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Economic Round-up: June 2022

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Fears of slowdown in global growth have intensified over the past month as multiple high frequency indictors are showing strains of stress (PMIs, commodity prices). Further, major central banks have re-affirmed that taming inflation remains a key priority and G-7 countries have announced a ban on Russian oil imports. These factors have also lent fears to probability of slowdown in growth. However, with easing restrictions in China, activity seems to be reviving, but downside risks still persist.

Global growth: While lockdown restrictions in China have eased owing to drop in Covid-19 cases and both manufacturing and services PMI has picked up, elsewhere growth is witnessing a slowdown. Global PMIs have dropped in Jun'22, US' consumer confidence index is down, and retail inflation in UK and US remains at decadal high. Commodity prices are also cooling-off, as a sign of looming global growth slowdown. These concerns have revived the debate of extent of tightening to be adopted by major central banks (Fed, BoE, ECB). However, in case inflation remains elevated, central bankers have re-affirmed that they will provide unconditional support to cool down the prices.

Global Central Banks: Deviation in global central bank actions continues to remain. While US Fed, BoE, Swiss National Bank (first hike in 15 years), and RBI have hiked rates, ECB remains on stand-by for now but is expected to begin rate hike cycle from Jul'22. On the other hand, BoJ and PBOC remaining accommodative. US Fed has recently announced 75bps rate hike in Jun'22, following 50bps hike in May'22. Various Fed officials have indicated that this trend might continue if inflation is not curbed. BoE also hiked rate by 25bps this month, its 5th rate hike since Dec'21.

Key macro data releases: India's eight core industries expanded to a 13-month high to 18.1% in May'22 from 9.3% in Apr'22. This was led by broad based improvement across the sectors with refinery, steel, cement, electricity and fertilizers each clocking double digit growth in May'22. However, coal output moderated marginally. Centre's fiscal position at the start of FY23 remains on solid footing with gross tax revenue rising by robust 29% in FYTD23 (Apr-May'22), with direct taxes up by 61% and indirect taxes up by 9%. Spending by the government has also been front-loaded this year with overall expenditure growth at 22%, led by jump in capex.

India's headline CPI edged down to 7.04% against our expectation of 7% and compared to 7.8% in Apr'22. This was driven by favourable base (6.3% in May'21). Government has also announced MSP hike and increase in gold import duty, which might push inflation higher in the near-term. We see a case for RBI hiking repo rate by another 50-75bps.

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Global developments

Global recession-uncertainty looms

Final estimates of US GDP show that in Q1CY22 growth (QoQ, annualised basis) was weaker than earlier estimated (second estimates) and fell by (-) 1.6% versus (-) 1.5% decline expected earlier. This is also much lower than 6.9% increase in Q4CY21. Other macro prints such as dip in manufacturing PMI (24-month low in Jun'22) and consumer confidence (lowest since Feb'21) has further raised concerns over a looming recession. Even global manufacturing PMI slipped to a 22-month low of 52.2 in Jun'22 from 52.3 in May'22 led by UK (24-month low), Eurozone (22-month low) and US ISM (24-month low). Pace of expansion also softened in Japan and India. As a result, both oil and other commodity prices (copper/aluminium/zinc) have come down, as fears of weak global demand persists. Oil prices remain subdued despite G-7 countries imposing a ban on Russian oil imports.

Central bank heads of US, UK and EU also met at the ECB forum this month and have re-affirmed that all stand ready to hike rates aggressively in order to tame inflation. Recently, UK's inflation had hit 40-year high of 9.1% in May'22, while in case for US it was up at 8.5% in May'22 (highest since 1981).

On the brighter side, China's manufacturing (50.2 in Jn'22 from 49.6 in May'22) and services PMI (54.7 in Jun'22 from 47.8 in May'22) improved amidst easing of lockdown restrictions. However, developments around property market, reoccurrence of infections and softer consumer spending remain key concerns.

RBI hikes again

RBI in its latest policy raised repo rate by 50bps to 4.9%. Accordingly, the upper and lower bound of policy rate stand at 4.65% and 5.15% respectively. The hawkish policy has focussed largely on elevated inflationary concerns. Stance has also been changed focusing 'on withdrawal of accommodation'. CPI forecast has been revised upward by 100bps in FY23 to 6.7% (our est.: 6.5%). More importantly in the next three quarters, headline CPI is expected to be above RBI's upper tolerance band. RBI has maintained its growth forecast for FY23 at 7.2%, as the MPC believes that recovery is gathering strength. However, prolonged war between Russia and Ukraine, supply chain bottlenecks and high pressure on input costs may impact margins of companies, thereby contributing to downward risks to growth. We thus expect another 50-75bps rate hike in the current cycle.

Global central bank decisions

Following a 25bps rate hike in Mar'22, and 50bps increase in May'22, US Fed in its latest meeting has raised the policy rates by 75bps, as inflation continues to soar. Cause of inflation were attributed to ongoing war and Covid-19 related lockdowns in China, leading to demand-supply mismatch. The rate increase announced was a unanimous decision. Higher costs will percolate to consumers in the form of more expensive mortgages, credit cards and other loans. The rate for a 30-year fixed-rate mortgage averaged 5.7% in the week ending Jun 30. That's up sharply from under 3.1% in Dec'21. Policy rate is projected

to increase to 3.4% by end of CY22 (1.9% projected in Mar'22), 3.8% by end of CY23 and back to 3.4% by the end of CY24. Growth outlook has been downgraded to 1.7% (CY22) from 2.8% estimated earlier in Mar'22. Inflation is estimated at 5.2% this year versus 4.3% earlier.

Bank of England (BoE) went for 5th straight rate hike of 25bps, highest level in past 13 years. As per the central bank's projections, overheating of inflation is likely to persist for next few months. CPI inflation is expected to be over 9% and then rise to slightly above 11% in Oct'22. GDP is expected to fall by 0.3% in Q2CY22 and unemployment rate was projected to rise to 5.5% in three years' time.

BoJ continued in its path of policy divergence by following ultra-dovish monetary response to support growth. It kept the policy rate unchanged in its Jun'22 meeting and has also renewed its pledge to keep bond yields at zero. Post policy, on account of rising yield gap with the US, yen has weakened considerably and even dropped to its 24-year low.

Special studies

What is driving FPI flows?

India has seen a sharp acceleration in FPI outflows in recent months. In fact, FPIs have been net sellers in the domestic markets since Oct'21. In CYTD22, FPI outflows from India have totalled US$ 28.5bn (upto 22 Jun 2022). This is consistent with other Emerging Markets (EMs), which have seen huge capital outflows in recent times. This has been on the back of a global risk-off sentiment amidst increased expectations of a slowdown in global growth and surging inflation globally. This has prompted central banks across the world to hike rates. Fed has been at the forefront, hiking policy rate to 150-175 bps this year and expectations are that this can go up to 300-350 bps. This has further exacerbated FPI outflows from EMs, including India.

The relative performance of Sensex vis-à-vis US stock markets (Dow Jones Industrial Average) had been mapped out. It was seen that both the stock markets moved in tandem in CYTD22. In fact, while Dow Jones fell by 16.1% this year, Sensex has performed relatively better and fallen by only 11%. Hence, there is no discernible reason for investors to prefer other markets. When compared with other global markets, Sensex is relatively better placed than other developed markets (DMs) which have seen a sharp fall in the equity markets. Even for EMs, while the MSCI EM index has fallen by 19.2% in CYTD22, Sensex has fallen by only 10.4% in the same period.

It may be a noted that while FPI inflows into equity markets have fallen, inflows into mutual funds, especially under the equity segment have shown an improvement. From Rs. 16.5 thousand crores in Jan'22, equity inflows have risen to Rs. 29.4 thousand crores in May'22. For the year CYTD22, inflows into the equity segment have risen to Rs. 118.7 thousand crores. On the other hand, debt segment has seen net outflows of Rs. 3.6 thousand crores so far this year, with the bulk of the outflows concentrated in May'22.

FPIs have an important role to play in financing India's current account deficit. Latest data from RBI showed that India's current account deficit expanded to US$ 38.7bn (1.2% of GDP) in FY22 from a surplus of US$ 24bn (0.9% of GDP) in FY21 as trade deficit surged.

For FY23, trade deficit is likely to expand further amidst a pickup in economic activity as well as higher commodity prices, pushing CAD higher. We estimate CAD at 3% of GDP or ~US$ 100bn. Capital flows will be important to finance the deficit. At the present run-rate of ~US$ 5bn per month, FPI outflows in FY23 can surge to ~US$ 60bn in FY23, putting further pressure on India's BoP. However, investor sentiment might revive in the later part of the year. In such a case, FPI outflows may be limited to ~US$ 30-40bn in FY23.

Global Inflation Boiling up

According to World Bank, advanced economies are expected to witness much slower growth at 2.6% in CY22 from 5.1% in CY21, with further moderation expected in CY23 at 2.2%. Global inflation print is likely to remain above the central bank's (CB) mandate for most of the countries as the CB's plan to rein in inflation. There also has been an exacerbated risk of stagflation (sluggish growth and high inflation), going further. Global inflation print has scaled to its highest level since the 1980s, with persistent surge in crude and food prices. UK's inflation climbed to a 40-year high in May'22 at 9.1% on the back of the global supply chain bottlenecks with elevated gasoline prices reaching a record high. This has further aggravated the fears of recession. Bank of England stuck to raising rates at a gradual pace of 25bps to cool inflationary pressure. On the other hand, US economy had outstripped market expectation with the CPI print scaling to its highest level since 1981, at 8.6% in May'22. As a result, Fed in its last policy meet applied the Hammer and Tongs approach as it hiked policy rates by 75bps with more hikes expected through the year. This signals its commitment to tame the inflation print.

Countries such as Turkey have been embattling higher inflation for the past few decades and given the subdued global cues; has spiked to a 23-year high at 73.5% in May'22 (70% in Apr'22). Upwards price pressure due to ongoing global supply chain bottlenecks, had also pushed Germany's inflation print to 7.9% in May'22 (7.4% in Apr'22).

Now that we have established that despite global inflation soaring, all the countries cannot be viewed similarly as no one glove-fits-all. It is rather pertinent to see each country individually with a wide lens in order to assess the impact of inflation. Also, India has been doing relatively better than other countries on this account. While comparing these countries together, India's inflation moderated to 7% in May'22 from 7.8% in Apr'22. For other countries such as Thailand (7.1% versus 4.7% in Apr'22), Korea (5.4% versus 4.8%) and Philippines (5.4% versus 4.9%) inflation has been on an uptrend (Fig 5). With advanced economies such as US and UK clocking much higher inflation at 8.6% (5% in May'21) and 9.1% (2.1% in May'21) respectively. On the other hand, an emerging economy such as India had registered an inflation of 7% in May'22 compared with 6.3% in May'22.

Indian economy has also been facing the brunt of 'imported inflation' led by mounting pressure on energy, fertilizers and other inputs. However, the aggravated impact of the same has been curtailed with proactive measures such as reduction in excise duty, duty free import of soybean and sunflower oil. Furthermore, expectation of normal monsoon along with bumper Kharif production is also likely to keep food inflation in check.

Compared with other global countries, India is in a much better place to manage inflation. Yes, the current inflation does continue to remain above RBI's mandate. However the

rate hike spree by RBI (including out of policy-rate hike in May'22) signifies inflation is back as a priority for the central bank.

Forex risk of India Inc.

The recent decline in the rupee had ignited concerns on the external sector stability of the economy. Apart from macro economy repercussions, a depreciating currency also impacts the profitability of companies which have high exposure in terms of foreign currency. In this study we evaluated a sample of 2,171 companies and focused on those industries which are more vulnerable due to higher trade deficit value (Exports: FOB – Imports: CIF). Notably, our sample constituted 20% of the exports in merchandise trade basket, while imports comprise 33% of total in FY21. Sectors such as crude oil, industrial gas and fuels, trading, consumer durables and telecom are the top 5 industries with highest deficit. Extrapolating the export-import growth for FY22 to the data, we find that for FY22 as well, the deficit as a proportion of net sales is likely to increase. For FY23, a volatile currency will provide further discomfort to these companies.

Crude oil, industrial gas and fuels, trading, consumer durables and telecom were the top 5 sectors with the highest deficit. The deficit was calculated as the difference between Exports: FOB value and Imports: CIF value of companies.

We also looked at how the net sales of companies might be impacted due to the rupee depreciation. Industrial gas and fuels, Electricals, Consumer Durables, Crude Oil and Telecom sectors have the highest share of deficit to net sales. In case of these industries the profits tend to get impacted when the rupee depreciates and hence there is need for hedging forex risk by getting into forward/futures contracts. In the absence of such cover the risk carried on their books will tend to increase with successive doses of rupee depreciation.

Sectors such as healthcare, textile, IT, retailing and FMCG etc. are insulated as they are net earners of forex. These sectors hence gain when the rupee depreciates.

So what to expect in FY22 and FY23?: 21 of the 31 industries considered had a trade deficit which cumulated to Rs 6.5 lakh crore or about US$ 88 bn (assuming an average rate of Rs 74.22/$). If crude oil is excluded it would be Rs 2.5 lakh crore or US$ 34 bn.

On an average basis the rupee would have depreciated by around 6.5% in FY22 and FY23. The trade deficit had peaked at around US$ 192 bn for the country in FY22. Given that the forward premia for the year has been in the range of 3.5-4.5%, there may have been a disincentive to take cover for forex exposures. Ideally a part of the exposure should be covered or else the loss to be borne would be high at a time when the rupee is depreciating.

Industries which have a high ratio of trade deficit to net sales should be actively hedging their forex exposure especially when there are limits to which the cost can be passed on to the consumer. Besides in an environment where the commodity prices are also increasing across the board input costs are bound to increase. It would be advisable to have hedging policies in place at the firm level to also address the issue of forex risk given that the average depreciation in a year could be in the region of 3-3.5%.

Do states have space to reduce VAT on petrol?

With rise in international oil prices in the last year retail price of petrol has moved up ever since the government linked the base price to global trends i.e. April onwards. The central government has provided relief in terms of excise duty cut first in Nov'21 and more recently in May'22. The message passed on to the states is that they too must try and lower their taxes to lower price of fuel products. However, the challenge for any government (centre or states) is that if taxes are reduced there would be a tendency for their tax collections to get affected. It is a zero sum game.

Backdrop: International crude prices had risen considerably from its low of US$ 19/bbl seen in Apr'20 during Covid-19 times. The volatility in international oil prices was also seen in domestic retail prices of petrol and diesel. Domestic retail prices of petrol and diesel started increasing in tune with global oil prices. Petrol prices had risen from Rs 73/lt to Rs 113/lt between Apr'20 to Apr'22 and diesel prices from Rs 65/lt to Rs 100/lt. thus, it was important to understand how the mechanism of pass through of international prices to domestic retail prices works.

When retail price of petrol rose to Rs 109.7 as on 1 Nov 2022, government gave relief to the consumers by reducing petrol duty on petrol from Rs 32.9/lt to Rs 27.9/lt. VAT also was reduced simultaneously as the base price came down. For Delhi for instance, with the OMCs holding on to their price and the centre lowering excise duty, the VAT on petrol came down to Rs 15.5 from Rs 23.99 level in Nov'21.

Recently, in May'22, government has again cut the excise duty on petrol and diesel by Rs 8/lt (from Rs 27.9/lt to Rs 19.9/lt) and Rs 6/lt (from Rs 21.8/lt to Rs 15.8/lt), respectively. This has led to a call to states to reduce VAT in response to the current excise duty cut by the centre.

It was observed that 16 States had made gain between 20-30 paise/litre due to the increase in oil prices combined with cut in excise duty of the centre, while for another 12 States, the gains had been between 10-20 paise/litre. Therefore it may be concluded that States have limited fiscal space to further cut VAT rates, in consonance with the current excise duty cut if they have to ensure that their revenue does not decrease.

As can be seen, states have limited scope to lower the VAT on petrol without affecting their tax revenue. In FY21 for instance states earned Rs 2.21 lakh crore on duties on petroleum products while the centre earned Rs 4.20 lakh crore. In the first nine months of FY22, the states earned Rs 2.07 lakh crore while for the centre it was Rs 3.10 lakh crore. The centre's collections were lower post the reduction in duty in November. In these 9 months, VAT/sales tax were Rs 1.89 lakh crore and the highest collections were in Maharashtra (Rs 24,886 crore), Uttar Pradesh (Rs 18,998 crore), Gujarat (Rs 15,600 crore), Tamil Nadu (Rs 15,291 crore) and Karnataka (Rs 14,182 crore).

Study on performance of banks in FY22

We had analysed the financial performance of 28 banks of which 12 were Public Sector Banks (PSBs) and the balance 16 Private Sector Banks (PVBs). We had looked at the key indicators of profitability, margins and efficiency ratios for the consolidated groups. Growth in net interest income (NII) was lower in FY22 relative to FY21 due to a lower interest rate regime. Notably, cost to income ratio fell slightly for PSBs but rose for private banks. Non-interest income growth was lower for the banking system. Under the current rising interest rate cycle, this component would need close monitoring. GNPA ratio had improved in FY22 both for PSBs and PVBs. Return on assets (RoA) had also improved both for PSBs and PVBs. Salary cost to operating expenses declined across the industry.

Key Takeaways:

• NII of industry moderated to 10.5% in FY22 compared to 22.4% in FY21. This was on account of moderation in interest income to 2% from 10.4% in FY21, on account of a low interest rate regime and muted credit demand. Interest expenses on the other hand had declined by 4.4% as against an increase of 2.8% in FY21.

• For PSBs, NII edged down to 8.1% in FY22 from 28.3% in FY21. For PVBs, there was only slight moderation in NII to 13.5% from 15.3% in FY21.

• Non-interest income of PSBs has fell by 1.5% in FY22 against 24.3% increase seen in FY21, whereas for PVBs, it had been fairly stable and increased by 8.7% in FY22 from 6.5% in FY21, which has indeed supported their operating income.

• Operating Profit of the industry rose at a softer pace of 7% in FY22 against 24.7% in FY21. Notably, due to an elevated base in FY21, the numbers look modest.

• Cost to income ratio of the industry has increased marginally to 47.65% in FY22 from 46.78% in FY21. However for PSBs, the ratio moderated slightly to 50.42 in FY22 from 50.94% in FY21.

• Provisions for the industry have fallen by 25.2% in FY22 from 3.7% decline in FY21. For PSBs, provisions fell by 27.9% in FY22 from 2.1% decline in FY21. For PVBs, provisions declined by 19.8% from 6.9% fall in FY21. The decline may be attributed to the fact that banks have been making progressive provisions for NPAs in the last few years thus obviating the need for the same in the current financial year.

• Net Profit of PSBs rose to Rs 66,540crore in FY22 from Rs 31,818crore in FY21. For PVBs, net profit rose to Rs 93,037 crore from Rs 71,259 crore in FY21.

Have global commodity prices cooled down?

The World Bank data on commodity prices has some revealing takeaways because contrary to what is perceived prices of some groups of commodities have eased in May relative to April and while there are still some pain points, there can be hope of inflation coming under control in the coming months if the May pattern is carried forward. Two developments need to be kept in mind when analysing these prices. The first is that the intensity of sanctions has increased and the second is that China was in a lockdown mode and has emerged out of it from June.

Among the energy products coal price has retreated in May while European natural gas price has also declined. However, natural gas from USA continues to witness high growth in prices. Therefore oil related products are still a concern for the global economy given their importance for all countries. Prices of beverages have declined over April and in case of cocoa and coffee, prices are lower than December too. Tea however has witnessed an increase over December and January with both the Sri Lanka and India auctions registering higher prices since December. However, compared with April prices have come down.

In case of the oil, complex prices have tended to cool down in May with coconut oil, palm kernel oil, soybean meal and mustard oil witnessing a decline. Palm oil prices increased by 2% which can be attributed to Indonesia announcing a ban before withdrawing the same. The interesting data point is sunflower oil where Ukraine and Russia are major suppliers to the global market. As oils are substituted quite swiftly, the withdrawal of sunflower oil supplies from the global market has led to a migration from sunflower oil to other oils. Therefore demand for sunflower oil has come down leading to lower prices. Groundnut oil prices have retreated since the war while soybean oil price has gone up.

Grains continue to be a problem area as the removal of Russian and Ukrainian wheat has pushed prices on a continuous basis. India has been affected due to drop in production and hence the ban on exports should help to ease prices over time. There has been marginal decline in maize price.

Metal prices have decline in May and the China factor may be the major driving factor. These prices could decline further once the world economy slows down on account of central banks increasing interest rates. Prices have been on the decline even when compared with January, which is just before the war started. Russia has a dominant space in iron ore and prices did increase in March and April, but have come down subsequently. Nickel was the exception where prices increased over January, but came down in May. The precious metals scene followed the trend in base metals with gold, platinum and silver declining in May compared with both January and April. Gold is considered a safe harbor when global conditions are volatile. In this crisis like situation, the dollar has been strengthening and as it has an inverse relation with gold, has moved in the downward direction.

Key policy announcements

- Customs duty on gold has been increased from 10.75% to 15% as the surge in gold imports is putting pressure on current account deficit. Thus, to curb import of gold, customs duty has been increased.

- Since domestic crude producers sell crude to domestic refineries at international parity prices, as a result, the domestic crude producers are making windfall gains. Taking this into account, a cess of Rs 23,250 per tonne (by way of special additional excise duty-SAED) has been imposed on crude. Import of crude would not be subject to this cess. Also, this cess will have no adverse impact, on domestic petroleum products/fuel prices. Further, small producers, whose annual production of crude in the preceding financial year is less than 2 million barrels will be exempt from this cess.

- Also, prices of HSD and Petrol have shown a sharper increase and as exports are becoming highly remunerative, it has been seen that certain refiners are drying out their pumps in the domestic market. In view of this, cesses equal to Rs 6 per litre on Petrol and Rs 13 per litre on diesel have been imposed on their exports. Like HSD and Petrol, the international prices of ATF have risen sharply. Accordingly, on the same reasoning, as stated above for diesel and petrol, a cess of Rs 6 per litre has been imposed on exports of ATF.

- The 47th GST Council recently met in Chandigarh. Recommendations relating to GST rates included rationalization to remove inverted duty structure. Following this, GST rates on ink (printing/drawing etc.), knives, power driven pumps, machines for cleaning/sorting of eggs/fruits, LED lamps/lighting fixtures, drawing instruments, work contracts for roads/bridges, Tetra pak, has been hiked from 12% to 18%. In addition, rates on machines for cleaning/sorting of seeds/grains/pulses has been increased from 5% to 18%. Also, rates on solar water heaters, prepared/finished leather, job work in relation to processing of hides/skins/footwear/clay bricks has been hiked from 5% to 12% and that and cut and polished diamonds to 1.5% from 0.25%. Concessions have also been withdrawn on cheques, maps (from 0 to 18% now), petroleum (from 5% to 12%) and e-waste (from 5% to 18%).

- Net direct tax collections as of 16 June 2022 were recorded at Rs 3.4 lakh crore (up by 45% YoY) compared with Rs 2.3 lakh crore during the same period last year. Gross direct tax collections stood at Rs 3.7 lakh crore, up from Rs 2.6 lakh crore last year. This included corporate tax collection of Rs 1.9 lakh crore and income tax collection of Rs 1.8 lakh crore.

- The Cabinet Committee on Economic Affairs, has approved ‘Deregulation of Sale of Domestically Produced Crude Oil’, whereby Government has decided to cease allocation of crude oil and condensate w.e.f. 01.10.2022. This will ensure marketing freedom for all Exploration and Production (E&P) operators. The condition in the Production Sharing Contracts (PSCs) to sell crude oil to Government or its Nominee or Government Companies shall accordingly be waived off. All E&P companies will now be free to sell crude oil from their fields in domestic market. As earlier, exports will not be permissible.

Data Releases

Fiscal

Centre's fiscal position at the start of FY23 remains on solid footing with gross tax revenue rising by robust 29% in FYTD23 (Apr-May'22), with direct taxes up by 61% and indirect taxes up by 9%. Centre's net revenue receipts is also maintaining a steady growth (2%) so far with collections at Rs 3.6 lakh crore versus Rs 3.5 lakh crore during the same period last year. Spending by the government has also been front-loaded this year with overall expenditure growth at 22% (Rs 5.9 lakh crore), led by 70% jump in capex spending (Rs 1 lakh crore). Even revenue spending is robust at 15.3% (Rs 4.8 lakh crore). With this, fiscal deficit (12MMA basis) was at 6.7% in May'22 compared with 7.1% registered last year in the same period.

Core industries

India's eight core industries expanded to a 13-month high to 18.1% in May'22 from 9.3% in Apr'22. This was led by broad based improvement across the sectors with refinery (16.7% from 9.2% in Apr'22), steel (15% from 2.2%), cement (26.3% from 7.4%), electricity (22% from 11.8% in Apr'22) and fertilizers (22.8% against 8.7%) each clocking double digit growth in May'22. However, Coal output moderated marginally but still remained robust at 25.1% compared with a growth 28.8% in Apr'22. On a FYTD basis, growth in eight core industries improved by 13.6% against the growth of 36.3% last year.

MSP

The government announced MSPs for the Kharif season and the impression received is that the increases have been uneven (between 4.4% and 8.9%) and well above the increase of last year. Hence the balance between ensuring fair price to the farmer and keeping an eye on inflation has been a challenge. The average price hike would be around 5.8% for these commodities. Given a weight of 3.4% in the overall index, the direct impact on WPI inflation can be around 0.20% if all crops receive the higher price.

Currency outlook: Pressure on INR

Increasing risks of global recession drove global currencies lower. On the other hand, DXY continues to trade near a two-decade high supported by safe-haven appeal as well as Fed's aggressive policy stance. Fed Chair reiterated the Central Bank's commitment to provide "unconditional" support to tame rising inflation. Similar views were echoed by ECB President. Soaring inflation across countries and synchronized monetary policy tightening has increased the risks of a global recession, denting investor sentiment. EM currencies have been particularly hit, including India. In the last few trading sessions, INR has touched a record-low several times breaching the 79/$ mark on 1 Jul 2022. Apart from global factors, headwinds on the domestic front have also increased. We expect, INR to remain under pressure in the near term and trade in the range of 78.5-79.5/$ in the next fortnight. In FY23, we expect INR in the range of 78-80/$.

Favourable base supported CPI

India's headline CPI edged down to 7.04% against our expectation of 7% and compared to 7.8% in Apr'22. This was driven by favourable base (6.3% in May'21). Food inflation moderated to 8% from 8.3% in Apr'22. CPI excl. food and fuel edged down to 6% from 7% in Apr'22.

If we see the sequential momentum of food inflation, the narrative shows price pressure is building up. On a sequential basis, food inflation increased by 1.6% in May'22 from 1.5% in Apr'22. Among major items which noted a considerable MoM jump within food includes vegetables (5.2% against -0.4% in Apr'22), meat and fish (2.5% versus 0.5% in Apr'22) and sugar (0.6% versus 0.2%).

Supported by transport and communication inflation (9.5% against 10.9%, YoY; 0.3% versus 3%, MoM), CPI excluding food and fuel moderated both on MoM and YoY basis. Within the miscellaneous component, governments' excise duty cut and lower gold prices supported lower print in transport and communication and personal care and effects inflation.

We expect CPI to be ~ 6.5% in FY23. Significant risks emanate from rising crude prices, which are currently at +US$ 120/bbl. Even the spatial distribution of monsoon plays a significant role in the upcoming days on cereal inflation. Further on a sequential basis, some items of food inflation are still inching up. So a combination of these factors along with supply side bottlenecks will continue to pose upward pressure on CPI print. Apart from this depreciating currency will also pose risks in terms of imported inflation Thus, RBI will be more hawkish and aggressive in its pace of rate hikes in the coming months.

WPI remains elevated

Slightly higher than our expectations (forecast of 15%), WPI for May'22 has come in at 15.9%, up from 15.1% in Apr'22. This implies that inflation continues to remain at its highest in the current (2011-12) series. Barring manufacturing, other sub-heads such as food and fuel, registered an acceleration in inflation in May'22. However, on a MoM basis, WPI print has eased (1.4% versus 2% last month), with all sub-heads witnessing further deceleration in May'22 after peaking in Mar'22.

Food inflation in May'22 is at its highest (10.9%) since Dec'19 (11.2%) and has moved up from 8.9% in Apr'22. This is led by significant increase in prices of vegetables (56.4% in May'22 versus 23.2% in Apr'22), followed by milk (5.8% versus 5.1%), eggs, meat and fish (7.8% versus 4.5%) and spices (18.4% versus 14.6%).

Fuel and power inflation in May'22 rose to 40.6% from 38.7% in Mar'22, led by increase in electricity price index (16.2% versus 10% in Apr'22). On the other hand, coal prices remained steady (unchanged from Apr'22 at 2.8%), while mineral oil index moderated (61.9% versus 62.5%).

Core inflation in May'22 eased to 10.4% in May'22 from 11.1% in Apr'22. Manufactured products inflation was also down at 10.1% in May'22 from 10.9% in Apr'22 Of the 22 commodity sub-indices, 8 indices rose at a slower pace in May'22 than Apr'22 led by

basic metals, pharma products, leather items, manufactured food, computer and electronic products, transport equipment and fabricated metal products.

IIP- Output climbs to 8-month high

Industrial output rose to 8-month high of 7.1% in Apr'22 from 2.2% in Mar'22 led by improvement across all the sectors and base effect. Last year, during this period the second wave of Covid-19 was prevalent and state-wide restrictions were imposed, pushing the industrial growth on a downhill. Mining sector edged upwards to 6-month high of 7.8% in Apr'22 (3.9% in Mar'22). Manufacturing output also crept up to 8-month high to 6.3% with over 18 sectors registering an improvement. Electricity output (11.8% in Apr'22 from 6.1% in Mar'22) continued to track upwards momentum on the back of the pickup in economic activity, reflecting stronger demand. Notably, over a 2-year horizon, IIP index is 150.2% above the pre-pandemic level in Apr'22 compared with a growth of 27% in Mar'22. Mining and electricity output too edged upwards to 47.2% (10.2% in Mar'22) and 54.9% (30% in Mar'22) in Feb'22. Furthermore, manufacturing output also turned out to be above the pandemic level (214.7% in Mar'22).

Within use-based classification, broad based improvement was seen across all the sectors. Primary goods output has expanded to 10-month high of 10.1% in Mar'22 from 4.5% in Apr'22. Capital and intermediate goods output have also registered an improvement of 14.7% (2% in Mar'22) and 7.6% (1.8% in Mar'22). Output of Infra goods moderated by 3.8% against 6.7% in Mar'22. Moreover, Consumer durable goods rose to 8-month high of 8.5% in Apr'22 compared with a decline of (-) 2.6% in Mar'22. Output of Consumer non-durable also registered an improvement at 4.9% in Apr'22.

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