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Economic Round-up: November 2022

IMF chief had pointed to 1 in a 4 chance of sub-2% global growth, with Fed Chair noting that the possibility of 'soft landing' still remains on the table with inflation rate easing, strong payrolls data and steady unemployment rate. Investors anticipate a probable peaking of rate in 2023, with the possibility of a pause in global tightening cycle. ECB chief had also spoken of growth weakening in Eurozone but not contracting. Hope is also drawn from easing of Covid-19 curbs in China after protest rattled the second largest economy. However, it is too early to anticipate a quick turnaround in global economy and much remains to be seen.

Global Central Banks: Recently US Fed Chair Powell had highlighted that Fed might 'slow down' pace of interest rate hike. He also hinted that these smaller hikes should not be seen as a sign of Fed giving up on a fight against inflation. This comes against the next Fed meet which is scheduled on 13-14th December 2022. In India, RBI is also expected to continue with rate hike, albeit the pace would also be slow here given the cool-off already visible in inflation, with further moderation likely in the coming months. RBI might also revise GDP forecast downwards in its upcoming policy meet.

Key macro data releases: India's GDP growth slowed down to 6.3% in Q2FY23 from 13.5% in Q1FY23 on the back of base effect. Manufacturing sector disappointed the most as it contracted by (-) 4.3% against a growth of 4.8% in Q1FY23. The same has been reflected by lower growth in SME sector and fall in profits that has impacted value added for organised sector. Against this, we expect a growth of 6.8% in FY23 with downward bias on the back of volatility in the global market.

GST collections remained above Rs 1.4 lakh crore mark for the 9th consecutive month in Nov'22. On MoM basis, collections registered marginal slowdown to Rs 1.46 lakh crore from Rs 1.52 lakh crore in Oct'22, mainly owing to IGST settlement. On FYTD basis collections continue to average Rs 1.5 lakh crore and on a cumulative basis have reached Rs 10.2 lakh crore this year (FYTD23) versus Rs 8 lakh crore in FYTD22.

On the fiscal state, India's fiscal deficit widened to Rs 7.6 lakh cr for the Apr-Oct'22 period which is 39% higher than last year. It has already reached 45.6% of the targeted level, compared with 37.3% as of H1FY23 and 36.3% in FYTD22. Led by uptick in direct tax collections (by 25.9% in FYTD23 compared with 23.5% in H1), gross revenue jumped up by 18% for the same period. Both corporate and income tax also registered an improvement. Revenue spending in FYTD23 on the other hand is at par (54.3%) compared with last year (53.7%).

Growth in core sector output slowed down to 20-month low of 0.1% in Oct'22 from 7.8% in Sep'22. Coal is the only industry which registered growth of 4.6% even though the base effect was high at 14.7%. This might be linked to better demand from industry as electricity production growth was also low at 0.4% over 3.2% last year. Fertilizer production was up at 5.4% as we are in the midst of the rabi sowing and demand would be steady. Steel production was up by 4% while cement fell by 4.3%. Government capex has been the driving factor here. Cement has declined due to the high base effect of 14.6% registered last year. On cumulative basis, cores sector output was up by 8.2% compared with a growth of 15.6% for Apr-Oct'21.

CPI for Oct'22 moderated by 6.8% in line with the expectation down from 7.4% in Sep'22, led by base effect. Food inflation cooled-off to 7% from 8.6% in Sep'22. Core Inflation also softened to 5.9% (from 6.1%) led by moderation in transport and communication, along with easing off fuel prices. We do expect the RBI to continue to increase the repo rate, albeit by a smaller quantity of 25-35 bps in the coming policy to be in tune with what other central banks are doing.

Global developments

Impending global recession

The global economy is facing strong headwinds on the back of high inflation and weakening growth. Coupled with, high interest rates, financial vulnerabilities and the ongoing geopolitical conflict has added to the growing risk of debt distress and food insecurity in low income countries. OECD in its monthly outlook has highlighted that world is witnessing massive energy price shock, biggest since 1970. The same has been translated to higher prices. The shortage could force Europe to rationing their usage as the gas prices are pushed upwards. OECD expects the global GDP to drop down from 3.1% in 2022 to 2.2% in 2023 and 2.7% in 2024. A sharp slowdown in growth is already evident for US and Europe. Inflation while remaining elevated even in 2023 is expected to moderate from 2022 levels to 6.6% with further dip likely at 5.1% in 2024. At this time, OECD has suggested while monetary policies are likely to continue with rate tightening, governments can provide more targeted support such as new energy-related polices or measures. Furthermore, investing towards energy security with EU & UK exploring alternate options to replace Russian gas supply for next winter. Also structural policies should prioritise more on a) keeping international trade open, b) ways to boost labor force participation, c) in order to minimize long –term cost of pandemic, invest in new skills.

In line with market expectation, US Fed in its minutes highlighted the possibility of smaller pace of rate hike in the upcoming policy meet. Members noted that slower pace could possibly reduce the risk of instability in the financial system. Even the Fed Chair Powell in his recent media briefing confirmed the same, however he raised caution that monetary policy will remain restrictive 'until the job is done'. Despite concerns of chronic inflation, the economy grew by 2.9% for Q3CY22 at an annualized pace (revised form 2.6% reported earlier) led by strong consumer, business spending and exports. US retail sales also picked up pace, edging upwards by 1.3% in Oct'22 on a MoM basis, from a flat growth in Sep'22. The uptick was led by motor vehicles suggesting an improvement in supply conditions. Additionally, higher sales in furniture store (1.1%), online retail sales (1.2%) also supported the overall growth. Sales in gasoline stations (4.1%) was also higher on the back of higher prices. US labor market continued to showcase resilience, shrugging off fears of recession as employers added over 0.26mn jobs, higher than expectations. Even the average hourly earnings rose by 0.6% in Nov'22 from 0.5% in Oct'22.

On the other hand, US manufacturing PMI slipped in to contraction territory to 49 level in Nov'22 from 50.2 in Oct'22 raising concerns of economic downturn. US homebuilding dropped sharply in Oct'22 with single family project slipping to its lowest level in 2.5 years. Housing starts dropped by 4.2% to 1.42mn units, seasonally adjusted compared with 1.48 mn units in Sep'22. Multi family housing which is used a proxy to gauge rents, improved as higher mortgage rates pushed prospective home buyers to continue as renters.

European Commission proposed the European semester cycle of economic policy coordination. It plans to draw out guidance in order to tackle the energy crisis and make Europe more digitally inclusive and greener. A coordinated action to safeguard economic and financial stability while protecting firms and households from the ongoing challenges (fallout of Russia invasion of Ukraine, high energy prices, growing debt levels and rising borrowing costs has impacted both household and businesses alike).

In a major respite, annual inflation in Eurozone eased for the first time in over 17-months to 10% in Nov'22 from 10.6% in Oct'22. The increase was led by energy prices which moderated by 34.9% in Nov'22 from 41.5% in Oct'22. Further, food prices inched up marginally to 13.6% in Nov'22. Core inflation (excluding food and energy) remained sticky at 5%. However, investors and ECB were wary if the inflation levels have actually peaked. Divergence in inflation rates across EU economies also added to concern. While Germany's inflation rate moderated (11.3% from 11.6%), for France the prices were higher at 7.1% in line with Oct'22 number. With the possibility of inflation pressure fading, Eurozone composite PMI climbed up to a 2-month high to 47.8 in Nov'22 from 47.3 in Oct'22, though it continues to remain in the contractionary zone. Germany's investor sentiment improved more than anticipated to -36.7 in Nov'22 from -59.2, though economic outlook of the country continues to remain negative.

China's economy is expected to grow by 3.2% in CY22 with IMF suggesting further trimming down of growth remains a possibility. This well be much below the official target of 5.5% growth and comes at the back of zero-Covid policy with severe lockdown, tight quarantine orders and eruption of protest movement against such guidelines. This could further add a bigger dent to the global growth which is already suffering from energy shocks, high inflation and fears of imminent recession in European economies looming large. China's retail sales witnessed the first ever decline since May'22 with sales declining by 0.5% in Oct'22 on annual basis. Investment in real estate too declined (8.8%), while unemployment rate unchanged at 5.5% in Oct'22. Rising infections and strict policies had hit the manufacturing and consumer spending. During this period, average prices of new homes in over 70 cities are down by 1.6% in Oct'22 (-1.5% in Sep'22). Exports too declined by 0.3% in Oct'22 raising concerns about recovery of the second-largest economy (growing at its slowest pace in decades). On the other hand, fixed asset investment till date (Jan-Oct'22) rose by 5.8% much lower than anticipated.

Global central bank decisions

Bank of Thailand has raised policy rates for 3rd time in a row by 25bps (1% to 1.25%) in order to manage inflation and support growth. BoT has also lowered its growth forecast to 3.2% (3.3% earlier) in 2022 and 3.7% (previously 3.8%) in 2023. The downward revision is on the back of growing risk to global outlook, which however is expected to be offset by growth in tourism sector. The committed has raised its inflation forecast to 3% from 2.6% next year, even as the Central Bank continues to 'closely monitor risk to inflation and any potential increase in cost-pass through as domestic prices also remain uncertain'.

For the 3rd straight month, China's central bank (PBoC) has kept the key lending rates unchanged. The 1-year prime lending rate is at 3.65% and 5-year stands at 4.3%. With policy divergence widening with other countries, the impact on fund flows remain to be seen. Though investors remained worried on expectation of further weakness in yuan on the back of easing monetary conditions. However, PBoC has reduced the reserve required ratio (RRR) by 0.25 percentage points from Dec'22 onwards and this is expected to release over 500 bn yuan of liquidity for banks. This will also signal an encouraging sign by the bank towards supporting growth.

In its fight to contain accelerating inflation, Central Bank of New Zealand hiked policy rates by a record 75bps to 4.25% from 3.5% (highest rate since Jan'09). The Central Bank has also revised its projection of peak benchmark rate to 5.5% (expected to reach next year) before it decreases. It also expects higher unemployment rate next year and possibility of economy falling briefly in to shallow recession.

Both Central Bank of Sweden and Israel have reduced the pace of normalisation. Sweden's Central Bank (Riskbank) hiked policy rate by 75bps in its latest policy meet, after raising the rates by 100bps in Sep'22. It expects much higher inflation in 2023 with policy rate averaging to 2.8% in 2023 (currently at 2.5%). Central Bank of Israel hiked policy rates by 50bps (3.25%-11 year high) after hiking rates by 75bps in the previous meeting. The Bank expects more rate hikes are warranted to cool down inflation (currently at 5.1% in Oct'22). Possible peaking of benchmark rate is likely by 2023, with rates reaching to 3.5%. Against this, the Bank expects economy to grow by 6% this year and 3% next year.

Special studies

Where is bank credit growing?

Growth in Bank credit has accelerated during the financial year which is a positive sign of economic activity picking up though banks are challenged by a slower growth in deposits. RBI data for month ending October shows that overall gross bank credit has grown by 17.9% on an annual basis compared with 6.8% last year. Total outstanding credit is now Rs 128.89 lakh crore. Data across sectors is available for around Rs 120 lakh crore. Significantly the largest component now is personal loans with a share of 31.4%. This is followed by manufacturing and services which are almost the same with 27.4% and 27.6% respectively. Agriculture had a share of 13.2% while the balance was food credit.

In case of industry the sharp growth rates in micro & small and medium industries has been maintained with acceleration seen for the former. The contribution of ECLGS has been significant here. In case of large industry there was a marginal fall in 2021 which has been reversed and this lower base has resulted in higher growth of 10.9%. The share of large industry in credit to industry is high at 76.5% followed by micro and small with 16.8% and medium with 6.7%.

The services sector in general has benefited In FY23 with the lifting of covid-based restrictions across all segments. This has resulted in an uptick in activity as seen in the GDP growth numbers too. GVA growth to the trade, transport, communications etc. segment was high at 19.5% for the 6 month period on top of growth of 19.3% in 2021. Accordingly growth in credit to this segment was robust led by credit to NBFCs and trade. Within services, the share of NBFCs is 38% followed by 23% for trade (wholesale and retail combined).

Within industry, sectors such as petroleum, coal and chemicals are some of the sectors driving credit growth. In all the sectors except rubber and rubber products there has been a relatively high growth in the production levels as per the IIP. In case of engineering, where the classification is different, there was a decline in production as per IIP in the first half of the year for electrical machinery of 7.6% and an increase for the non-electrical machinery.

Hence, it can be concluded that growth in credit is linked to the overall state of the economy. It has been deduced the regime of higher interest rates has so far not come in the way of growth in credit. It would need to be seen if this trend continues for the remaining part of the year. However, we do expect the economy to slow down in the next few months due to the exhaustion of the pent up demand phenomenon which provided an upward thrust to consumption. Also the recessionary tendencies in the west will leave its imprint on exports in particular which will have an impact on all related industries. All this combined with the repo rate hike effect would tend to moderate the growth in credit which will come down to the region of 14-15% for the year.

Trends in India's trade and impact of global economy

India's trade deficit in FYTD23 had surged to US$ 175bn as of Oct'22 compared with US$ 94bn in FYTD22, driven by faster pace of import growth (due to revival in domestic activity and higher commodity prices). Imports were higher at US$ 437bn in FYTD23 versus US$ 328bn last year. At the same time, exports had risen at a slower pace and have reached US$ 262bn in FYTD23 so far compared with US$ 234bn last year. Our analysis has shown that negative impact of slowing global growth will outweigh the positive impact through a depreciating currency. We thus expect CAD to inch up to 3.5% of GDP in FY23, from 1.2% in FY22.

Key conclusions:

- India's exports in 7 months of FY23 (Apr-Oct) have risen to US$ 262bn (+11.8%) from US$ 234bn (+55.6%) last year and US$ 185bn in the pre-pandemic period (FYTD20). This growth has been led by higher exports of petroleum products (US$ 49.7bn versus US$ 33.9bn last years), followed by agri (US$ 22.9bn versus US$ 20.bn) and chemical (US$ 17.9 versus US$ 16.5bn) products.
- Improvement in exports has also contributed to pick up in credit growth of industries, which has risen by 12.6% in FYTD22 (Apr-Sep'22) compared with 1.7% increase in FYTD22. Within this, credit to petroleum industry has gone up by 76% (20% last year) and credit to chemical sector has gone up by 23% (2%).
- Imports have also surged further and have risen to US$ 437bn in FYTD23 (Apr-Oct'22) compared with US$ 328bn in the same period last year, registering a growth of 33% on a YoY basis. Also compared with the pre-pandemic period (FYTD20), imports are about 53% higher. This has been on the back of higher oil and non-oil-non-gold imports (core imports). Oil imports were up by 60% and rose to US$ 131bn from US$ 82bn (+115%) last year. Non-oil imports rose by 30% to reach US$ 282bn from US$ 217bn (+59%) during FYTD22.
- Against this, India's trade deficit is now tracking higher at US$ 175.4bn in FYTD23 compared with US$ 94.2bn in FYTD22. It is even higher than US$ 100.7bn during FYTD20, as imports have rebounded more strongly than exports.
- Imports also increase as GDP goes up. Looking at the data from 1951, correlation between India's GDP and India's exports is 0.98. Thus, as our growth is expected to be less impacted due to external factors, and domestic demand is expected to remain steady, imports are estimated to go up further. For FY23, we estimate trade deficit at ~US$ 300bn and CAD is likely to be 3.5% of GDP compared with a deficit of 1.2% of GDP in FY22 and a deficit of only 0.9% of GDP in FY20.
- In order to understand the impact of global economy on India's foreign trade, following factors were used including export growth, movement of INR and global GDP. Based on regression analysis, following was deduced: 1% appreciation in INR/USD causes ~0.5% decline in our exports, while 1% growth in global GDP helps boost our exports by ~4.5%. With world economy expected to slow down it is likely to have a much greater negative impact on our exports, which cannot be cushioned completely by a depreciating rupee.
- Services exports also will be impacted. For the same period (since 1980s), it was also observed that 1% appreciation in INR/USD implies ~0.4% decline in services exports and 1% increase in world GDP leads to ~4% increase in services exports. Despite ballooning of import bill of services we expect a healthy surplus account, and our services balance has risen ~1.6x in FYTD23 (US$ 63bn), since the prepandemic period (FYTD20: US$ 39bn).

How have companies fared in Q2FY23?

Financial performance of an aggregate sample of 1,917 companies shows that net sales continue to increase, despite witnessing slight moderation. Higher expenditure costs have implied gross profits have slowed while net profits have declined. Interest costs are inching up but their impact has not yet been felt. Amongst key sectors, iron & steel, construction materials, hospitality have seen significant decline in profits.

- Quarterly financial performance shows that net sales rose by 24% in Q2FY23 against 27.4% in Q2FY22.
- In absolute terms, net sales were up at Rs 25.6 lakh crore in Q2FY23 as against Rs 20.6 lakh crore in Q2FY2.
- Profitability on the other hand has weakened on account of expenditure increasing at a faster rate than sales. This has resulted in 2.4% increase in gross profits compared with 9.4% increase in Q2FY22.
- However, both PAT and PBT have registered negative growth, with PAT declining by 5.4% and PBT by 1.3% in Q2FY23, compared with 58.7% and 51.3% increase, respectively, in Q2FY22.
- After analysing financial results of 1,519 companies excluding Banks, Finance, Insurance and IT companies, it was observed:
- Net sales growth was steady at 26.7% compared 37.5% growth in Q2FY22.
- Growth in overall expenditure was higher at 34.4% in Q2FY23 versus 38% during the same period last year. As a result, gross profits, PBT, PAT all declined.
- Interest coverage ratio has improved to 5.3 in Q2FY23 from 3.5 during last year in the same period. Interest burden of companies (% of turnover) has also reduced and has fallen to levels below pre-pandemic times. It fell from 2.6% to 2.4% in Q2FY23.

Comparing sector wise performance on profitability, it was noted of the 38sectors only 13 reported a profit of 30% in PAT in Q2FY23. These include realty, paper, agri, trading, consumer durables, diamond & jewellery, infrastructure, retailing, healthcare and capital goods. About 14 sectors also registered negative growth in profits including hospitality, iron & steel, construction materials, plastics, crude oil, textile, media & entertainment, industrial gases & fuels and plastics. Rising input costs have impacted industries such as industrial gases and fuels, aviation, hospitality, logistics, education &training and trading, where total expenditure cost rose the most.

The study also delves deeper in terms of understanding the reasons that drive sectoral performance. Oil and Gas business benefited from sustained production through operational efficiency and better realization with increase in ceiling price for domestic gas by the government. On the back of better availability of electronic components, automobiles industry reported higher sales volume. However, the electronics component shortages are still limiting production volumes. Profits were affected by high commodity price increases and electronic component supply constraints.

Textile business faced challenging times as export orders have been affected from USA and EU. However, apparel fabric demand has been stable in the domestic market. Consumer durable Sales were affected by high retail inflation which resulted in weak consumer demand. Sales of mixers grew steadily in H1 with higher sales in alternate online channels. Same also seen in the lighting and fans industry where rural stress and weak consumer demand affected turnover. Edible oils experienced dual market shocks of high prices followed by a steep decline in prices. However, turnover remained flat due to slow uptick in semi-urban and rural demand.

Higher domestic sugar and ethanol prices contributed to the earnings though could not compensate for the higher input costs of last season. Prices were higher for ethanol and sugar. The currency benefit due to rupee depreciation along with a flatter workforce improved performance of the IT sector. Housing demand continued to remain buoyant during the period. Residential sector performance continues to witness ongoing improvement and despite the rise in mortgage rates, affordability of home ownership remains high.

Have companies started investing in capital?

Has the investment cycle picked up? This question has been asked all the time and there have always been some conflicting opinion. The centre has so far expended 46% of the targeted Rs 7.5 lakh crore of capex in the first 6 months of the year. However, the picture for the states is not that encouraging.

The total projected expenditure on capital for FY23 for this set of states is to be Rs 6.92 lakh crore which is just a bit lower than that of the centre which is Rs 7.5 lakh crore. The states however have been slower with just 25% of the budgeted amount being spent so far which is Rs 1.8 lakh crore.

Turning to the corporate sector, the best way to gauge capital formation is to look at the balance sheets of companies which are published for the first half of the year. Total fixed assets (defined as sum of gross fixed assets and capital work in progress) increased from Rs 33.83 lakh crore as of September 2019 to Rs 36.86 lakh crore in September 2022, which is a compound growth rate of 2.9%. Growth in Sept 2022 over Sept 2021 was 5.1% and an improvement over 3.1% registered over 2020 and 0.6% over 2019.

The top 5 sectors namely, refineries, power, telecom, iron and steel and oil, which are all in the infrastructure space, account for 60% of total fixed assets of the sample companies. This means also that for giving a kick start to the investment cycle in the country it is essential for the thrust to be on infrastructure where the onus is on the government under the prevalent conditions where private sector is still in a wait and watch mode. The top 20 industries account for 85% of total fixed assets as of September 2022 and 97% of incremental investment made over the last 3 years.

The CAGR in fixed assets was 2.9% for the three year period ending September 2022. Among the top five industries in terms of share in total assets, higher than sample average growth was registered in case of iron and steel (55%), telecom (4.5%) and refineries (3.4%). It was virtually flat in case of oil exploration and 2.6% for power.

PSBs which have been investing in technology registered high growth of 6.8%, industrial gases 8%, chemicals 12.2%, household and personal products 67.2%, private banks 8.2%, tyres 9.1%, passenger cars 8.4%. There has been a fall in growth in fixed assets in case of non-ferrous metals, IT-software and textiles. On the positive side, industries which had a small share in total assets but have witnessed very high growth are retailing (12.4%) and gas transmission (10.2%). These are the rising sectors and would be investing more as they expand their activities.

Finally, there is need for big ticket infra based investment required to boost overall capital formation. The manufacturing sector would be investing based on the capacity utilization status; and hence in the very short term will be restricted to the growing sectors. It will not be a broad-based scene to begin with as several industries are still getting to grips with the aftermath of the pandemic where their business was distorted substantially.

Small savings versus bank deposits

After keeping rates stagnant for almost 2-years, the government had recently announced a hike in interest rates for small savings scheme. Overall out of the total 12 schemes, interest rates on 5 of the schemes was raised in the range of 10-30 bps. On the other hand, while banks have increased term deposit rates to some extent, savings deposit rate continues to remain at a low of 2.7%. Even term deposit rate of 1 year maturity fetches a lower rate of interest than the corresponding small saving instruments. The study compares the trends in bank deposits with small savings deposits and the role of interest rate differential between the two.

Small savings comprise of three main components: deposits, saving certificates and public provident fund (PPF). With a share of 23% in total savings, savings certificate is also major player, followed by PPF (7.6%) which is amongst the least preferred by investors. This is largely attributable to 15-years to lock-in period.

Banks continue to remain the preferred choice for consumers when compared with small saving schemes. However, small savings have the benefit at the margin of offering higher rates as these are adjusted only periodically and linked to market rates. Often in the downward cycle, the government chooses not to lower their rates which make them attractive for the households. As post offices are located all over the country, their touchpoints in rural India is significant. Of the 1.56 lakh post offices 1.41 lakh are in rural areas. In comparison, out of a total of 1.51 bank branches (as of Sep'22), only 35% or 53,380 are in the rural areas.

Further, in the current scenario due to a rising consumption growth, household savings have come down. On the other hand, bank credit demand has seen a sharp pickup while deposit growth has remained benign. In such a scenario, for banks to effectively compete with the higher returns offered under the small saving schemes, deposit rates need to be increased.

It has been observed that based on revealed preference of consumers bank deposits still dominate as the preferred choice of saving. But as seen above, there is a very gradual though marginal shift witnessed over the last few years, with the share of small savings inching up. This issue assumes particular importance in the present scenario when banks are looking to raise funds to finance the rising credit demand. Banks cannot afford to lose out on these funds and may have to rise deposit rates further to attract customers.

Key policy developments

The Union Cabinet, has approved the Nutrient based subsidy rates for phospatic and potassic fertilizers for Rabi season in agriculture year 2022-23 (1 Oct-31 Mar'23). This will provide smooth availability of all P&K fertilizer at subsidized rate and support the agriculture sector. It will be released to the fertilizer companies at approved rate and provided to farmers at a much more affordable price. The government has absorbed the price volatility in the international market for fertilizer and raw material. The financial outlay for the subsidy stands at around Rs 51,875cr, this includes support for indigenous fertilizer through freight subsidy.

The Cabinet has also approved the mechanism of procuring ethanol by Public sector oil marketing companies, under the ethanol blended petrol (EBP) programme. Higher ethanol price will be extracted from different sugarcane based raw material as a part of the EBP plan for the upcoming season. Additional GST and transportation charges will also be payable as a part of this. The EBP programme allows OMCs to sell petrol blended with ethanol up to 10%. This reduces the import dependencies and also promote the use of alternative and environment friendly fuels. The target of 20% ethanol blending in petrol has been advanced by the government from 2030 to 2025-26. With the availability of large quantity of ethanol form the start of the sugar season, government has also decided to re-define the Ethanol Supply year.

Data Releases

GDP growth slows in Q2FY23

GDP growth for Q2 came in at 6.3% which is slightly lower than our forecast of 6.5%. While most numbers were on expected lines, manufacturing has been a disappointment with a negative growth rate.

1. Mining and manufacturing have both witnessed negative growth rates. For mining, a high base effect combined with fall in output of oil and gas would be the factors driving it down. IN case of manufacturing it has been clearly affected by low growth for the SME sector (as per IIP) and fall in profits that has affected value added for the organized sector.

2. Agriculture growth of 4.6% should be viewed with caution as it is only early kharif harvest that would get included. The allied sectors are more likely to have pushed up this growth rate.

3. Construction is a good reflection of the real estate sector- both housing and commercial which has witnessed a revival.

4. The trade, transport etc. sector has done well with growth of 14.7% supported by high GST collections as well as revival of logistics which was partly functional till Mar'22.

5. Steady growth in bank business has helped to generate growth of 7.2% along with the real estate sector.

6. Public administration and other services has grown at a slower rate of 6.5% over a high base of 19.4%.

7. The high collection in taxes has helped to increase the net taxes component thus pushing the GVA growth at 5.6% to 6.3% for GDP.

8. Capital formation appears to have just about be maintained at 29.6% compared with 29.4% last year.

9. The GDP deflator has come down to 10% this quarter from 13.2% in Q1. This will come down further as seen by the WPI which is trending downwards.

We do expect GDP growth to be around 6.8% for the year, with a downward bias depending on the changing economic environment. But the downside will not be more than 0.2-0.3%

Currency outlook: INR strengthened in Nov'22

Dollar demand waned and other global currencies edged up as Fed Chair hinted at tapering the pace of rate hikes starting from Dec'22. Expectations that inflation has likely peaked and concerns over growth suggest that the Fed may be less aggressive. Markets have scaled back their expectations of peak Fed Fund rate. Hence, we may see some correction in DXY after its rather successful stint this year. INR remained range-bound in the last fortnight. Importantly, it recorded a 1.7% monthly gain against the dollar for the first time this year. We foresee INR in the range of 81-82/$ in the near-term supported by buoyant FPI inflows, lower oil prices and a weaker dollar.

Bond Market Round-up

Global bond yields broadly went into a downswing in Nov'22, a situation not seen in the past few months. US 10Y yield fell by 44bps, 14bps of which was attributed to the overnight fall, post Fed Chair's dovish speech. Markets are now anticipating a slower pace of rate hike by Fed. CME Fed watch tool is now pricing in a 50bps rate hike with 82% probability attached to the outcome which was around 45% as on 31 Oct 2022. IY US swap rates which are indicative of terminal rate is trading above 4.8%. Other global yields are also likely to feel the contagion of falling US 10Y yield. Most central banks' policy decisions are also scheduled this month and slight easing in the rate cycle is expected. In the Eurozone, some economies provided comfort with regard to moderation in flash CPI data.

On the domestic front, 10Y yield traded in the range of 7.26-7.48% in Nov'22 with higher volatility compared to last month. The trajectory was on the downside comforted by ~10% decline in international crude oil prices. Even some moderation in inflation data in Oct'22 raised hopes of a smaller pace of rate hike by RBI. Considerable flattening of India's yield curve was also noticed as short end yields remained inflexible while yield on long end papers fell. Another notable thing noticed in the current month is that, banks have been heavy sellers of government securities especially PSBs. This might be because of the rising wedge between credit and deposit growth, which has raised their demand for funds.

Core industries

Core sector growth in October was flat at 0.1%. While this is a sign of weakening activity, the high base effect has also had a role to play as growth was 8.7% last year. Hence, given that growth last year had moderated from November onwards we may expect a better performance from the core sector. Coal registered growth of 4.6% even though the base effect was high at 14.7% and may be linked to better demand from industry as electricity production growth was also low at 0.4% over 3.2% last year. Fertilizer production was up at 5.4% as we are in the midst of the rabi sowing and demand would be steady. Steel production was up by 4% while cement fell by 4.3%. Government capex has been the driving factor here. Cement has declined due to the high base effect of 14.6% registered last year. On a FYTD basis, output of eight core sector rose by 8.2% with future prospects likely to be driven by pick up in infra activity. Against this we expect IIP growth to also be low at 2-3% (provided consumer goods show a revival).

Central government finances

Entering into H2FY23, central government's fiscal data shows that on FYTD basis (Apr-Oct) fiscal deficit reached 45.6% of the targeted level, compared with 37.3% as of H1FY23 and 36.3% in FYTD22. In terms of spending, a positive development is on the capex side, wherein government has spent 54.6% of the budgeted amount compared with 45.7% during the same period last year (FYTD22) and 45.7% as of H1FY23. Revenue spending in FYTD23 on the other hand is at par (54.3%) compared with last year (53.7%). On the income side, government has seen 18% jump in gross tax revenues during Apr-Oct'22 period, up from 17.6% increase in collections during H1FY23. This was driven by pickup in direct tax collections, which rose by 25.9% in FYTD23 compared with 23.5% in H1. Both corporate (24.1% versus 21.6%) and income (27.7% versus 25.7%) improved. On the other hand, indirect tax collections registered marginal slowdown (11% versus 11.8%). Within this, while collections under customs rebounded (9.5% versus -6.9%) due to festive demand supporting imports, excise collections remained subdued (-18.8% versus -18.5%). Overall, centre's net revenue moderated, as it was up by 7.1%

compared with 8.2% in H1. Going forward, we can expect revenue spending to pick up pace (subsidy disbursements), and we continue to estimate only marginal slippage of 0.2-0.3% in fiscal deficit ratio.

CPI cools down in Oct'22

Headline CPI moderated to 6.8% in Oct'22 from 7.4% in Sep'22, led by food, fuel and core inflation. Food inflation decelerated to 7% from 8.6% in Sep'22, led by vegetables, fruits, oils and pulses. Core inflation too softened to 5.9% from 6.1%, due to dip in transport & communication segment, as fuel prices cooled down. However, it is expected to remain sticky in the same range as domestic demand indicators remain healthy, also supported by the festive/holiday season. MoM trends in food inflation are showing that risks to food inflation still persist and will have to be watched closely in the coming months. We also expect RBI to continue hiking rates till repo rate reaches 6.5%, with 35bps hike in Dec'22.

Core CPI (excl. food and fuel) edged down to 5.9% in Oct'22 from 6.1% in Sep'22. Even RBI's preferred measure of core CPI (core excl. pan, tobacco and intoxicants) eased, albeit at a slower pace of 6.2% versus 6.3% in Sep'22. This was on account of moderation in inflation index for transportation & communication (4.6% in Oct'22 versus 5.4% in Sep'22) and recreation & amusement (6.1% versus 6.3%). On the other hand, inflation index for clothing and footwear (10.2%), housing (4.6%), household goods and services (7.6%) remained unchanged in Oct'22. CPI reading for Oct'22 highlights that base effect is beginning to show its impact on headline data. Dip in food and fuel inflation has provided a much needed breather, with food inflation in Oct'22 (7%) slipping to much lower than H1FY23 (7.8%). As we expect consumer demand to remain healthy in coming months as well, pressure on core CPI will be maintained. Despite softening of CPI, we expect RBI to hike rates further, until it is convinced that headline CPI has sustainably fallen within RBI's target range. We expect 25-35bps rate hike in Dec'22 and estimate end-period repo rate at 6.5%

WPI eases to 19-month low

WPI cools off further (5th consecutive month) to 8.4% in Oct'22(10.7% Sep'22), supported by broadbased moderation in food, fuel and manufactured product inflation. Within food, prices of fruits, tomato and onion contributed to the moderation. However, there is an uptick in prices of cereal and protein based items. Globally, wheat prices have also registered an upswing due to uncertainties related to Ukraine exports. Core WPI softened further to 4.7% in Oct'22 from 7% in Sep'22 led by dip in manufactured inflation (4.4% from 6.3% in Sep'22). Fuel inflation was down in Oct'22. Going further, on the back of moderation in global prices, WPI is expected to ease further.

Food inflation in Oct'22 slipped to 1-year low of 6.5% from 8.1% in Sep'22. This was on the back of moderation in prices of both fruits and vegetables. Fuel and power inflation moderated to an 18-month low of 23.2% in Oct'22 from 32.6% in Sep'22. This was led a dip in the mineral oil index to 29.1% (19-month low) from 46% in Sep'22. It must be noted after peaking at 74.6% in Apr'22, mineral oils index has since been moderating. There was a broad based slowdown in mineral oil inflation with ATF (58.7% versus 91.8%), HSD (43.1% versus 66%) and kerosene oil (84.6% versus 104.9%) registering moderation in Oct'22. On the other hand, coal inflation edged up to 4.2% in Oct'22 from 2.5% in Sep'22. Electricity prices rose by 20.5%, unchanged from Sep'22.

Core inflation eased significantly to a 22-month low in Oct'22 at 4.7% compared with 7% in Sep'22. Inflation in manufactured products moderated to 4.4% in Oct'22 from 6.3% in Sep'22. Within this group, out of a total of 22 commodity sub-indices, only 3 noted an increase in inflation in Oct'22 compared with Sep'22, while the others saw a slower pace of price increase. Highest deceleration was seen in the prices of basic metals and paper and paper products. Within basic metals, prices of copper contracted at a faster pace of 6.5% in Oct'22 compared with a decline of 5.8% in Sep'22.

IIP growth scales up

Industrial growth increased by 3.1% in Sep'22 (-0.7% in Aug'22). Higher output is on the back of growth in electricity output which was up by 11.6% in Sep'22 and mining output growing by 4.6% from a contraction of 3.9% in Aug'22. Manufacturing output (77.6%) which contributes the most to the industrial production was up a tad bit by 1.8% in Sep'22 (-0.5% in Sep'22). Even as fears of global economic slowdown aggravate across countries. India's growth remain steady with industrial production output likely to improve H2FY23 on the back of steady recovery as has also been signalled by some frequency indicators (robust tax collections, soaring credit growth).

Within use-based, primary good output accelerated by 9.3% in Sep'22 compared with a growth of 1.7% in Aug'22. Capital goods output clocked double digit growth and was up by 10.3% in Sep'22 (from 4.3% in Aug'22). Infra (7.4% from 2.1% in Aug'22) and intermediate good (2% from 1.2% in Aug'22) output also registered an improvement in Sep'22. However, output of consumer durable disappointed the most as it contracted by 4.5% against a decline of 2.5% in Aug'22. Output of consumer non-durable goods contracted at a slower pace by 7.1% in Sep'22 (-9.5% in Aug'22).

In H1FY23, IIP growth has expanded by 7% compared with 23.8% growth in H1FY22. Recently, India's manufacturing PMI had slipped slightly to 55.1 in Sep'22 from 56.2 in Aug'22, though it moved up to 55.3 in Oct'22. The latter half of the year is likely to do much better on the back of the favorable base and taking in to account the festive demand, in this period. Robust tax collections, likelihood of moderation in inflation and uptick in government spending in the coming months is expected to boost the economy.

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