2 January 2023

**Sonal Badhan**
**Economist**

# Economic Round-up: December 2023

**US economy continues to show divergent trends in growth, with consumer demand holding ground, labour market cooling and real estate sector signalling marginal improvement in conditions. On the other hand, other major economies such as China and Eurozone continue to struggle more. PMIs indicate that manufacturing and services activity is losing steam in both regions. Drop in business sentiment index in Germany is another sign of firms losing confidence in economic outlook of the region. In UK as well, central bank has pencilled in stagnation in their forecasts, but inflation will still remain above bank's targeted level. As a result, BoE has hinted that rate cuts might not be on the cards in the early part of CY24 at least. ECB is also of a similar view and has reiterated that rate cut talks are premature. Fed on the other hand is expected to cut rates thrice this year. India remains a brighter spot amongst all, as manufacturing activity continues to improve (Nov'23 PMI), inflation is coming down and GDP in H1FY24 has surpassed expectations. This week, first advance estimates of GDP for FY24 will shed further light on our growth trajectory.**

**Global growth:** Major economies have entered CY24 with a gloomier outlook. As economic activity remains bleak in Eurozone, UK and China, in the US, economy is on track for soft landing. Labour market weaknesses are becoming more visible in the US, while balance sheet of consumers remain healthy so far. Real estate sector appears to be benefiting from dovish Fed outlook, which has led to significant drop in 30Y fixed mortgage rates (currently at lowest since Jun'23). In the year ahead, while Eurozone is expecting mild recession, UK economy is expected to stagnate. Growth in US and China is estimated to slowdown. India will remain the fastest growing major economy in FY25, despite noting some moderation.

**Global Central Banks:** In Dec'23, US Fed, ECB, BoE, and BoJ continued to keep their respective rates on hold. Fed's policy statement was considered to be more dovish than anticipated, as dot plot shows that the central bank might cut rates thrice this year. However analysts are pencilling in aggressive rate cuts by Fed, on account of cooling inflation and labour market. In contrast, BoE and ECB have hinted that talks of rate cuts are premature at this stage, leading analysts to price in rate cuts only from H2CY24 onwards. BoJ is also expected to move away from its ultra-loose policy this year, beginning with increasing short term rates.

**Key macro data releases: India's CAD** recorded a deficit of US$ 8.3bn (1.0% of GDP) in Q2:2023-24, lower than US$ 9.2bn (1.1% of GDP) in Q1:2023-24 and US$ 30.9bn (3.8% of GDP) a year ago (Q2:2022-23). The two critical factors driving the CAD have been software services, which have reached around US$ 70bn in first half, and remittances, that are now close to US$ 48bn. On the side of capital account, FPIs have been more buoyant than FDIs so far this year.

**CPI inflation** rose to its three month high of 5.55% in Nov'23 and slightly lower than our estimate of 5.7%. This was attributable to 209bps jump in food inflation which rose to 8.7% in Nov'23 from 6.6% in Oct'23. Core CPI moderated further to 4.1%. All broad sub components of core noticed a drop in inflation in Nov'23. Amongst them, components such as household goods and services, clothing and footwear and housing noticed fair degree of moderation.

# Global developments

## Global growth: Entering 2024 on shaky ground

US economy has shown mixed trends in growth in different sectors. On one hand, while consumption indicators (retail sales, consumer confidence) seem to be holding ground, on the other hand, labour market is showing signs of cooling down. Real estate market has recorded marginal recovery. Retail sales in the US rose unexpectedly in Nov'23 by 0.3% (MoM), following (-) 0.2% drop in Oct'23. This was driven by jump sales of restaurant and bars, and motor vehicles and parts. Falling oil prices led to drop in gasoline sales in value terms and. Sales of electronics and appliances also fell. Consumers remained confident in Dec'23 as well, as conference board consumer sentiment index jumped to 110.7 (highest since Jul'23) from 101.0 in Nov'23. The push mainly came from 35-54 age bracket, with annual income more than US$ 125k. Both, current situation (business and labour market) and expectations index, inched up. This stands in contrast to cooling labour market data. Initial jobless claims for the week ending 23 Dec 2023 rose by 12k to 218k (est.: 210k). Continuing jobless claims for the week ending 16 Dec 2023 also rose by 14k to 1.88mn, thus suggesting difficulty in finding new jobs once laid off from the previous one. Despite this, real estate market seems to be recovering, as existing home sales rose by 0.8% (MoM) in Nov'23, supported by dovish tone of Fed policy. Interest rates on benchmark securities (10Y G-Sec) have fallen sharply. In line with this, 30Y mortgage rate has also come down to 6.61% as of 28 Dec 2023, lowest since Jun'23. This is likely provide support to home sales in Dec'23 as well.

Eurozone's flash manufacturing PMI showed that output contracted further in Dec'23, as the index fell to 44.1 from 44.6 in Nov'23. Dip in new business orders has led to decline in backlog orders, cutting down on inventories/stocks and job losses. Even services activity remained in contraction in Dec'23, with index down to 48.1 from 48.7 in Nov'23. Conditions remain bleak in both France and Germany. In case of France, service sector activity is at nearly 3 year low. Germany's IFO index fell to 86.4 in Dec'23 from 87.2 in Nov'23, driven by drop in both current situation (88.5 versus 89.4) and expectations (84.3 versus 85.1) index. Businesses are more sceptical of outlook in H1CY24, as new business orders are unable to pick up and government also had to cut spending following a court ruling. Analyst expect possibility of stagnation or mild recession has increased further this year.

China's official manufacturing PMI shows deepening contraction in manufacturing activity as the index dropped to 49 in Dec'23 (est.: 49.5) from 49.4 in Nov'23, owing to declining export orders and persistent weakness in domestic demand. On the other hand, non-manufacturing PMI improved to 50.4 from 50.2 in Nov'23. Within this, while services activity remained into contraction (49.3 in Dec'23—unchanged from last month), construction activity supported growth as index rose to 56.9 in Dec'23 from 55 in Nov'23. In Nov'23, domestic industrial activity rose by 6.6% in Nov'23, up from 4.6% in Oct'23. Even retail sales accelerated, and was up by 10.1% in Nov'23 following 7.6% in Oct '23. However, fixed asset investment cooled off slightly in CYTD23 (Jan-Nov) to 2.9% from 3% between Jan-Oct. Government recently announced that budget deficit ceiling of 3% for 2023 might be relaxed, so as to allow government to provide room for fiscal stimulus. There are hopes that government will raise at least 1tn Yuan of sovereign debt to spend on infrastructure projects. This has revived hopes of improving demand conditions in the coming months.

## RBI

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 possibility of a rate cut before Q2FY25.

## Global central bank decisions

US Fed left its policy rates unchanged at 5.25-5.5% for the 3rd consecutive time in Dec'23 meeting. The policy statement was more dovish than anticipated, with the central bank affirming that policy rates seem to be restrictive enough. The dot plot also indicates possibility of three rate cuts in CY24, leading to ~75bps reduction in policy rates. Downward revision in core PCE forecasts (2.4% versus 2.6% earlier for CY24, and 2.2% versus 2.3% earlier for CY25) further signals that Fed is confident that present level of policy rates are elevated enough. Markets are however expecting even more rate cuts, to the tune of ~150bps, as labour market cools down and economy is also showing signs of slowdown.

Bank of England (BoE) for the third consecutive time since Dec'21 left its policy rate unchanged at 5.25%—15 year high, in its Dec'23 meet. The decision was not unanimous with 6 out of 9 members opting for a pause and the other three voted for a 25bps hike. This trend was similar to Nov'23 policy decision, hinting that BoE's still not discussing rate cuts. The policy document retained the statement that, monetary policy "likely to need to be restrictive for an extended period of time". Many BoE officials have also hinted that talks of rate cuts are still premature, more than 7% increase is wage remains concern for the central bank, as it targets to achieve 2% inflation limit. Thus, most analysts believe that BoE is expected to maintain 'higher for longer' stance and no rate cuts can be expected in H1CY24.

Following other major central banks, ECB also decided to pause in its Dec'23 meeting. However, ECB President Lagarde reiterated that rates can be expected to remain higher for longer. This is because the central bank expects inflation to bounce back in the coming months, owing to the impact of low base and some tax changes. ECB President also announced that no discussion on rate cuts has taken place as yet and members are of the belief that policy should remain restrictive for now. Central Bank chief confirmed that H1CY24 data will be critical in determining the future path of rate trajectory.

Bank of Japan yet again retained its stance of keeping the monetary policy ultra-loose monetary policy in its Dec'23 meeting. The central bank noted that firms are signalling further rise in wages even in 2024, but inflation has still not reached BoJ's target on a durable basis. Most analysts believe that BoJ will first begin with increasing the short-term rates from (-) 0.1% to 0%, and then withdraw from pullback on other stimulus measures (bond purchases). It is expected that from Apr'24, BoJ will begin tightening.

# Special studies

## Highlights of RBI's Financial Stability Report

RBI has attested to the strength of the Indian economy in its latest half-yearly Financial Stability Report. India's macroeconomic fundamentals have been underlined by moderating inflation, narrowing CAD, sustained growth and rising foreign exchange reserves. Against this backdrop, the health of the financial sector continues to be steady amidst sustained growth in bank credit, adequate capital, liquidity buffers, strong earnings and lower NPAs. Balance sheets of both corporate and banking sector have also strengthened and this is prompting anew investment and credit cycle. Apart from this, stress tests results indicate that even under severe stress scenario, capital reserves of SCBs remain adequate and GNPA ratios are also likely to inch up only marginally.

The FSR also noted that due to increasing interconnectedness, the share of interbank exposures in the total assets of banking system reached a 3-year peak in Sep'23. This leaves the financial system susceptible to contagion risk. However, it is unlikely to lead to the failure of any bank. With heightened volatility and uncertainty in the global financial system, risks of a spillover also cannot be entirely ruled out. It is therefore important to closely monitor the evolving picture and react proactively. This also needs to be supplemented with prudent management exposures and building of financial buffers

RBI's in the Financial Stability Report (FSR) alluded to the strength of the domestic banking system. The strong performance of the financial system has been underlined by:

- adequate buffers
- robust earnings and
- improvement in asset quality

Improved margins due to higher interest rates has helped banks' profitability. However, with the interest rate cycle expected to have peaked, some pressure on this front is expected. Concerns have also been raised on the impact of sustained period of high interest rates on banks due to valuation losses. This is particularly important since banks hold ~63.6% of their investments in held-to-maturity (HTM) category, which are not marked to market. However, RBI's assessment showed that unrealized losses on HTM securities have fallen from Mar'23.

Some of the highlights mentioned in the report are:

- Underpinned by strong interest margins and buoyant credit demand the net interest income (NII) of banks have improved leading to a pickup in earnings. RoA and RoE have increased to 1.2% and 12.9% respectively in Sep'23, from historic lows of (-) 0.2% and (-) 2.2%, respectively, in Mar'28.
- Credit growth has continued to outpace deposit growth.
- Monetary policy transmission to both lending and deposit rates has been higher in this rate cycle.
- Banks' risk-weighted asset ratio (CRAR) remained robust at 16.8% in Sep'23, which is much higher compared with the minimum regulatory level of 11.5% (including capital conservation buffer).
- Further, the common equity tier 1 (CET1) ratio, representing the highest quality of regulatory capital was also above the regulatory threshold of 8% (including capital conservation buffer), and stood at 13.7% in Sep'23.
- Gross non-performing assets (GNPA) dipped further to 3.2% in Sep'23 from 3.9% in Mar'23.
- Net NPA also at a multi-decade low of 0.8% versus 1% in Mar'23.

- Sector wise, there has been a broad based improvement in GNPA ratios across all key sectors. Even so, at 7%, GNPA ratio in the agriculture sector remained elevated.
- The FSR also highlighted that lending to retail segment, particularly unsecured loans by both banks as well as NBFCs has increased sharply in the past two years. However, the GNPA ratio for personal loans has moderated in Sep'23.
- However, within personal loans, higher GNPA levels can be seen for credit card receivables, particularly for private sector banks (PVBs) and Foreign banks (FB).
- Despite higher rates, NPAs in the housing sector have remained relatively stable.
- For SCBs as a whole, GNPA ratio under unsecured retail loans has improved to 2% in Sep'23 from 2.5% in Sep'22.
- However, there are signs of stress in terms of risk profiling and high vintage delinquency. Apart from this, it was found that 42.7% of customers availing consumption loans already had three live loans at the time of origination and 30.4% of customers availed more than three loans in the last six months. Even more importantly, 7.3% of customers availing a personal loan below Rs 50,000 had at least one overdue personal loan
- Under industry, GNPA for infrastructure sector (ex. electricity) and petroleum and coal products has shown an uptick.
- Bank lending to SCBs, both by public sector banks (PSBs) and private sector banks (PVBs) accelerated in H1FY24, despite the expiry of Emergency Credit Line Guarantee Scheme (ECLGS).
- Overall, the GNPA ratio for this sector has declined to 4.7% in Sep'23 from 6.8% in Mar'23 and 7.7% in Sep'22.
- SMA-2 accounts, however, rose to 1.7% in Sep'23 from 0.9% in Mar'23.
- GNPA of loans extended under the ECLGS has increased to 6.5% in Sep'23 from 5.5% in Mr'23 with services and trade accounting for a majority of delinquencies.

Some other interesting observations made in the FSR are:

- With respect to bank lending to NBFCs, the report noted that almost 80% of bank credit goes to NBFCs which are rated AA or above.
- However, due to increase in co-lending initiatives between banks and NBFCs, and high ratios of SMA (1+2) for some banks, there are inherent risks. To mitigate this, the RBI introduced a preemptive step of increasing the risk weight risk weights on certain segments of consumer credit by banks and NBFCs, along with increasing the risk weight of bank credit to NBFCs.
- As a result, the CRAR of SCBs estimated to decline by 71bps to 16% and CET1 may fall by 58bps to 13.2%. However, this will vary from bank to bank.

Results of stress test:

- Results of macro stress test reveal that Indian banks are well capitalized to handle any macro-economic shocks, without requiring additional capital infusion.
- Consolidated CRAR of 46 major banks is expected to dip from 16.8% in Sep'23 to 14.8% in Sep'24 under the baseline scenario, 13.5% under medium stress scenario and 12.2% under severe stress scenario. Even so, it will remain above the minimum regulatory threshold under all the three scenarios.

- CET1 ratio is also expected to decline to 12.2% (baseline), 11.1% (medium stress) and 10 (severe stress) by Sep'24.
- GNPA ratio of SCBs is expected to moderate further to 3.1% by Sep'24 under baseline scenario, from 3.2% currently. Under medium-stress scenario, it is expected to rise to 3.6%, and further to 4.4% under severe stress scenario.

For the NBFC sector, the FSR notes the following:

- CRAR for NBFCs stood at 27.6% in Sep'23 versus the regulatory requirement of 15%.
- GNPA ratio has declined from a high of 7.2% Dec'21 to 4.6% in Sep'23.
- The report also noted that due to the difference in nature of operations of different NBFCs, there are inherent risks which can spill over to the financial system.
- NBFC-Investment and Credit Companies (ICCs) which are primarily engaged in retail lending, depend heavily on bank borrowings (48% of their total borrowings in Sep'23). Consumer loans, on which risk weights were increased recently, formed 44.7% of the incremental retail loan growth over the last one year.
- Alarmingly, the share of unsecured loans in the NBFC sector rose from 24.6% in Mar'23 to 31.9% in Sep'23, increasing at a CAGR of over 20%.
- Even for NBFCs-IFCs (Infrastructure Finance Companies), are another source of risk as their exposure to the power sector makes them vulnerable. Share of bank borrowings to this category of NBFCs stands at 29.5% as of Sep'23.
- Stress tests for NBFCs to shocks from credit risks for 146 NBFCs suggest that under the baseline scenario, the one-year ahead GNPA ratio and CRAR is estimated at 3.8% and 22% respectively. Under a medium risk shock GNPA ratio increases to 5% per cent and the resultant income loss and additional provision requirements reduce the CRAR by around 70bps from the baseline. Under the high-risk shock, CRAR declines by 101bps relative to the baseline, to 21%.

## Lower Rabi sowing

There has been some concern over the Rabi crop ever since the Ministry announced that overall Kharif output was to be lower this year. The latest data as of $29^{th}$ December shows that Rabi sowing has been patchy across crops, and lower at the aggregate level.

- Overall sown area of Rabi crops have improved by 0.9% compared with last year as of 29th Dec 2023.
- Total sown area of wheat (1.9%) and rice (2.3%) have climbed up.
- Sown area of coarse cereals is higher by 5.5% led by Maize (10.8%) and Barley (3.9%).
- Even the sown area of oilseeds (2.7%) have risen with mustard registering much higher acreage (4.1%).
- On the other hand, pulses have registered lower acreage for this period and has largely been dragged down by gram (-6.1%).

## Sensex scales new heights: But what about other indices?

The Sensex has now settled at above 70,000 and this is a good sign for the market as it reflects hope and future growth. Corporate performance too has been good for the second successive quarter in terms of earnings which has pushed up sentiment. Along with this performance has been some strong statements made by the RBI on GDP growth for this year which is to be 7%. High frequency indicators such as PMI, IIP, GST, advance tax collections among others show a lot of buoyancy. Also the news that the Fed may no longer hike interest rates but consider instead lowering them next year has given additional boost to FPI flows which have flowed in.

In this context, it would be of interest to see how other stock markets have performed. There is as usual no clear picture. For the developed markets it can be seen that UK, Switzerland and Canada are lagging while the others have witnessed an increase of above 10%, with the NASDAQ delivering the highest returns.

In case of emerging markets the picture is quite disjointed.

- Argentina, which is not represented here witnessed growth of over 440% which can also be attributed to some indexation for inflation which is above 130% right now.
- The Latin American markets have done well while in Asia it is only Taiwan, Saudi Arabia and India which have registered above 15% growth.
- The rest have grown at much lower rates with China, Thailand and Hong Kong witnessing a decline in stock indices during this period.
- South Korea is up by around 9% while Australia and Indonesia are up by around 5%.

Overall too, there does not appear to be any clear relationship with GDP growth with a negative coefficient being witnessed for this set of countries. Germany for instance is to register negative GDP growth though the markets have done very well. Hong Kong, Thailand and China would be growing at higher rates relative to other developed countries though below their potential but have witnessed negative growth in stock indices.

It may be assumed that the markets have generally been bullish with sentiment changing course as the world economy has done better than expected at the beginning of the year.

## How does inflation compare across countries?

Inflation in India came in at 5.6% for November which is likely to remain high even in December due to higher food prices. There is however a lot of comfort drawn from the rather stable core inflation numbers in the last few months which is more susceptible to demand side forces and, in turn, can be controlled by monetary policy. However, food inflation is driven more by supply side pressures where shortfalls in production do manifest in higher prices. While inflation of 5.6% is definitely higher than the RBI target of 4% but within the band of 2%, how does this compare across other countries?

We tracked inflation numbers for different countries (as per the latest availability, which varies between September and November). Inflation in India does appear to be on the higher side at 5.6% compared with most other nations. Argentina and Turkey are excluded due to extreme inflation numbers of 143% and 62% respectively. It should be pointed out that inflation in India has been volatile, as it is driven by food prices and hence shown differing tendencies every month.

From a policy perspective often one does talk of the real rate. Hence if the policy rate in India, which is the repo rate, is at 6.5%, the real policy rate for the latest month would stand at 0.9%.

It should be remembered that this year, policy rates have been driven by rather unusual circumstances across countries which are based on targeting a certain inflation rate on a sustained basis. Also, with inflation rates not following a linear path when there is higher weight for food products, there is tendency for real policy rates to show similar movements in the opposite direction. Therefore, central banks do take a more nuanced view of inflation, looking not just at the past but also future when arriving at a decision on rates.

**Movement in global commodity prices**

In this context it would be interesting to see how commodity prices have shaped up over the last year. World Bank prices are used here for different categories of goods. The period chosen is November 2023 over November 2022

The overall picture is quite varied: energy is down, metals equally distributed, oils down, fertilizers down, precious metals up, beverages and grains generally down with rice being an exception. Evidently the driving factors are quite different.

## Trends in general government subsidies

In this note we had briefly analysed the trends seen in general government (centre and states) subsidies. Data for central government showed 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. The 10-year average (% of total subsidies) for this component is ~2.5%, and out these 10 years (FY14-23), for 7 years, the ratio ran above average (FY16-22; average 3.6%). It has now seen substantial reduction with cuts made to price stabilisation fund and procurement of cotton by cotton corporation fund. This ratio was thus brought down to 0.5% as FY23RE and is targeted to be even lower at 0.2% by the end of FY24 (BE). In terms of % of GDP also, share of fertilizer subsidy has gone up from 0.6% in FY14 to 0.9% in FY23, share of food subsidy is up from 0.8% to 1%, while that of petroleum has dropped from 0.8% to 0.03%.

Within **fertilizer subsidy** also, a change in trend is visible over the past seven years. In FY17, total fertilizer subsidy stood at Rs 7 lakh crore, of which Rs 5 lakh crore was paid for Urea based subsidies and Rs 2 lakh crore was for Nutrient based subsidies, implying a share of 73% and 27% respectively. By FY23, while Urea subsidies still remain dominant (66% share in total fertilizer subsidies), nutrient based subsides have seen a significant increase (34% share). During this period (FY17-23), when fertilizer subsidies rose at a CAGR of 20%, Urea subsidies rose by 18% and Nutrient based subsidies by 24%.

**Food Subsidies** over the 10 year period of FY14-23, have seen 11.5% CAGR growth from Rs 92,000 crore in FY14 to Rs 2.7 lakh crore by FY23. Following the implementation of the National Food Security Act (NFSA), 2013, food subsidies saw an average of 18% growth between FY14 and FY16. After that, subsidy bill saw some rationalisation and it came down by 10% on an average between FY17 and FY19. However, as Covid-19 pandemic struck, government announced PM-Garib Kalyan Ann Yojna (PMGKAY), which benefitted ~80 crore individuals and pushed food subsidy bill from Rs 1 lakh crore in FY19 to Rs 1.1 lakh crore in FY20 and Rs 5.4 lakh crore in FY21. Until the end of CY22, beneficiaries received free food grain under PMGKAY and also received subsidised ration under NFSA. To streamline the disbursements, both schemes were merged from Jan'23 onwards. As a result, subsidy bill was brought down to Rs 2.9 lakh crore by FY22 and Rs 2.7 lakh crore by FY23. In FY24, the cost is targeted at Rs 2 lakh crore. Here, there might be marginal slippage in the target as government has recently announced that free food grains scheme will be extended for another five years.

**How have states fared?:** We studied a sample of 28 states and UTs for which the data was available, and noted that state subsidies were up by 5.7% (CAGR) between FY19 and FY23. In absolute terms, there hasn't been a dramatic change, as it has ranged between Rs 2-3 lakh crore in non-Covid years. Only during Covid-19 pandemic subsidy bill edged up to Rs 3.4 lakh crore in FY21 from Rs 2.2 lakh crore in FY20. In the last fiscal year as well, subsidy bill settled at ~Rs 3.1 lakh crore. A major part of these subsidies goes to for power, water, agriculture and health. Out of our sample of 28 states, budgets of 21 states provide subsidy projections for FY24. This shows that subsidy bill is expected to come down to ~Rs 2.6 lakh crore. However, the 2 key states missing from this estimate are Karnataka and Punjab. Considering that these two alone accounted for ~15% of the total subsidy bill in FY23, subsidy bill by the end of FY24 could again settle at ~Rs 3 lakh crore.

Out of 28 states and UTs analysed, 10 contributed towards 81% of the total subsidies in FY23, with Maharashtra (13.9%), Tamil Nadu (9.5%) and Gujarat (8.3%) leading the way. As size of the budgets of these state as big, their share in overall subsidies are also higher. Similar is the case with states like Karnataka, Rajasthan, A.P. and U.P.

Hence, in order to gauge the burden of subsidies in each state, we looked at subsidy per capita. However, these numbers should also be read with caution, as the population figures used for our calculation pertains to 2011 census and by FY23, population would have increased notably, making the denominator bigger and ratio smaller than it appears now.

As of FY23, states like Punjab, Karnataka, Gujarat, and Tamil Nadu, spent over Rs 4,000 per person on subsidy, while states like Maharashtra, Rajasthan, Haryana, Chhattisgarh spent more than Rs 3,000 per person. Amongst the bigger states, Odisha (Rs 868) and UP (Rs 1,064) had lowest levels of subsidy per capita, followed by West Bengal, Madhya Pradesh and Andhra Pradesh.

# Data Releases

## Currency outlook

Global currencies gained at the expense of the dollar as prospects of looming Fed rate cuts weighed on the greenback. While INR appreciated by 0.2% in Dec'23, it ended 2023 0.6% lower. When compared with a 10%+ depreciation last year, INR's performance was quite remarkable. Apart from a weaker dollar, lower oil prices, strong FPI interest and range-bound external deficits also worked to the advantage of the Rupee. RBI also did a commendable job of managing the currency by limiting volatility. Prospects for INR look bright in the near-term, primarily driven by a weakness in dollar. We expect a range of 83-83.5/$ in the near-term. For 2024, INR can break past the 83/$ mark and inch towards 82/$. However, RBI is unlikely to allow INR to appreciate beyond that given that exports are still facing headwinds due to the uncertain global environment.

## Bond Market Round-up

Global yields continued their downward trajectory. Expectations of easing financial conditions increased post Fed policy and recent inflation readings of major economies, which gave relief to central banks. Thus, we are entering 2024 with the narrative of a softer interest rate regime in the near term. India's 10Y yield also felt the reverberation of the same. In Dec'23 it fell by 11bps and in CY23, it inched down by 15bps. Going ahead, we do not expect much volatility in India's 10Y yield, as we have seen buying support broadly reigned in amidst resilient macros. We expect India's 10Y yield to remain in the range of 7.19-7.25% in the current month. The short end part of India's yield curve would continue to exhibit volatility based on the evolving liquidity conditions which we feel will normalize in the range of 0.5-0.6% of NDTL in the coming months (currently at ~0.9% of NDTL).

## CAD

India's current account balance recorded a deficit of US$ 8.3bn (1.0% of GDP) in Q2:2023-24, lower than US$ 9.2bn (1.1% of GDP) in Q1:2023-24 and US$ 30.9bn (3.8% of GDP) a year ago (Q2:2022-23). Underlying the lower current account deficit on a year-on-year (y-o-y) basis in Q2:2023-24 was the narrowing of merchandise trade deficit to US$ 61.0bn from US$ 78.3bn in Q2:2022-23. Last year was the time the economy was buffeted by high commodity prices due to the Ukraine war. Services exports grew by 4.2% on a y-o-y basis on the back of rising exports of software, business and travel services. Net services receipts increased both sequentially and on a y-o-y basis.

The two critical factors driving the CAD have been software services, which have reached around US$ 70bn in first half, and remittances, that are now close to US$ 48bn. On the side of capital account, FPIs have been more buoyant than FDIs so far this year. India's current account deficit moderated to 1.0% of GDP in H1:2023-24 from 2.9% of GDP in H1:2022-23 on the back of a lower merchandise trade deficit. Net increase in forex reserves was around US$ 27bn in H1.

## SCB's fortnightly performance

Deposits held with SCBs: RBI's fortnightly data shows that, SCBs (including HDFC merger impact) in FYTD24, i.e. between Mar'23 and Dec'23 (as of 15th Dec), have registered an increase of Rs 17.5 lakh crore as incremental deposit (+9.7%), with demand deposits noting Rs 1.4 lakh crore (+6.4%) increase, and time deposits recording Rs 16.1 lakh crore (+10.1%) increase in this period. Excluding the impact of HDFC merger, deposits have risen by Rs 16.2 lakh crore (+9%) in FYTD24 so far. Last year in FYTD23 (Mar-Dec), deposits had risen by Rs 8.9 lakh crore (+5.4%), as Rs 9.3 lakh crore (+6.5%) increase in time deposits was slightly offset by Rs 0.4 lakh crore (-1.9%) decline in demand deposits.

SCBs' credit growth: Lending by SCBs (including HDFC merger) has risen by 15.6% in FYTD24 so far (between Mar'23 and 15 Dec 2023), implying an incremental credit growth of Rs 21.3 lakh crore. If we exclude the impact of HDFC merger, then incremental credit growth was only Rs 15.5 lakh crore, noting 11.4% increase, which is still slightly higher than 10.6% increase (+ Rs 12.6 lakh crore) registered in FYTD23 during the same period.

During this period investments increased by Rs 4.4 lakh crore (Rs 5.45 lakh cr including HDFC). Hence on the assets side there was an increase of close to Rs 20 lakh cr (excluding HDFC) while deposit increased by Rs 16.2 lakh crore. This explains the persistent liquidity deficit in the system witnessed for over a month now.

## How transmission has fared?

- The transmission of interest rates was better for PSBs relative to PVBs. The change is taken from Apr'22 just before RBI embarked on the journey of rate hikes, to control inflation.
- In case of PSBs the transmission on fresh term deposits was almost complete with an increase of 240 bps. On the lending side, WALR rose by 183 bps.
- For PVBs the increase on fresh deposits was lower 195 bps and that on loans was 154 bps.
- The increase in MCLR on 1 year loans was again higher for PSBs relative to PVBs with the difference being 23 bps for this period.
- PVBs had a higher share of loans under EBLR at 78% compared with PSBs with 37%. Yet the transmission of rate increase was swifter for PSBs.
- In the same period the accretion to deposits have been Rs 31.7 lakh crore (outstanding deposits as of Apr'22: Rs 166.2 lakh crore, outstanding deposits as of 15 Nov 2023: Rs 197.9 lakh crore). For credit, there has been accretion of Rs 38 lakh crore during the same period (outstanding credit as of Apr'22: Rs 119.6 lakh crore, outstanding credit as of 15 Nov 2023: Rs 158.1 lakh crore). (All figures are including the impact of merger).
- Looking at the movement of other interest rates, it is clear that the transmission has been pretty fast on short term rates (TBill rates). This is also contingent on the evolving liquidity conditions. The entire movement of repo was priced in to OIS to some extent. 10Year sovereign yield on the other hand, remained broadly stable, reflecting robust demand conditions on the back of resilience of Indian economy.
- Tighter liquidity conditions in the wake of restrictive policy has resulted in WALR going above repo in the current cycle.

## WPI out of deflation

**Food inflation at 3-month high:** Headline WPI rose by 0.3% in Nov'23, lower than our estimate of 1.5%, but rebounded from (-) 0.5% decline in Oct'23. The jump was driven by food inflation which rose by 4.7% in Nov'23 from 11.1% in Oct'23. Within food, rate of inflation in case of vegetables (16.5% in Nov'23 versus 5.7% in Oct'23), fruits (1.7% versus -1%) and milk (0.4% versus -0.1%) rose significantly. Amongst vegetables, major push came from items like Onions (41.3% versus 22.7%), tomato (74.1% versus -13.5%), carrot, cucumber, and pumpkin.

Inflation for items like food grains (1.3% versus 1.5%) and eggs (2.7% versus 3.3%) also rose, but at a slower pace. Within food grains, pressure was seen easing across the board, but was more notable in case of paddy (0.8% versus 1.6%). Wheat inflation also slowed a bit (1.6% versus 1.8%). These trends are in line with movement in international prices. As indicated by World Bank's pink sheet, paddy prices have moderated a bit to 39% in Nov'23 following 40.2% increase in Oct'23, while wheat prices continue to decline at a similar pace (-29% in Nov'23 versus -29.1% in Oct'23).

**Fuel and power inflation at 3-month low:** Deflation in fuel and power inflation accelerated once again in Nov'23 as it fell to (-) 4.6% from (-) 2.5% in Oct'23. This was on account of slowdown in deflation in mineral oil index (-5.7% versus -0.4% in Oct'23). On the other hand, coal inflation remained unchanged from last month at 1.8% in Nov'23, while deflation in electricity came down (-5.3% versus -11.1%). Within mineral oils, apart from LPG and lube oils, all other sub-indices posted a decrease in Nov'23 compared from last month. Most notable deceleration was visible in case of Bitumen, ATF, Kerosene, Naphtha, and Furnace Oil. The movement is in line with international crude prices which fell from US$ 88.7/bbl in Oct'23 to US$ 82/bbl in Nov'23. Even on YoY basis, decline in oil prices accelerated to (-) 9.7% in Nov'23 compared with (-) 5.2% decline recorded in Oct'23. Oil prices continue to remain under pressure in Dec'23 (so far) as they have fallen to US$ 75.6/bbl. If prices fall further/remain at similar levels, it will provide a cushion to headline WPI next month as well.

**Decline in core WPI broadly slowing:** Core inflation remains in deflation for the 9th consecutive month in Nov'23, but the pace is slowing as it fell by only (-) 0.5% compared with (-) 1% in Oct'23. Deflation in manufactured products also slowed, as it fell by (-) 0.6% in Nov'23 following (-) 1.1% decline in Oct'23. Of the 22 commodity sub-indices, 14 indices rose at a faster pace in Nov'23 than Oct'23 led by, basic metals, other manufacturing, wood products, textiles fabricated metal products and motor vehicles. Within basic metals, pace of increase in case of copper (4% in Nov'23 versus 4.6% in Oct'23) and lead (2.9% versus 4%) eased a tad, while price index for Zinc (-7.6% versus -5.7%) and Aluminium (-1.6% versus -0.2%) continued to decline. On an international level, as reflected in World Bank's pink sheet, deflation in lead prices eased (-0.6% in Nov'23 versus -3.7% in Oct'23), but on the other hand, it fastened in case of copper (-9.4% versus -5.2%), Aluminium (-12% versus -8.7%) and Zinc (-23.1% versus -21.8%).

## CPI inflation

**Food driving CPI higher:** CPI inflation rose to its three month high of 5.55% in Nov'23 and slightly lower than our estimate of 5.7%. This is attributable to 209bps jump in food inflation which rose to 8.7% in Nov'23 from 6.6% in Oct'23, on YoY basis. Among major food items, vegetable prices rose at the sharpest pace by 17.7% in Nov'23 from 2.8% in Oct'23. Even fruit prices rose by 11% from 9.3%. Pulses inflation maintained its double digit pace of 20.2% from 18.8%. Even inflation in sugar and confectionary category rose by 6.6% from 5.5%. Cereal and spices inflation have also remained stickier at 10.3% and 21.5% respectively. Notably, 6 of the 12 broad categories of food inflation have remained above 6%.

**Core CPI (excl. food and fuel)** has moderated further to 4.1%. All broad sub components of core noticed a drop in inflation in Nov'23. Amongst them, components such as household goods and services (3.6% in Nov'23 from 3.9% in Oct'23), clothing and footwear (3.9% from 4.3%) and housing (3.6% from 3.8%) have noticed fair degree of moderation. However, health, education and personal care items of inflation have remained stickier.

**Fuel and Light inflation** fell by 0.8% in Nov'23 from -0.4% in Oct'23, on YoY basis and by 0.1% from 0.3%, on a sequential basis, due to moderation in prices of Kerosene.

**Way forward:** CPI print in Dec'23 is expected to be choppy. We are not ruling out the possibility of an above 6% print in Dec'23, on account of unfavourable base coupled with the continuation of bumpiness in onion, potato and garlic prices. Erratic weather conditions have resulted in the same. Notably, if we exclude the usual seasonal slump in vegetables such as cauliflower, cabbage and brinjal, the increase in vegetable index would be sharper. The high frequency price data of some essential items such as salt, tea, sugar, potato, Urad dal and Rice are already seeing some momentum building up in Dec'23. However, with steps taken by the government such as extension of export curb on onion, some correction in prices is already seen. But all is contingent on how the arrival of the late Kharif harvest of the crop would pan out.

Apart from this, threat also remains with regard to Rabi sowing trailing behind last year, which might impact crops such as wheat and pulses. Even the Kharif output of pulses have been far below last year. The demand side story of Indian economy also remain fairly resilient with services and manufacturing sector holding up well. Q2 financials also spoke of rural demand gaining ground. Thus concomitantly, we do not rule out upside risks to inflation. Our forecast for FY24 is ~5-5.5%.

## Growth in Industrial Production shines

IIP growth accelerates: IIP growth expanded to a 16-month high clocking double digit growth of 11.7% in Oct'23, above our expectations (8.5%) and compared with a growth of 6.2% in Sep'23. This was largely led by broad based improvement across all sectors. Growth in mining and electricity sector expanded to 13.1% and 20.4% against a growth of 11.5% and 9.9% respectively in Sep'23. Output of manufacturing moved up to 10.4% in Oct'23 against a growth of 4.9% in Sep'23. Amongst manufacturing sectors, at least 14 out of 23 subdivisions have registered positive growth in Oct'23. Manufacture of machinery and equipment (26.1% versus 4.8% in Sep'23), other transport equipment vehicles (26.4% versus 7.1%), leather (16.5% versus -0.7%) and motor vehicles (24.4% versus 11.4%) recorded highest improvement. Slower pace of contraction was registered in manufacture of furniture (-7.2% versus -20%), wearing apparel (-5% versus -18.2% in Sep'23) and computer, electronic (-5.3% versus -8.7%) amongst others.

On a FYTD basis (Apr-Oct), industrial growth has rose to 6.9% in FYTD'24 from 5.3% in FYTD'23. Mining and manufacturing growth has expanded to 9.4% and 6.4% respectively in FYTD'24, while electricity growth has moderated by 8% in FYTD'24 (9.4% in FYTD'23).

**Broad based improvement:** Within use-based, all the sectors have registered much higher growth in Oct'23. Growth in capital goods jumped up to 22.6% against a growth of 8.4% in Sep'23. Even intermediate and primary goods scaled higher to 9.7% (6.1% in Sep'23) and 11.4% (8% in Sep'23) respectively in Oct'23. Strong movement in construction and real estate activity supported the growth in infra and construction output, recording a growth of 11.3% in Oct'23. Scaling to a 16-month high, consumer durable goods reported growth of 15.9% against a growth of 1.1% signalling some pick up in discretionary demand. Even slow but steady recovery is visible in consumption led by FMCG output which edged up to 8.6% in Oct'23 after moderating to 3% growth in Sep'23 on the back of festive demand.

## Disclaimer



Visit us at www.bankofbaroda.com

**For further details about this publication, please contact:**

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
sonal.badhan@bankofbaroda.com