicality of lending and higher debt servicing costs.



Additional regulatory changes, insights from latest RBI FSR report

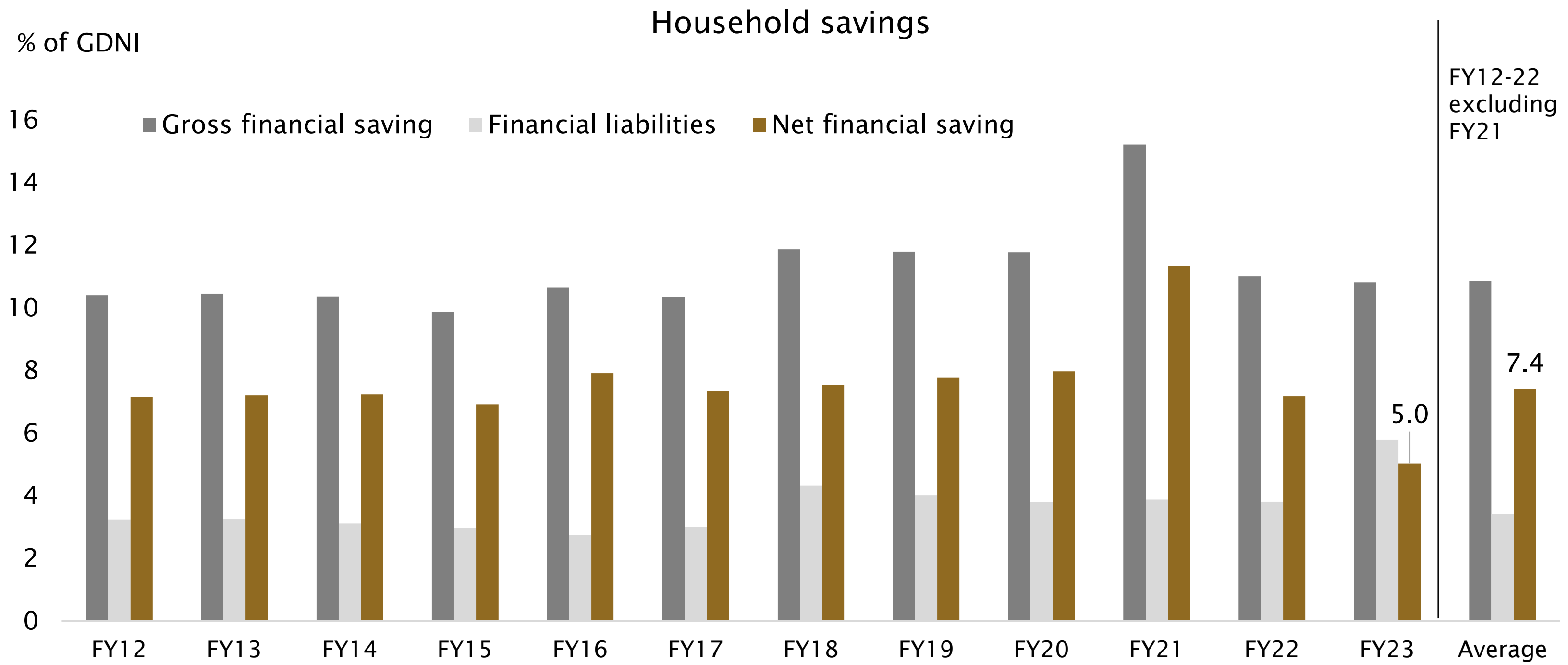
- **Investments in alternative investment funds (AIFs):** In December, the RBI issued a notification advising regulated entities (REs) not to make investments in any scheme of AIFs which has downstream investments either directly or indirectly in a debtor company of the RE. The measure aims to address concerns relating to evergreening by REs through AIFs by substitution of their direct loan exposure to borrowers with indirect exposure through investments in units of AIFs. The RBI has imposed additional caveats on existing investments in terms of liquidation and provisioning.

- **Revised norms for investment portfolio of commercial banks:** In September, the RBI issued principle-based norms for classification of commercial banks' investment portfolio to ensure transparency and alignment with global standards. Among various revised directions include symmetric recognition of gains and losses, a clearly identifiable trading book under Held for Trading (HFT), removing the 90-day ceiling on holding period under HFT, and allowing non-SLR bonds to be held under the Held to Maturity (HTM) category.

- **Bond market vulnerabilities in advanced economies:** In its latest FSR note, the RBI noted the increase in vulnerabilities in global bond markets over the past two decades driven by surge in hidden leverage among non-banking financial intermediaries (NBFIs), withdrawal of banks and primary dealers from their traditional role of market makers and a decrease in overall liquidity in government bond markets. In the US, there has been an increase in the exposure of hedge funds to cash-futures basis trade. Since these positions are highly leveraged and are exposed to both changes in futures and repo margins, they impose a financial stability vulnerability.

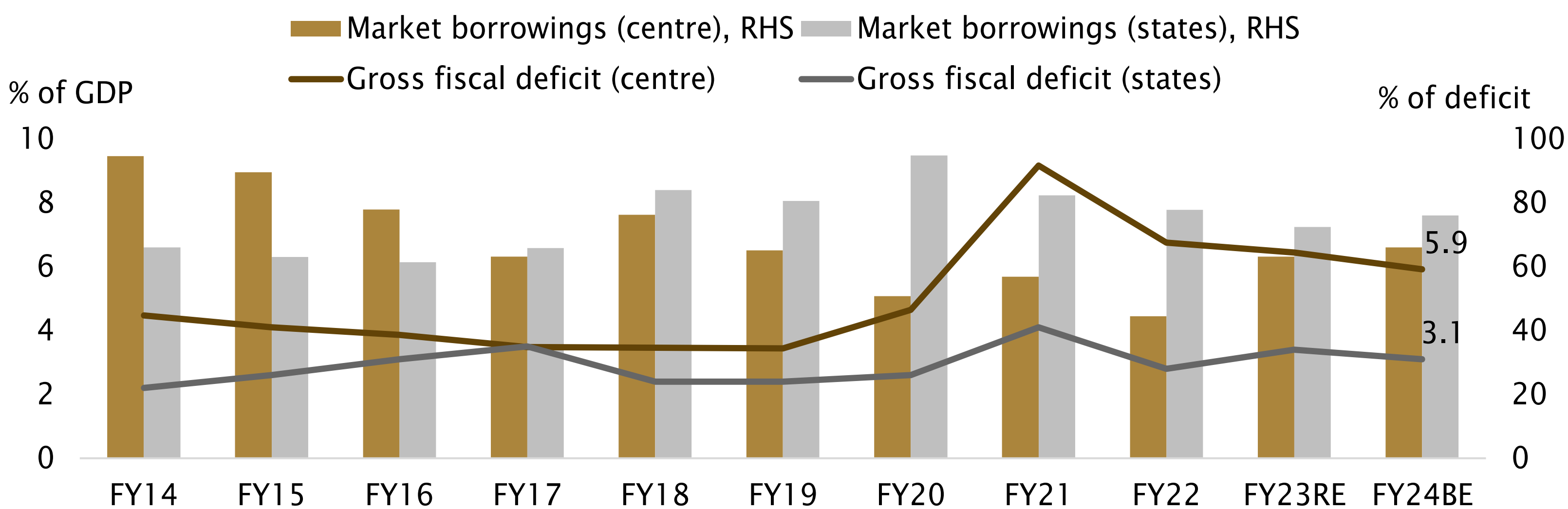
Lower household savings, if persistent, could reduce fiscal space

- RBI's measures to rein in consumer credit comes in the backdrop of reduced household net financial savings and an increase in financial liabilities in FY23.
- In its FSR note, the RBI noted that the increase in financial liabilities is being driven by borrowings from financial institutions, and largely towards creation of physical assets (mortgages and vehicles).
- **While the compositional shift in favor of physical savings could boost investment in the economy and support the private investment cycle, it could also reduce fiscal space for the government and lower funds for other productive sectors, particularly if the trend of lower household savings persists.**



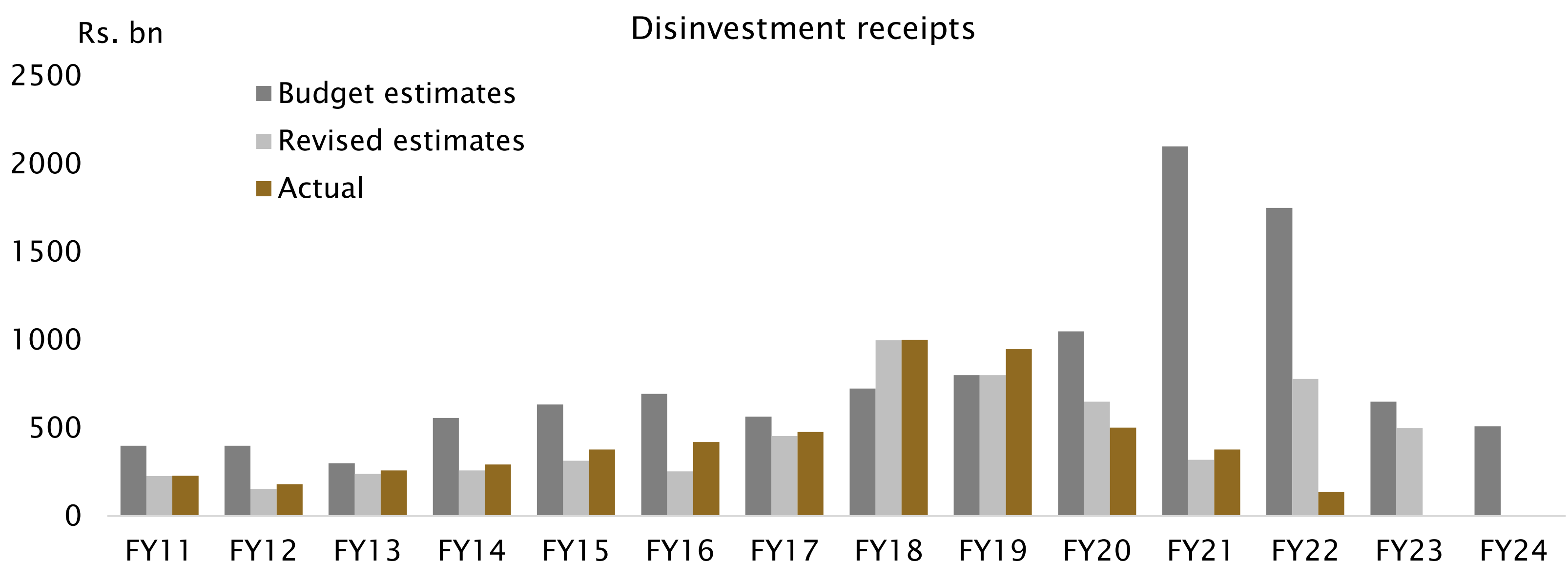
Centre's fiscal numbers largely on track; state finances vulnerable

- **During April-November FY24, the centre's fiscal deficit was at 50.7% of FY24 budget estimates, lower than 58.9% during the corresponding period a year ago.**
  - Though the government's fiscal numbers seem to be on track, there is a risk of an increase in spending ahead of the polls. Also, the NSO's lower estimate of nominal GDP, if accurate, could add a statistical drag to fiscal deficit numbers.
- **During April-November FY24, gross fiscal deficit of 22 states was at 50.5% of BE, up from 29.9% a year ago**. Revenue deficit widened, and grants from the centre fell.
  - Going ahead, the **return to the Old Pension Scheme** by a few states and indications of some other states moving in the same direction **would exert pressure on state finances** and impact the quality of expenditure.
  - Post FY17, the states' dependence on market borrowings increased following exclusion from NSSF financing. However, post FY20, the states' dependency on net market borrowing fell and that of loans from the centre increased.



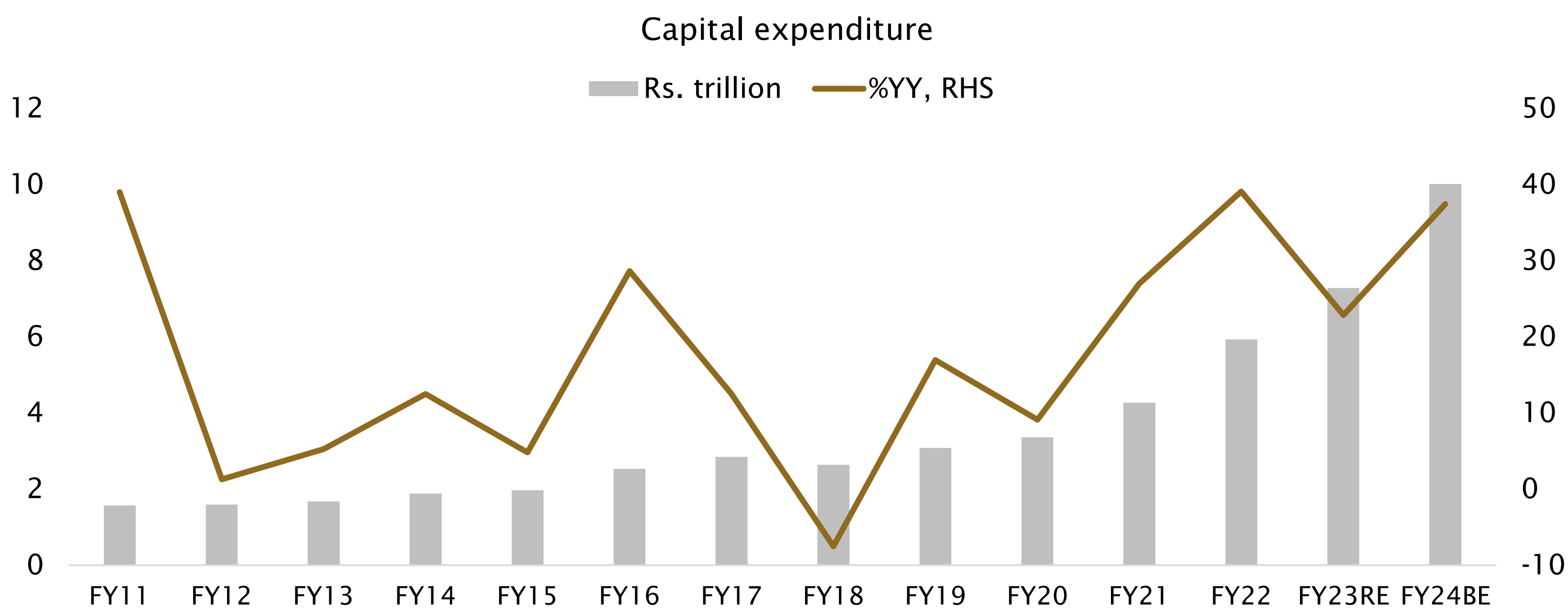
Centre’s disinvestment receipts to undershoot FY24 BE

- **Since FY20, actual disinvestment receipts have consistently undershot budget estimates. In the current fiscal year too, the centre’s disinvestment receipts were muted at Rs.89 billion during April-November, which was 15% of FY24BE.**
- The insufficiency of disinvestment receipts this fiscal is likely to be compensated by buoyant tax and non-tax revenues, with non-tax revenues already at 94% of FY24BE.
  - During April-November, net tax revenues amounted to 62% of FY24BE, aided by lower tax devolution and sharper increase in non-tax revenues.
  - **Within non-tax revenues, dividend and profits have already exceeded FY24BE**, largely aided by RBI’s dividend of Rs.874.2 bn, which is higher than both the amount transferred last year (Rs.303.1 bn) and the FY24BE of Rs.480 bn crore under dividends/surplus transfer of central and state-run banks and financial institutions. **Interest receipts have also been strong.**



Centre's pace of capex spending could ease in upcoming Budget

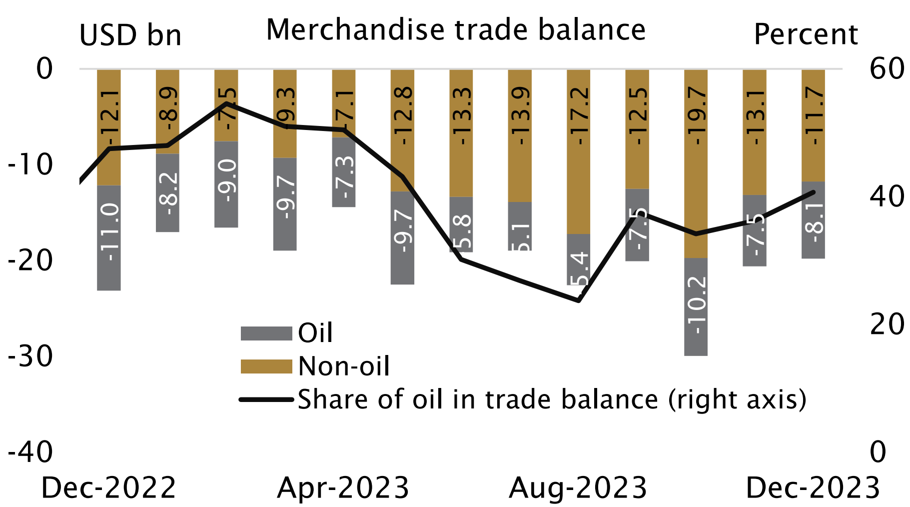
- During April-November, the central government's capital expenditure increased 31%YY, accounting for 59% of FY24BE of Rs.10 trillion.
  - Spending on roads and railways continued to drive capex, while loans to states were at half of BE.
- During the same period, revenue expenditure was contained at 4%YY, also amounting to 59% of FY24BE.
- **In the upcoming Union Budget, the centre's focus on capital expenditure is likely to continue, albeit at a modest pace relative to the previous year, as the government focuses on fiscal consolidation to reduce fiscal deficit to 4.5% of GDP by FY26 under the FRBM Act.**



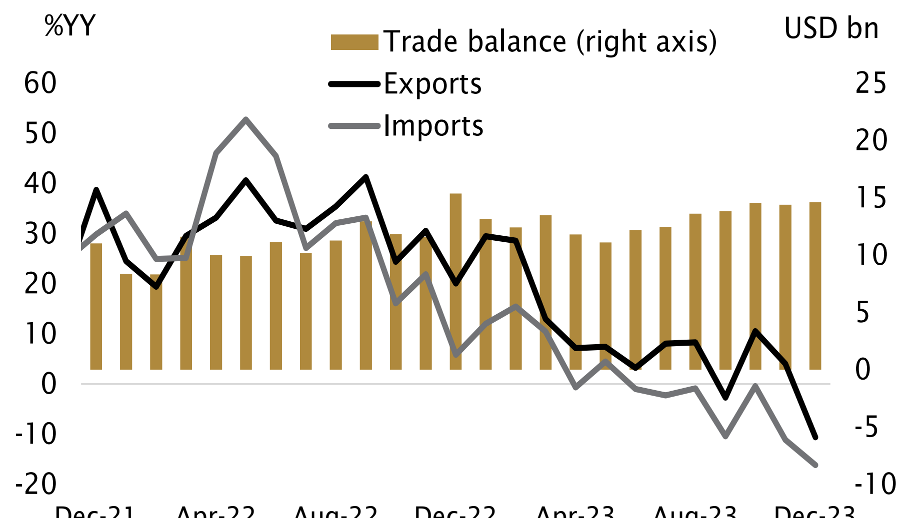
Merchandise trade balance narrowed in December

- After widening to a record high in October, merchandise trade deficit narrowed for the second consecutive month in December.
  - **In sequential m/m terms, exports rose at a faster pace than imports, so that trade deficit eased to USD19.8bn from USD20.6bn in November.** Core trade balance (non oil, non gems and jewellery) also exhibited a similar trend.
  - Oil exports declined, while imports were largely stable from the previous month, so that the share of oil in trade deficit increased.
  - Items that contributed the most to export growth: engineering goods, iron ore, and gems and jewellery, electronic goods, drugs and pharmaceuticals.
  - Items that contributed the most to import growth: electronic goods; gold; artificial resins and plastic materials; coal, coke and briquettes
- **Services surplus increased to USD14.6bn from USD14.4bn in November amid a sequential decline in both exports and imports.**

Merchandise trade

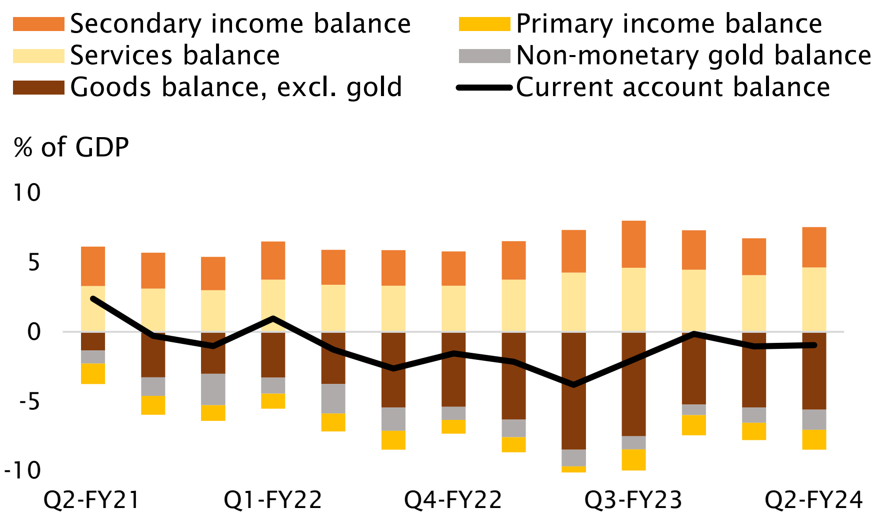


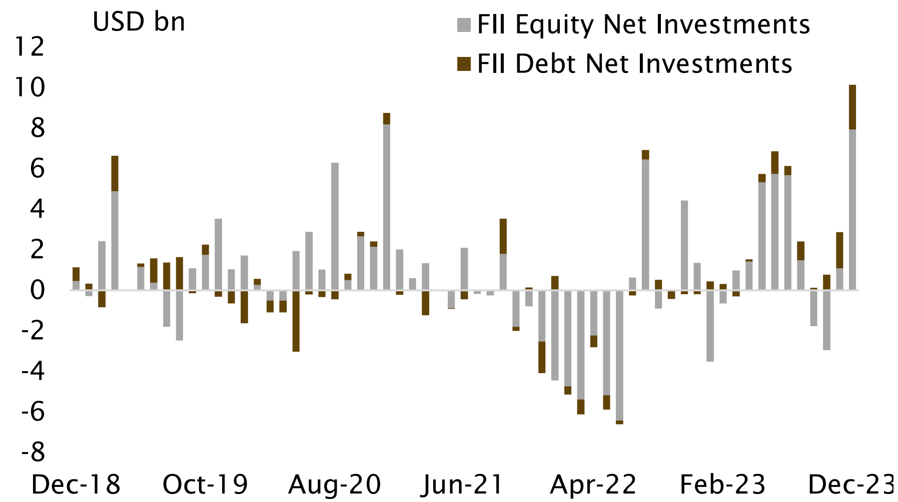
Services trade



Current account deficit moderated in Q2-FY24

- **The current account deficit moderated to 1.0% of GDP (USD 8.3bn) in Q2-FY24 from 3.8% (USD 30.9bn) in Q2-FY23.**
  - **The narrowing in CAD was driven by a lower deficit on goods account and a larger surplus on services account.**
- Overall balance of payments swung to a surplus of 0.3% of GDP (USD 2.5bn) from a deficit of 3.8% of GDP (USD 30.4nbn) in Q2-FY23.
- Capital account surplus increased to 1.2% of GDP (USD 10.0bn) from 0.2% of GDP (USD 1.5bn) in Q2-FY23.
  - The increase in surplus was due to a swing in banking capital from deficit to surplus that offset the drag from foreign direct investment. Net FDI fell for the first time in the post-pandemic period.
  - **Portfolio flows have improved in recent months, aided by, among other factors, inclusion in JP Morgan's EM debt index from June 2024.**



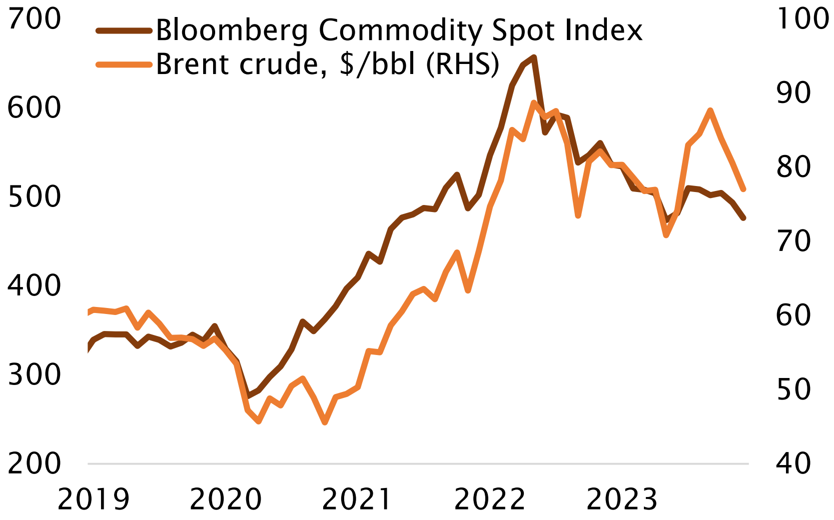


Commodities prices, trade flows vulnerable to Red Sea disruptions

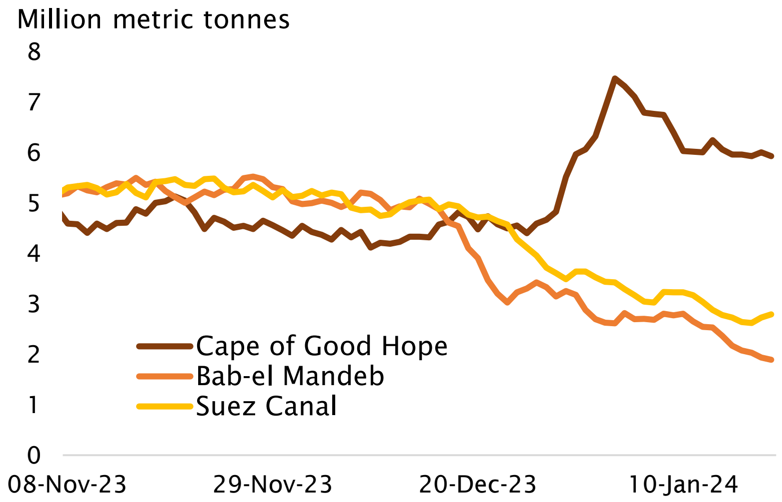
- Commodity prices have moderated after peaking in mid-2022. Similarly, crude oil prices, despite being volatile, have eased after increasing in September this year, keeping a lid on India's oil import bill.

- Based on demand-supply dynamics, commodity prices are likely to remain soft in 2024 due to a moderation in demand amid an expected slowdown in global growth.

- However, **the increasing geopolitical tensions pose a risk not only to commodity prices, but also to overall trade flows. The recent disruptions in the Red Sea have prompted shipping companies to re-route traffic via safer, longer routes that are adding to shipping costs and delays.**



Disruptions in the Red Sea – Daily Transit Trade Volume, 7-day moving average

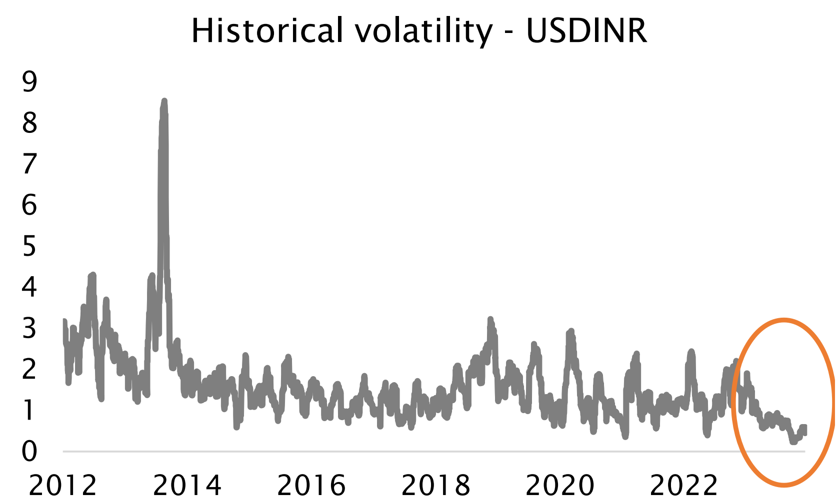


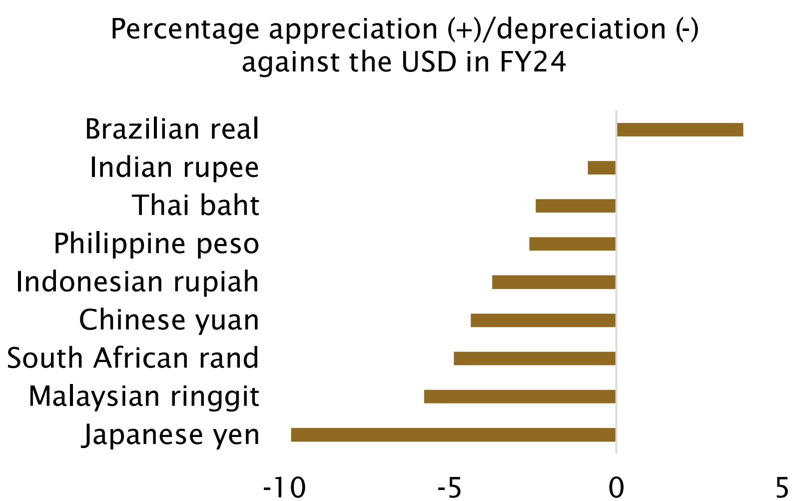
INR remains largely stable against USD compared to peers

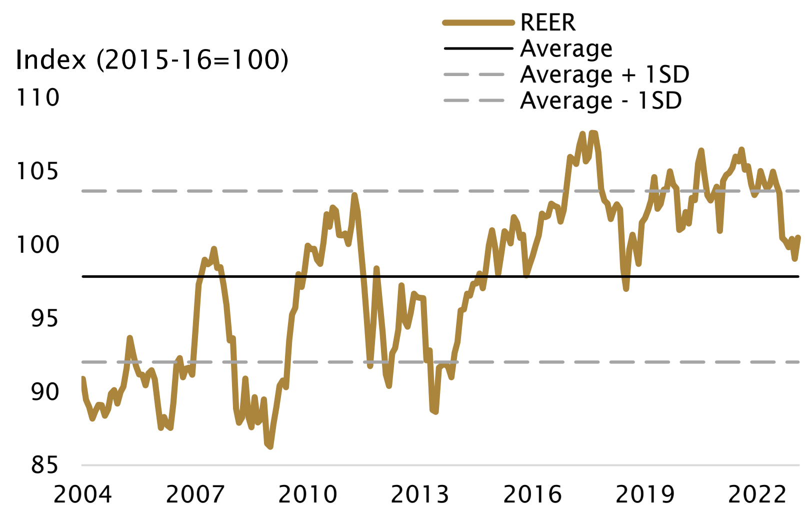
- **Since the beginning of the current fiscal year FY24, the INR has depreciated around 1% against the USD**, indicating resilience amid an uncertain global economic backdrop.

- The stability in currency is underscored by low volatility

- The real effective exchange rate continues to hover close to the long term average.

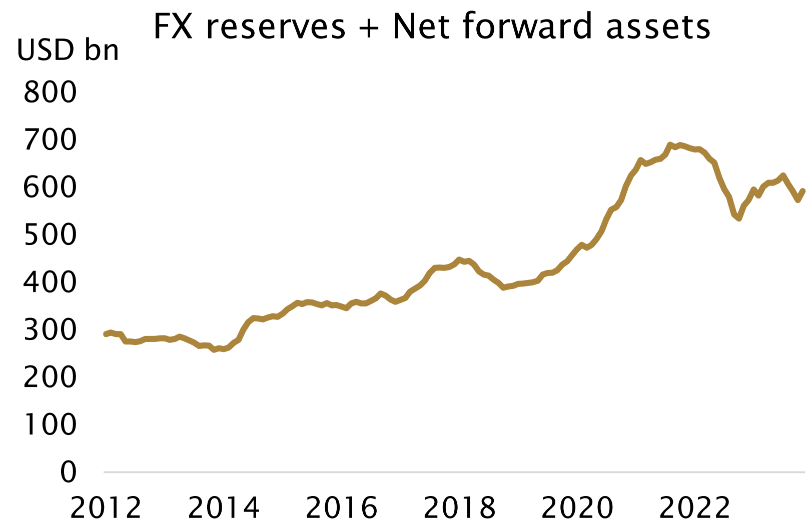






RBI's forward book slips into negative after more than three years

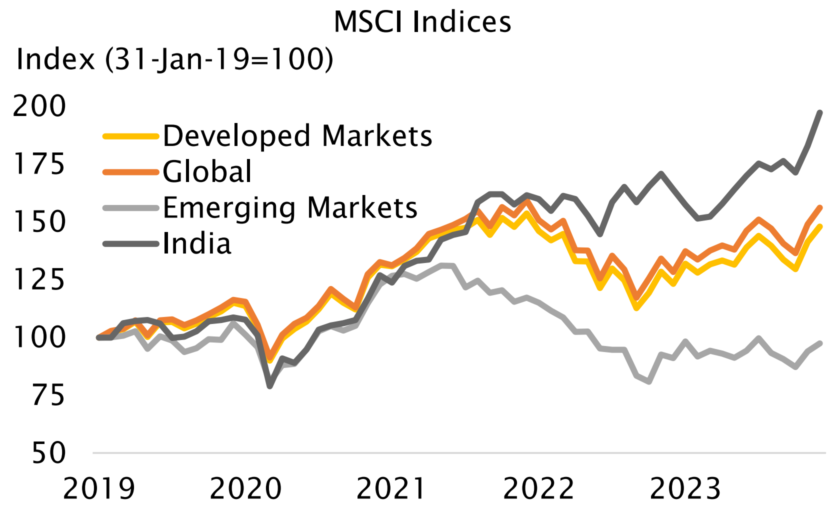
- Foreign exchange reserves, including outstanding forward positions, increased to USD 592.3bn in November, up from USD 573.9bn in October.
- **The central bank has been a net seller of USD in the spot market since August.**
- Given the tight liquidity conditions in the domestic banking system, **the RBI also intervened in the forward market, with its outstanding position turning negative for the first time since July 2020.**

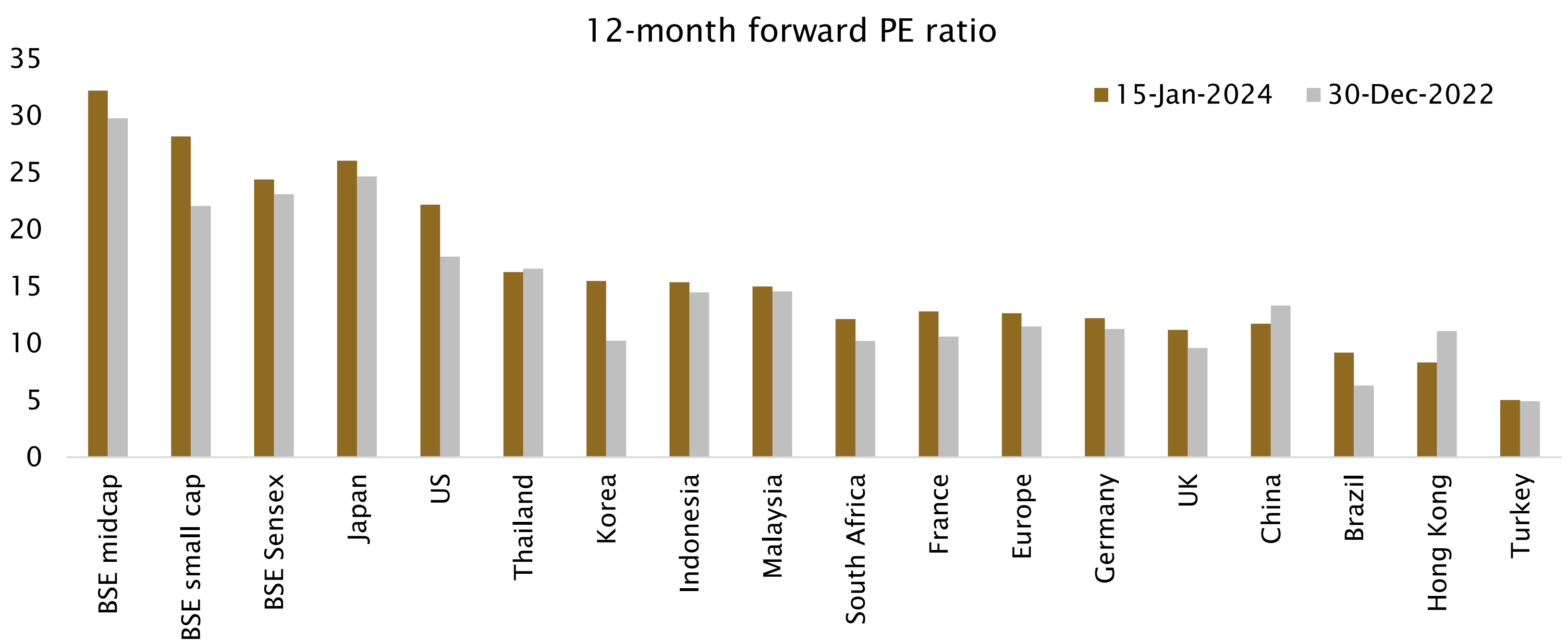


(USD mn)	RBI gross sale $	RBI gross purchase $	RBI net purchase of $	Outstanding forward sales (-)/purchase (+)
Nov-23	36,915	34,986	-1,929	-11,901
Oct-23	36,960	36,650	-310	-14,608
Sep-23	29,265	27,757	-1,508	4,642
Aug-23	4,356	500	-3,856	10,068
Jul-23	1,843	5,315	3,472	19,468
Jun-23	3,281	7,785	4,504	19,468
Last 12 months	1,45,864	1,65,774	19,910	

Indian equities have outperformed peers amid high valuations

- **Indian equities have outperformed their global counterparts**, reaching new all-time highs.
- However, **valuations remain expensive relative to peers** and sustaining current levels will largely hinge on healthy corporate performance and fundamentals.





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