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Economic Round-up: September 2022

Major global Central Banks have announced steep policy hikes in Sep'22, and have vowed to remain hawkish as long as inflation levels remains elevated. In addition, weak Q2CY22 GDP prints (US, Germany) and downgraded forecasts for both CY22 (US) and CY23 (US and Eurozone) have further accentuated concerns of slowdown in global growth. OCED now expects global growth to average 2.2% in CY23, down from 2.8% estimated earlier. High frequency data (flash PMIs) are also showing signs of uneven growth in major economies. Inflation trajectory and impact of rate hikes on real economy will be key to watch in the coming months.

Global growth: As shown by flash PMIs for Sep'22, both manufacturing and services activity in Europe signals further downturn in economic activity. In UK, services activity remains under acute stress while pace of contraction in manufacturing activity seems to be easing. However in case of US, both manufacturing and services activity has shown signs of revival, although services PMI still remains in contractions. Both US Fed (for CY22 and CY23) and ECB (for CY23) have downwardly revised their growth forecasts. This reflects the estimated impact of tight monetary conditions on real economy. In case of Eurozone, energy crisis and stubborn inflation will shave off growth prospects next year. German economy is expected to witness the impact from Q3CY22 onwards. Uneven recovery in China (falling property prices, industrial profits, divergent trends in official and non-official manufacturing PMIs) also poses threat to global growth.

Global Central Banks: In Sep'22 major global Central Banks delivered steep rate hikes, with US Fed increasing rates by 75bps and BoE by 50bps. Stubborn inflationary trends have forced central banks to maintain hawkish stance. They have acknowledged its possible impact on economic activity by downgrading their growth forecasts. This has refuelled recessionary fears, thus tanking equity, currency and debt markets. Major equity indices such as Dow Jones (-4.8%), FTSE (-4.8%), S&P (-5.4%), Nikkei (-5%) and Sensex (-3.4%) have fallen sharply since Fed's policy. DXY is up by 1.3%, and US 10Y has risen by 30bps. India's RBI too increase policy rate by 50bps. However PBOC and BoJ still remain accommodative.

Key macro data releases: India's fiscal situation remains steady so far till Aug'22. Centre's fiscal deficit (% of GDP, 12MMA basis) is at 6.4% as Aug'22. Concerns regarding deficit levels had emerged as government announced extension of PM-GKAY scheme till Dec'22 and 4% increase in central government employees' DA allowance. Laggard disinvestment receipts are another concern. However, with buoyant revenue receipts, and higher than estimated nominal GDP, it is expected that slippage in fiscal deficit will be almost negligible. On the industrial production side, core sector has registered progressively a slowdown in growth rate for the third successive month to 3.3% in Aug'22, partly due to base effect (12.2% growth last year.).

CPI firmed up again to 7% in Aug'22 from 6.7% in Jul'22. Food inflation shot up considerably to 7.6% from 6.7% in Jul'22, led by vegetables milk and milk products, fruits. Core inflation was sticky at 5.8% in Aug'22 as well. We continue to believe that RBI will hike rates by another 50bps in the current cycle. Going forward, we expect India's 10Y yield to trade in the range of 7.3-7.45% this month. We also expect the rupee to trade in the Rs 81-81.95/$ range in the near-term.

Global developments

Risks to recession rising

Recent US GDP data shows that economy contracted by (-) 0.6% in Q2CY22 (unrevised from previous estimate), following (-) 1.6% decline in Q1CY22, thus implying onset of technical recession. Consumer spending in Q2 rose by 2%, but these gains were offset by dip in business inventories and housing investment. US Fed has also lowered its growth projections for CY22 to 0.2% from 1.7% estimated earlier. With US CPI remaining higher than anticipated at 6.3% in Aug'22 (5.9% in Jul'22) and core PCE deflator (US Fed's preferred indicator to gauge inflation) too increasing by 0.6% in Aug'22 (est.: 0.5%) from 0% in Jul'22, the Central Bank is expected to continue hiking rates aggressively. This has further increased the risks to deepening economic recession. However, so far, domestic demand in the US has held ground with consumer confidence index rising to 108 in Sep'22 from 103.6 in Aug'22. Even retail sales beat expectations (0%) in rose by 0.3% (MoM) in Aug'22. US labour market too remains resilient with weekly jobless claims dropped by 16,000 to 193,000 for the week ended 24 Sep 2022.

Eurozone's GDP growth in Q2CY22 rose by 0.8% (QoQ) following 0.7% increase in Q1. In YoY terms, GDP was up by 4.1% in Q2 following 5.4% increase in Q1. Bigger economies like Germany (Q2: 0.1% versus 0.8% in Q1) and France (Q2: 0.5% versus -0.2% in Q1), contributed the least to growth. Component wise, household final consumption expenditure (+0.6pp) and GFCF (+0.2pp) contributed the most to growth, followed by government final expenditure (+0.1pp). On the other hand, external sector growth acted as a drag (-0.2pp). While ECB expects CY22 growth to average at 3.1%, up from 2.8% projected earlier in Jun'22, it will see a sharp slowdown in CY23 when growth is estimated to slow down to 0.9% from 2.1% earlier. OECD has forecasted an even lower growth of 0.3% (down from 1.6% in Jun'22) for Euro Area in CY23. The risks to full blown recession have also been highlighted with shock emanating from-increased prices of food and energy products, reduced energy supply and problems in China's property market/high corporate debt levels/severe Covis-19 restrictions. It is widely believed that owing to sky rocketing inflation (70-year high of 10% in Sep'22) and energy crisis, Germany is set to enter recession from Q3CY22 itself with growth falling by (-) 0.1%, followed by (-) 0.3% decline in Q4 and (-) 0.2% decline in Q1CY23.

Chinese economy is also struggling to rebound and giving mixed signals. While the official PMI (surveying big companies) shows that manufacturing activity improved and PMI index rose to 50.1 in Sep'22 from 49.4 in Aug'22, Caixin Markit PMI (surveying MSMEs) shows that activity contracted further with index down to 48.1 in Sep'22 from 49.5 in Aug'22. In both cases, export orders index remained weak. Employment index was also subdued. Input price index fell, indicating possible decline in PPI. With declining commodity prices, weak domestic demand and stringent Covid-19 related restrictions, industrial profits of firms fell by 2.1% in Jan-Aug'22 period, down from 1.1% decline in Jan-Jul'22. Official non-manufacturing also fell from 52.6 in Aug'22 to 50.6 in Sep'22. Crisis in property market also continues with home prices declining more sharply in Aug'22 than in Jul'22, thus registering 12th consecutive month decline. Another added concern for China is steep deprecation in Yuan following aggressive monetary tightening across regions. Impact of this on capital flows, evolving property market crisis, and recovery in domestic demand will have to be closely watched for further cues on global growth.

RBI

RBI's policy was in line with expectations. A rate hike of 50bps materialized, withdrawal of accommodation remained. Inflation forecast for FY23 was unchanged at 6.7%. Liquidity is likely to be in deficit in H2 as well and RBI would rely on fine tuning operations. Going forward we expect, inflation worries to continue from seasonal food price shock and demand conditions gathering momentum. We expect CPI to be in the range of 6.5-7%. Our terminal repo forecast stands at 6.5%, thus a rate hike of another 50-60bps in the current cycle seems feasible. With the current 50bps rate hike, transmission to MCLR could be another 20-30bps, 10Y G-Sec yield is likely to trade in the range of 7.3-7.4% in the near term. Our growth projections at 7.2% is slightly higher than RBI's forecast of 7% for FY23 (will be revisited once more real sector data is available).

Global central bank decisions

US Fed delivered 3rd consecutive rate hike (highest since CY08) and raised the rates by 75bps hike to a new target range of 3%-3.25%. There is expectation of more rate hikes in the coming months, with median projections for federal funds rate now expected at 4.4% in CY22. As per the dot plot, Fed has signalled more rate hike with a target range of 4.75%-5% in CY23. Median projection for real GDP and core PCE inflation stands at 0.2% (1.7% June projection) and 4.5% (4.3% June projection) respectively for CY22.

In line with market expectations, Bank of England (BoE) raised policy rates by another 50bps to 2.25%, marking it the 7th consecutive rate hike and taking policy rate to levels seen last in CY08. The bank also cautioned that if inflationary pressures continue to persists then the "Committee will respond forcefully, as necessary". It now expects inflation to peak slightly lower than 11% in Oct'22 (13.3% projected in the last policy), owing to new PM's decision to cap energy prices and cut taxes. Still, inflation is expected to run above 10% for few more months in the near-term. BoE forecasts for growth also indicate that the bank thinks UK economy is already in recession with growth set to have contracted by (-) 0.1% in Q3CY22 (+0.4% estimated earlier), following (-) 0.1% decline in Q2CY22.

In a surprise announcement, Bank of England has announced to intervene in the market to address the free fall in GBP and bond yields. Market volatility increased steeply as the new PM announced £45bn stimulus package, offering tax cuts to boost demand. Market participants are worried about its impact on already stubborn inflation and risk associated with increased government borrowings. In order to calm the markets, BoE announced that it will buy £65bn worth long dated bonds till Oct 14 2022, with upto £5bn bond buying each day. In addition, the central bank also postponed its £838bn bond sale program (announced in its monetary policy), which was due to begin from this week. These measures have brought relief to Britain's currency and bond markets.

On the other hand, BoJ and PBOC continue to remain accommodative. BoJ kept its policy rates unchanged and vowed to main loose monetary policy as it expects inflation to undershoot its targeted 2% mark from Apr'23. Owing to divergent policy stance, Yen has suffered significant losses.

While PBOC kept lending rates unchanged in Sep'22 (1Y LPR at 3.65%; >5Y LPR at 4.3%), it has announced other measures to support the economy and its currency (Yuan). In order to support the real estate sector, the Central Bank has allowed local governments to cut mortgage rates in some cities for 1st time home buyers. PBOC will also guide the financial institutions to give more medium and long-term (MLT) loans to manufacturing sector and focus on stabilizing industrial supply chains. To arrest the steep decline in Yuan as other global central banks hike rates aggressively, PBOC has hiked the risk reserve requirement for forward foreign-exchange sales to 20% from 0%.

Special studies

Are states spending on capital?

The Indian economy does appear to be on the path of achieving growth of around 7% this year. In this context two engines, consumption and investment, will hold the clue. In case of consumption, the picture is mixed and the indication is that the next few months will be critical in the fructification of this factor. Investment is the tougher nut to crack. Investment by private sector could still take some time. But the centre has been fairly aggressive with capex this year with a total outlay of around Rs 7.5 lakh crore for FY23. However, states have an equally important role to play and the analysis here looked at how they have progressed so far in FY23.

The centre for the first 4 months of the year has already spent Rs 2.08 lakh crore which is 27.8% of the budgeted amount. The states however have been slower with just 14.7% of the budgeted amount being spent so far which is Rs 1.01 lakh crore. Hence, there is considerable slack here which needs to be made up during the course of the remaining 8 months of the year.

The interesting part of the budgeted capex by states is that of the Rs 6.92 lakh crore that has been projected, the dominant position is taken by Uttar Pradesh with a budgeted amount of Rs 1.24 lakh crore which is around 18% of the total. If this works out, it would be the second successive year where the state would lead in capex.

Further, overall capex is concentrated in the states of UP, Maharashtra, Karnataka, Tamil Nadu, Gujarat, MP, Odisha and Rajasthan which individually have a share of above 5% each and together account for 61.2% of total capex. If West Bengal is added with share of 4.8%, then the 9 states would account for 65% of capex. Therefore, the progress made by these states in particular need to be tracked as it would determine the pace of progress in meeting the targets.

There has been a tendency even in the past for states to go slow on capex in the initial months and accelerate subsequently when a clearer picture of their fiscal balances is known. Therefore, the last quarter could be the busy period for states in reckoning their capex. The GST collections this year have been very buoyant for both the centre and states and hence there is less reason for them to be circumspect at this point of time. Growth does need an equal push from both the centre and states and hence this piece is critical.

Last year, for a set of 22 states (which includes Delhi and Goa), 13 had underachieved their capex targets in FY22 while 9 had gone ahead. The states which missed their targets this year included also the larger states of Karnataka, Gujarat, MP, Odisha, Tamil Nadu and West Bengal. Therefore the possibility of slippages cannot be ruled out in case these larger states do not work fast on expediting projects in the next 8 months.

The Consumption piece: A Silver lining or a dark cloud

Consumption, with a major share in GDP is an important indicator when talking about how growth has fared. But we do not have much high frequency data to track it on a monthly basis, as retail sales data are not available. Although it is true that automobile sales do give us a signal whether people are spending or not. Company financials of FMCG and non FMCG segment also gives an idea but it comes on a quarterly/annual basis. GST collection data is also an indicator of how spending has been on goods and services. But it is in nominal terms and can be influenced by inflation. A way out is to look at the domestic production to get an idea about demand, assuming stocks don’t build up.

In this exercise, we have looked at production data of production for various consumer products in the Apr-Jul'22 period and compared it to the pre pandemic levels. This we believe is a better way of looking at data as there were sharp movements in 2020 and 2021 in both the directions which tend to inflate growth numbers both ways.

Interestingly, the economy looks as if it is 'moving' as reflected in the increased production of bottled water, creams and lotions, liquor, travel goods, aerated drinks etc. Even the PV sales data especially the high end segment reflect the same. Digital inclination persist as production of computers, laptops and mobile devices are increasing at a faster pace. This is notwithstanding an increase in prices.

What has been a concern is that major daily items of consumption ranging from biscuits, tea, cakes, pastries & muffins, toilet soap, toothbrush, readymade garments and footwear registered considerable drop in production which is below the pre pandemic period. Prices are also considerably elevated for these products and in double digits if we consider the build-up in inflation since Feb'20. So we expect 'pocket pinch' to hurt the hardest especially for middle class consumers.

Understanding the economics of fuel taxes

Fuel taxes have been a contentious issue in India especially at a time when inflation has been increasing. The central government has lowered the excise duty on petrol and diesel and nudged states to lower their VAT rates. Some have, though most have let it be, on grounds of their fiscal balances being affected. On the other side there has been an increase in prices of other fuel products like LPG and ATF. Therefore there are some prices which are going up while others are moving down, albeit gradually. At the same time the global price of crude oil has been volatile. There have been pertinent arguments made that when the crude oil price had crashed to low levels during the pandemic the benefit was not transmitted fully to the consumer as taxes were increased. Hence, the economics of fuel taxes is complex.

This study took an ex-post view on fuel taxes where we looked at aggregate consumption of all fuel products and juxtaposed the same with the aggregate tax revenue garnered by both the centre and state. This gave an idea on whether as consumers we paid higher effective taxes on fuel products through various cycles of crude oil prices.

Results of the study were as follows:

- Petroleum consumption in India showed a steady recovery from the pandemic in recent months. Increased mobility and pickup in economic activity contributed to this trend.
- There were a number of changes in the tax rates on petroleum products between FY20 to FY22, amidst volatility in global oil prices due to the Covid-19 pandemic as well as the Russia-Ukraine war.
    - The Central government announced a cut in excise duty on petrol and diesel in May'22, amidst a surge in global oil prices and an uptick in domestic inflation. Following this, several states also announced a cut in VAT on sale of petrol and diesel. Even so, taxes (Centre and State) accounted for about ~40% and ~35% of the retail selling price (RSP) of petrol and diesel in Delhi (1 Sep 2022).
- More interestingly, the governments are now earning more per kilogram of petroleum products sold than they did 5 years back. This suggests that despite lower tax rates/duties, the burden on consumers has increased.

- Taxes on petroleum products are a major source of finance for both the Centre and State governments. Our analysis also showed that the contribution of petroleum products to both the Centre and State governments has increased in the last 5 years.

Telecom sector & 5G Auction

India has the second-largest telecom market in the world with the country registering a strong subscriber base over the last decade. Given the recent structural reforms along with the rollout of 5G connectivity, the sector is poised to expand further in the coming years. Against this backdrop, this report attempted to analyse the telecom sector in some detail including auctions, bank credit etc.

India's digital economy is expected to grow by leaps and bounds and will be valued at US$ 1tn by FY26. Total Internet subscribers in the country is estimated to grow to 900mn in FY26 on the back of robust growth in rural area. In terms of FDI inflows, telecom sector is the 3rd largest sector with over 7% contribution. Over 98% of all telephone subscriptions are mobile subscriptions.

Credit to Telecom sector has grown over the years. After declining by 0.6% in FY18, the sector made a strong comeback, registering a growth of 34.5% in FY19 and continued with this upward momentum, with double digit growth in even FY20. However, given the pandemic induced slowdown, credit to telecom sector dropped by 21.9% in FY21. The following year (FY22), base effect enabled a favorable growth and is expected to climb higher in FY23.

The telecom sector has raised funds over the years through different modes including bonds. In FY20, the sector had raised Rs 2,414 crore and in FY21, this amount rose to Rs 28,861 crore in FY21 and moderated to Rs 9,150 crore in FY22.

ECB approvals in the Telecom sector has grown to US$ 1.3bn as of FY22 from US$ 0.8bn in FY21. This has been utilized in FY22 especially for the purpose of working capital and refinancing of loans. As of FYTD23, so far there has not been any ECB applications in the telecom sector.

In the month of Aug'22, Department of Telecom had auctioned 72,098 MHz of spectrum under the 5G auction across various bands. Of this, there was a sale of 51,236 MHz (71% of total) with Government mopping up Rs 1.5 lakh crore in auction. Given the auction has been completed, the allocation will start in the same month, with the rollout starting by Oct'22. In addition to this, the government has done away with 3% Spectrum Usage Charges (SUC) floor rate which will bring down the effective operational cost for the operators. This auction is also touted to be more successful than the last past auctions as over 71% of the spectrum has been sold compared with last 2-auctions where it was only 41% and 60%.

How has the IPO market performed?

2021 was the year for the equity market where we witnessed high IPO issuances as companies accessed this avenue for raising funds. During that time, a sum of Rs 1,21,680 crore was mobilized in the market. This was also the time when the secondary market witnessed an upsurge as evidenced by the movement in the Sensex which scaled new heights of 61,765 in 18 Oct 2021. There has however, been a lull in the issuances in 2022 (upto Aug'22) though the big IPO of LIC was undertaken in May'22. In this context it is interesting to see how these company shares have fared in the market.

Results of the study were as follows:

- Total issuances in CY21 were Rs 1,21,680 crore. In CYTD22 (till Aug'22), issuances have been far lower at Rs 38,155 crore. This takes the total issuances in CY21 and CYTD22 to Rs 1,59,835 crore.
- Sector wise E-commerce, auto and chemicals had the highest share in terms of issuances in CY21. In CYTD22, insurance, edible oil and textiles had the highest share.
- Listing price versus Issue price: In CY21, ~30% of companies listed at a premium of above 20% (highest since CY17) compared with 15% in CYTD22.
- Current price versus Issue price: In CY21, ~50% of companies have received return above 20% when the current price is compared with issue price. In CYTD22, some companies have recouped earlier losses (seen at the time of comparison of listing price against the issue price), with the number of companies giving return above 20% rising to ~43%.
- An academic exercise was conducted to show the present value of investment in IPOs for this entire period. This was to give an idea of the risk attached to investing in IPOs, given that they are operating at a discount/premium. For simplicity, it was assumed that an investor invested Rs 1 lakh uniformly in every IPO. This was then juxtaposed with the movement of Sensex. The results showed that in CY21, IPOs gave a return of 74%, whereas Sensex rose by 20%. However, big ticket IPOs were not faring well, as 16 of them with issue size of above Rs 1,000 crore were operating at a discount. In CYTD22, IPOs gave a return of 50% and Sensex increased by 1.6% in the same period. Notably, LIC was the only big ticket IPO in CYTD22 that was giving negative return.

Study on corporate debt market

In this study, we discussed the development of the corporate bonds market in India in the last decade. We also compared the cost difference between corporate bonds and bank lending and found that only AAA rated companies tended to have an advantage when issuing bonds in terms of cost. Others may still have to rely on lower cost bank credit for their financing funding needs

Corporate bonds issuances have seen a steady uptick in the last ten years. From just about Rs. 3 lakh crores in FY12, they jumped close to about four-fold at Rs. 7.8 lakh crore in FY21, before moderating to Rs. 6 lakh crore in FY22. Higher borrowings through corporate debt in FY21 was driven largely by RBI's measures such as TLTROs. In FY22, corporate bond yields rose in line with G-sec yields amidst a higher than expected borrowing programme by the government, elevated oil prices and rising global yields. This could partly have come in the way of issuances as unlike bank loans where interest cost varies with the monetary regime, cost of capital gets locked in at the issuance rate for bonds. As a result, issuances of corporate bonds was also lower in FY22. In FY23 so far (Jul'22), corporate bonds issuances have increased by 14.1% on a YoY basis.

Almost all of these issuances came from private placements as opposed to public issues. Furthermore, there has been no change in this trend in the last 10 years. Notably, while private placement accounted for 88% of the total corporate bonds issuance in FY12, its share rose to 98% in FY22. A major reason for this is that companies do not wish to undertake the cumbersome processes involved in case of a public issue. On the other hand, private placements provide a number of advantages to companies including lower costs, quicker turnaround time and better price discovery.

A closer look at the funds raised through corporate bonds issuances showed that it is dominated by the financial services. In fact, financial services account for more than 70% of the funds raised through corporate bonds. Within this, banks and asset financing firms were the major players. For this segment funds are their raw material for business and hence the bond market becomes the preferred source of finance. Most of these larger companies also tend to have a rating of AA and above which makes it cheaper for them to access this market.

Have global commodity prices retreated?

There have been significant developments in the global scene this year. Starting with the Russia-Ukraine war from March onwards, there have been attempts made by various central banks to slow down their economic growth to curb inflation. The rise in commodity prices started last year and was exacerbated by the war when prices of fuel, food, fertilizers and metals increased for a variety of reasons. It was more due to supply disruptions rather than upsurge in demand. China's flip flop with fighting the new wave of Covid-19 through lockdowns added to supply disruptions. Hence prices were driven downwards by lockdowns and rate hikes while they moved northwards due to disruptions.

Prices in Aug'22 compared with Feb'22 continued to increase mainly in the energy and fertilizers groups. This is where there is still impasse when it comes to supplies from Russia with the latest being the increased demand from Europe as we near winter time. Russia is also a dominant supplier of fertilizers in the global market. On the oilseeds front there still remains some pressure on soybean and groundnuts. It is marginal for soya oil, rice, coffee, sugar.

Commodities where prices fell by up to 10% were more in the agricultural space, though WTI has just about retreated while lead, nickel in the metals segment have come down sharply. Where prices fell more than 10%, here the significant commodities were palm oil and palm kernel oil, which are imported in substantial quantity by India. There were disruptions caused due to policy restrictions in exporting countries like Indonesia which did get reversed gradually.

Also the three precious metals platinum, gold and silver witnessed decline in prices. This can be attributed more to the dollar strengthening against the euro. Aluminium and copper have also witnessed decline in prices as demand has weakened in accordance with the slowdown being seen in growth across the developed economies in particular as well as China.

In conclusion, it can be said that commodity prices have been retreating to normal and have tended to move below the pre-war levels. Energy will continue to be a concern not just because of the Russia factor but also the approaching winter which will witness higher demand for both oil and gas. To this extent it does look like that imported inflation will be a limited concern for us going ahead.

Key policy developments

- The Union Cabinet has approved the extension for the Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY-Phase VII) for a further period of 3 months i.e. October to December 2022. Under this welfare scheme, 5 kg of food grain per person per month is provided free of cost for all the beneficiaries covered under NFSA [Antodaya Anna Yojana & Priority Households] including those covered under DBT. Financial implication for centre has been ~Rs 3.45 lakh crore upto Phase-VI of PMGKAY. With the additional expenditure of about Rs 44,762 crore for Phase-VII of this scheme, the overall expenditure of PMGKAY will be ~Rs 3.91 lakh crore for all the phases.

- A move that will support consumption demand, the Union Cabinet has approved the release of additional instalment of Dearness Allowance and Dearness Relief @ 4% to Central Government employees and pensioners due from 01.07.2022. The combined impart on the exchequer on account of both Dearness Allowance and Dearness Relief would be of the order of Rs 12,852.56 crore per annum; and Rs.8,568.36 crore in the financial year 2022-23 (i.e. for a period of 8 months from July, 2022 to February, 2023).
- To provide a push for capex spending, Union Cabinet has approved Indian Railways' proposal for redevelopment of 3 major railway stations with an approximate total investment of ~ Rs 10,000 crore. These stations include: New Delhi Railway Station; Ahmedabad Railway Station; and Chhatrapati Shivaji Maharaj Terminus (CSMT) Mumbai.

Data Releases

Currency outlook: Is 82 the new 80?

The last fortnight was marked by sharp volatility in the global markets, with the foreign exchange market being particularly badly hit. The Federal Reserve raised rates further by 75 bps, much in line with expectations. However, the forward guidance was much more hawkish than expected which led to a sharp knee-jerk reaction in the markets. In the currency market, dollar surged to a 20-year high while most global currencies depreciated to multi-year lows. Fallout from UK's expansive fiscal measures provided further negative stimulus to the markets. Even though BoE's announcement to buy gilts helped to calm investors' sentiments. PBOC and BoJ stepped in the market to provide support to their respective currencies. INR too was not immune to the hostile global sentiment and depreciated to a new record low of 81.94/$ on 28 Sep 2022. A combination of adverse global environment along with rising domestic headwinds is likely to keep INR under pressure. It is likely to trade in the range of 81-81.95/$ in the near-term (below the psychological mark of 82).

Bond Market Round-up

Financial tightening continued globally which led to sell-off in the bond market. The sharpest sell-off was seen for UK where expansionary fiscal policy was perceived as a threat to inflation. Fed's projection of 4.6% as the terminal rate for CY23, made investors believe that global rates are bound to rise. On the domestic front as well, RBI frontloaded another 50bps rate hike (total 190bps till date in the current cycle). However, this was much on expected lines, hence India's 10Y yield broadly remained stable, post policy. The main highlight in the domestic bond market in Sep'22, has been the sharper pace of increase in short end yields, whether be it T-bills of all maturity or short tenor government papers. We expect yield curve flattening to continue in the coming days, with short end papers rising at a faster pace than long end papers. This will be on account of liquidity slipping into deficit due to RBI's forex intervention and faster growth in credit.

10Y yield is likely to be broadly stable and is expected to trade in the range of 7.30-7.45% in the current month. Only discomfort might be another above 7% headline CPI print in Sep'22. We expect it to be between 7-7.3%.

Core industries

Core sector has registered progressively a slowdown in growth rate for the third successive month to 3.3% in August. This has been influenced partly by the statistical base effect of 12.2% growth last year. Cement and steel have witnessed low growth rates of 1.8% and 2.2% respectively which is indicative of lower levels of infra activity. Mining has done well at 7.6% which comes on top of 20.6% growth last year. Power sector growth was just 0.9% which is understated due to strong growth of over 16% last year. Return to normalcy in coal production is a positive for the economy which was under stress in April and May following the Ukraine war where there was shortage of coal. Fertilizers production was upbeat more in preparation for the Rabi sowing which will start from next month onwards. Refinery products have done well due to the higher offtake within the country as well as exports. Economic activity returning to normal has been a driver of this sector. We may expect industrial growth to be around 4-5% for August.

Central government finances

Revenue collections have been buoyant while there is uncertainty on the achievement of the disinvestment target. However the government is confident that the borrowing programme will not be breached as set by the Budget. The progress till August shows that the government's accounts are on course compared with last year. Fiscal deficit in FYTD23 (Apr-Aug'22) has reached Rs 5.4 lakh crore, which is 32.6% of the budget estimates (Rs 16.6 lakh crore), compared with 31.1% deficit achieved last year during the same period. Total expenditure made in FYTD23 so far stands at Rs 14 lakh crore, which 35.2% of the budget estimate (36.7% last year). This reflects a growth of 8.9% compared with 12.2% in Apr-Jul'22 period. Within this, revenue spending stands at Rs 11.4 lakh crore (35.6% of BE versus 37.7% last year), registering a lower growth of 3% growth in Apr-Aug'22 versus 4.8% in Apr-Jul'22. Under capex, central government has spent Rs 2.5 lakh crore so far (33.7% of BE versus 31% last year). Even in YoY terms, growth during Apr-Aug'22 was up at 46.8% versus 62.5% in Apr-Jul'22. On the income side, centre's revenue receipts have risen to Rs 8.2 lakh crore in FYTD23 (37.1% of BE versus 44.4% last year), implying a growth of 12.8% compared with 14.7% during Apr-Jul'22. Within this, net tax revenue stood at Rs 7 lakh crore (36.2% of BE versus 41.7% last year). In YoY terms, this has risen much slowly by 2.9% in FYTD23 versus 12.9% in Apr-Jul'22. Advance direct tax (net) collection data shows that till 17 Sep 2022, collections have risen by 23% compared to same period in the last year. In Q2FY23, advance corporate tax collections were up by 10.2% to Rs 1.5 lakh crore, while income tax collections were up by 9.5% to Rs 43,358 crore.

Advance Estimates for Kharif Crops (2022-23)

Total foodgrain production is pegged to be lower at 149.92mn tonne (target of 163.1 mn tonne) compared with 156 mn tonne last year (4th Advance estimate). As per the estimates, rice production is expected to drop to 104.9 mn tonne (falling by 6.1% compared with last year). This is in the wake of deficient rainfall in over 8 states including Bihar, Uttar Pradesh, Punjab and others; rice sowing is down by 3.7%. While overall pulses production would be retained, there will be lower output for tur and urad. For other crops, production of nutri/coarse cereals, maize and pulses is expected at 36.5 mn tonne, 23.1 mn tonne and 8.4mn tonne respectively. Oilseed production is likely to be lower by 1.3% this year (23.5 mn tonne against 238.9 mn tonne). Jute production is also likely to be lower by 2.5%. On the other hand, cotton and sugarcane production is expected to improve by 9.6% and 7.7% respectively. We may have to be concerned on how prices for rice and pulses would move going ahead.

CPI hardens

Against our estimate of 6.7% and compared to market consensus of 6.9%, headline CPI print was higher than estimated at 7% in Aug'22, on YoY basis. This is the 8th consecutive month that headline CPI print have remained above RBI's upper band of 6%. For Q2FY23, RBI estimated the print to be at 7.1%. Food inflation shot up considerably to 7.6% from 6.7% in Jul'22. Out of 12 food and beverage items of inflation, 7 of the food items have shown a pickup in momentum. Among them, vegetable inflation rose by 13.2% from 10.9% in Jul'22, fruits by 7.4% from 6.3%, milk and milk product by 6.4% from 5.8%, pulses from 2.5% against 0.2% in Jul'22. In Sep'22 as well, major food items such as vegetable, fruits, milk are showing a pickup in momentum. Further sowing of rice has been a concern which might put further pressure on cereal prices going ahead.

Core (CPI excl. food and fuel) was sticky at 5.8% in Aug'22 as well. However, core excl. pan, tobacco and intoxicants- a closely looked indicator by RBI has remained elevated at 6.1% against 6% in Jul'22. Within core, housing inflation rose to 4.1% from 3.9% in Jul'22. Household goods and services inflation remained elevated at 7.5% from 7.4% in the previous month. Despite fall in gold prices, inflation in the personal care and items edged up by 7% from 6% earlier. Inflation in education was also higher at 5.5% against 5% earlier. Going forward, outlook on core remains cautionary as high frequency indicators of growth for India is still performing better.

Inflationary pressure is still evident throughout the basket. Especially the food basket is a concern. More than 50% of it has remained above 6% in FYTD23. Even the high frequency growth indicators such as air passenger, port cargo, rail freight, and auto sales have shown considerable pickup in momentum. Thus core is also likely to remain sticky in the coming months. PMI data is also reflective of the fact that services activity is impressive. However, the spill-over impact of global growth slowdown and tightening financial conditions worldwide would impinge on the demand conditions of the economy sooner or later. RBI is also expected to continue with another round of rate hike. Our headline CPI forecast for FY23, stands at 6.5-7%, with risks remaining on the upside.

WPI begins to cool

Headline WPI eased much more than expected (BoB estimate: 13.4%) in Aug'22 to 12.4% from 13.9% in Jul'22, despite pick up in food prices. Food inflation in Aug'22 inched up by 9.9% from 9.4% in Jul'22. Barring prices of milk, all other sub-components registered an increase in inflation. Significant pick up was visible in the case of vegetables, fruits, eggs, meat & fish, and cereals. Within cereals, prices of both paddy and wheat were higher in Aug'22. Prices of pulses and spices & condiments too increased for the second consecutive month in Aug'22. These trends were mostly in line with international prices. World Bank's pink sheet shows that international rice prices have moved up by 6.4% in Aug'22 following 0.4% contraction in Jul'22. On the other hand, international prices of wheat have continued moderate in Aug'22 (16.5% versus 27.4% in Jul'22).

Fuel and power inflation in Aug'22 eased significantly to 33.7% from 43.8% in Jul'22 supported by broad-based moderation. Most significantly, mineral oil index dropped to 45.4% from 59.2% in Jul'22, on the back of decline in international oil prices (+38.6% YoY in Aug'22 versus 41.5% in Jul'22). Electricity price index also cooled off to 25.7% in Aug'22 from 32.4% in Jul'22. Coal prices too rose a slower pace of 2.5% versus 2.7% in the previous month. Within mineral oil index, barring prices of lube oil, all others fell. Sharpest decline was visible in prices of kerosene, petroleum coke, ATF, petrol, and furnace oil.

Core inflation eased for the fourth consecutive month in Aug'22 to 7.9% from 8.4% in Jul'22. Manufactured products inflation was also down at 7.5% in Aug'22 from 8.2% in Jul'22. Of the 22 commodity sub-indices, 12 indices rose at a slower pace in Aug'22 than Jul'22 led by basic metals, fabricated metal products, furniture, chemicals, textile and rubber and plastic products. Within basic metals, prices of copper contracted for the second consecutive month in Aug'22 (-5.7% versus - 0.8%), while that of aluminium (-7.1% versus -6.2%) and lead bars (-3.9% versus -2.6%) contracted for the third consecutive month in Aug'22. Zinc prices moderated once again in Aug'22 to 0.9% from 1.4% in Jul'22. Even at international level, as reflected in World Bank's pink sheet, prices of copper (-14.8% versus -20.2%), aluminium (-6.6% versus -3.6%) and lead (-14.2% versus -15.1%) have come down in Aug'22. On the other hand, global zinc prices still remain elevated (20.1% versus 5.4%).

IIP growth eased

As against our expectations (5.4%), industrial output eased to 2.4% in Jul'22 from 12.7% in Jun'22. Slowdown was expected on account of unfavourable base, and it was visible across sectors. Mining output contracted (-3.3%) for the first time since Feb'21 (-4.4%) and was down from 7.8% in Jun'22. Electricity production was down to 2.3% following 16.4% increase in Jun'22, while manufacturing growth slowed to 3.2% from 13% in the previous month. Within manufacturing, output contracted the most in case of electrical equipment (-15.6% in Jul'22 versus 11.8% in Jun'22), leather (-12.8% versus 1.3%), tobacco products (-8.8% versus 52.8%) and textiles (-8.6% versus -2.9%). Output of chemicals, pharma products, basic metals, computer and electronic items also moderated sharply in Jul'22 from the previous month. Compared with the levels seen in 2019 (pre-pandemic period), IIP growth was up by 14.2% in Jul'22 versus 28.3% in Jun'22.

Within use-based too, broad based moderation continued across all sectors. Output of consumer non-durables contracted in Jul'22 (-2%) after returning to growth in May'22 (1%) and Jun'22 (3%). Amongst others, sharp moderation was registered under capital goods (5.8% versus 29.1%) and consumer durable goods (2.4% versus 25.1%). Production of primary goods (2.5% versus 13.8%), intermediate goods (3.6% versus 10.5%) and infrastructure and construction goods (3.9% versus 9.3%) also disappointed.

While favourable base is expected to support growth in the latter half of H2FY23, tight global monetary conditions are beginning to show impact on global demand. In line with manufacturing PMIs of other major economies (down in Europe and China, stable in US), manufacturing PMI for India also eased a tad in Aug'22 to 56.2 from 56.4 in Jul'22. GST collections also softened marginally in Aug'22. Looming energy crisis in Europe and faltering demand in China due to Covid19 restrictions remain key risks to recovery.

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