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Economic Round-up: September 2023

Macro data points from the US, China are showing that economy is maintaining momentum /recovering, while in Eurozone and UK weakness in activity persists. In the US, continued tightness in labour market, and strength in domestic consumption (retail sales) also nudged Fed to revise upwards its GDP projections for CY23 and CY24. CPI estimates for CY23 are also projected to be higher than earlier anticipated. In Eurozone and UK on the other hand, central banks expect weaker economic activity in the remaining part of CY23. Winter season and rising international oil prices pose further threat to inflation. Recovery in China however offers a glimmer of hope to global demand. Pick up manufacturing and non-manufacturing PMIs, along with improvement in industrial output, retail sales and policy support by the government (RRR cut), has led to upward revision in various analysts forecasts for China's CY23 GDP growth. Going ahead, while major central banks are expected to keep monetary policy restrictive, its impact on growth will be watched more closely.

Global growth: Global growth remains unpredictable with US economy not slowing as much as anticipated, China showing signs of recovery and Eurozone and UK economies faltering more than expected. In the US, lower jobless claims, pick up retail sales and industrial output, improvement in employment sub-index for ISM manufacturing PMI and higher than expected job openings indicate that economy remains on solid ground so far. On the other hand, slowdown in demand from China, has hampered manufacturing activity in Eurozone and UK. However, now with china showing signs of improvement, global demand may also pickup, leading European economies out of their slumber.

Global Central Banks: In Sep'23, US Fed and BoE held rates unchanged, while ECB hiked its main policy rate by 25bps to 4%. While Fed's policy statement was more hawkish and signalled one more rate hike in CY23 and fewer rate cuts in CY24, analysts expect BoE to remain on continued pause now. In case of ECB, a lot will depend on the inflation trajectory, which may get impacted by rising international oil prices. For now, ECB president signalled that if policy was left at current restrictive levels, inflation may come back within the targeted ranged in the planned time frame. On the other hand in Asia, PBOC continues to loosen its monetary policy to support growth, and BoJ is hinting that discussions might be underway to formulate a gradual exit from its ultra-loose policy.

Key macro data releases: India's current account deficit **(CAD)** for the first quarter of FY24 came in at 1.1% of GDP as against 2.1% last year. In absolute terms the deficit was almost half of that last year at $ 9.2bn ($ 17.9bn in Q1FY23). The improvement in CAD was mainly due to a lower trade deficit of $ 56.6bn as against $ 63bn last year. This improvement was mainly due to the declining commodity prices globally. This will change track given the recent increase in crude oil prices which has been above $ 90/bbl in Sep'23 and is nearing $100/bbl in the coming days. We expect CAD to be in the region of 1.5-1.8% of GDP for the year.

CPI inflation came in at 6.8% in Aug'23, broadly in line with our estimate of 6.9% and far lower compared to 7.4% in Jul'23. The likely comfort came in from 157bps drop in food inflation which moderated to 9.9% from 11.5% in Jul'23. Core CPI moderated to 4.8%. It can be said that the impact of past transmission of higher rate is shaping up, and is resulting in softening demand conditions.

Global developments

US economy striking back; Europe remains wounded

Global PMIs show that manufacturing activity remains weak in Eurozone, UK and Canada, while some improvement is visible in US and China. Global PMI for Sep’23 came in at 49.1, compared with 49 in Aug’23. All sub-indices (output, new orders, employment, stocks of purchases, and suppliers' delivery times) continue to remain in contraction.

In the US, recent macro data points show that labour market still remains relatively tight and overall economic activity is not slowing as much as anticipated. US ISM manufacturing index rose to 49 in Sep’23 from 47.6 in Aug’23 as sub index for production (52.5 versus 50) and employment (51.2 versus 48.5) jumped back into expansion territory. New orders declined, but at a slower pace. Apart from ISM index, tightness in labour market was also visible in initial jobless claims data for the week ending 23 Sep 2023, which showed that 4-week moving average fell by 6,250 to 211k from 217.25k in the week before. Government’s JOLTS data also confirmed that number of job openings increased to 9.6mn in Aug’23 (est.: 8.8mn) from 8.9mn in Jul’23. This is also supporting consumption, as retail sales rose by 0.6% (MoM) in Aug’23 from 0.5% in Jul’23. Further, US durable goods orders bounced back in Aug’23, posting 0.2% increase versus est.: -0.5% decline and reviving from fall of -5.6% in Jul’23. This was led by orders for machinery, electrical equipment/appliances, computers, and fabricated & metal products. Even core orders (non-defence capital goods ex aircrafts) rose by 0.9%, versus a decline of -0.4% in Jul’23. This is expected to give Q3 GDP print a boost. Risks to growth are emancipating from more than expected drop in new home sales (-8.7% MoM) in Aug’23 and risks from continued increase in global oil prices.

Deterioration in Eurozone’s (EZ) manufacturing activity remains unfazed with PMI registering at 43.4 in Sep’23 from 43.5 in Aug’23. With demand pressures absent, manufactures have indicated continued production cuts. Employment, new orders index also fell further. Within Eurozone, while activity contracted at a faster pace in France (44.2 in Sep’23—lowest since May’20; 46 in Aug’23), it fell a tad slowly in Germany (39.6 versus 39.1). In both of these major economies, output, employment, delivery times and new orders continue to suffer. Even services activity remain weak, but is now declining at a slower pace (48.7 versus 47.9). The drag is coming more from France (44.4 versus 46.0), while in Germany pick up in pace was visible in Sep’23 (50.3 versus 47.3). In Germany also the improvement was also on account of clearing of backlogs, while other new orders still remain fragile. Germany’s IFO business climate index signals further pessimism amongst survey participants regarding the economic outlook. Index fell to 85.7 in Sep’23 from 85.8 in Aug’23. Within this, the current situation index fell more sharply to 88.7 from 89 previously. After GDP expected to decline in Q3, survey participants expect further fall in Q4 as well. Elsewhere in UK, both services and manufacturing PMIs show that both sectors are still facing demand problems, with those accentuating in the services sector (49.3 in Sep’23 versus 49.5 in Aug’23) and easing in the manufacturing sector (44.3 versus 43).

China’s official manufacturing PMI shows that activity rebounded in Sep’23 (50.2) from 49.7 in Aug’23. Even non-manufacturing PMI rose to 51.7 from 51 in the previous month. Other macro prints are also pointing towards a recovery. Industrial output rose by 4.5% in Aug’23 (est.: 3.9%)—fastest pace since Apr’23 and from 3.7% in Jul’23. Summer travel season also helped retail sales beat expectations (3%) in Aug’23 (4.6%) compared with Jul’23 (2.5%). To ensure that improvement is more on a durable basis, government is using policy tools such as RRR cuts and liquidity injections to support growth and help reeling property sector.

RBI

In the upcoming credit policy meet of RBI, which is scheduled on 6 Oct 2023, we expect MPC to maintain a hawkish pause and keep the rates unchanged. No change in stance is also expected, as RBI will keep liquidity tight to keep short-term rate higher and support INR. Liquidity tightening may also worsen close to election months. We have ruled out any rate cuts this fiscal year, and anticipate earliest possible rate cut in Q1FY25. Further, upward revision to RBI's CPI forecast for FY24 can be expected, by 10-20bps. However GDP forecasts are anticipated to remain unchanged. We expect 10Y yield to trade in the range of 7.15-7.25% next month.

Global central bank decisions

In line with market expectations, US Fed left its policy rates unchanged at 5.25-5.5% in the Sep'23 meeting. This was considered to be a hawkish pause because the central bank signalled probability of one more rate hike this year. The dot plot also shows fewer cuts in CY24 (2 cuts versus 4 expected earlier), indicating that Fed is likely to keep rates elevated for a longer duration of time. Stronger than expected economic momentum is the rationale behind Fed's rate trajectory, as it upwardly revised its GDP projections for CY23 (2.1% versus 1% as per Jun'23 projection) and CY24 (1.5% versus 1.1%) and CPI for CY23 (3.3% versus 3.2%). projection for Fed fund rate for CY23 was left unchanged at 5.6% and for CY24 it was pumped up to 5.1% (4.6% as per Jun'23 estimates).

Bank of England (BoE) for the first time since Dec'21 left its policy rate unchanged 5.25% in its Sep'23. The decision was not unanimous with 5 (including BoE Governor) out of 9 members opting for a pause. Dip in retail inflation to 6.7% in Aug'23 from 6.8% in Jul'23 and weakness in economic activity (particularly housing market), were the drivers of this decision. The central bank also revised downward its GDP projections Q3CY23 to 0.1% from 0.4% estimated in Aug'23. For H2CY23 also, growth is estimated to be lower than 0.25% (Aug'23 projection).

As opposed to other major central banks which opted for a pause in Sep'23, ECB decided to hike rates by another 25bps, taking main rate (deposit facility) to 4%. The Central Bank expects CPI to remain at elevated levels, for which maintain a restrictive monetary policy remains the key. It upwardly revised its CPI projection to 5.6% for CY23 (5.4% earlier) and to 3.2% for CY24 (3% earlier). Also, noting the impact of elevated rates and weak global demand conditions, it lowered its Euro Area GDP forecast for CY23 to 0.9% (0.7% earlier) and for CY24 to 1% (1.5% earlier).

China's PBOC announced RRR cut in Sep'23 as it lowered the rate by 25bps to ~7.4%. This move is expected to boost liquidity by 500bn Yuan, which will in turn help support housing and infra structure. However as per the latest decision, Medium Term Lending facility rate (MLF) unchanged at 2.5%.

Bank of Japan has so far maintained its decision to keep the monetary policy ultra-loose to achieve its inflation goal (2% mark) on a durable basis. However, more recently BoJ Governor has signalled that discussions might be underway to decide the exit plan, as in its latest statement the central bank mentioned that inflation target is more in sight now. Although in the near-term, it is planning to increase its bond purchase program this week, to curb increase sovereign yields.

Special studies

Do corporate bond issuances show investment is reviving?

There has been a sharp rise in the debt placements of corporates in the first 5 months of the year. It is tempting to conclude that this is a sign of companies investing in capital and that the investment cycle has begun. But closer examination of data shows that we may have to wait for some more time before it can be concluded that there is broad-based investment taking place.

Debt private placements, which accounts for almost 95-98% of total issuances historically had reached a high of Rs 3.31 lakh crore during the first 5 months of the year. This compares with Rs 1.91 lakh crore in FY22.

The level of debt placements has now gone back to the pre-pandemic times at Rs 3.31 lakh crore. Data on sectoral distribution of bond issuances is provided by CMIE which has been examined to figure out which industries have contributed to this uptick in issuances. The aggregate data as per this database is almost the same as that of SEBI.

The dominance of the financial sector continues, which includes NBFCs and banks, with the former driving the issuances. The finance sector now accounts for 86% of total issuances which also means that the other sectors including manufacturing have a low share in total. NBFCs as, can be seen have always had a high share in the bond issuances as it is one of their major sources of funds which are used for lending purposes. This share has been above 65% in all the years, but has reached a peak in 2023.

With dominance by the financial services other sectors had minor contributions in this exercise. The other industries involved were:

- Construction and real estate with 4.3%
- Other services like aviation with 3.9%
- Electricity with 3.2%
- Diversified with 1.9%.

Core manufacturing had share of just 1% of which chemicals had share of 0.4%. Hence it does appear that investment during this period has been low judged by the main source of long term financing.

Trends in growth in bank credit to the NBFC sector as well as the share in total credit were also analysed. In the last 8 years or so, there has been a rising trend with share moving from 5.1% in 2014-15 to almost 10% in 2022-23. Hence, the NBFC segment has become a major borrower in the financial system in both the debt market as well as credit system.

In this context, it would be interesting to see the lending pattern of NBFCs across various sectors.

NBFCs lend the most to industry which has share of 38%. Large industry dominates with share of 30.6%. In case of banks, the share in FY23 was 18% and has been coming down since FY15 when it was as high as 35%. This is both due to demand for funds being lower as well as banks focusing more on the retail portfolio. Retail loans had share of almost 30% for NBFCs which is exactly the same for banks.

Putting the two pieces together it can be surmised that as NBFCs have borrowed almost Rs 2.9 lakh crore from the market, they would be lending around Rs 0.9 lakh crore to large industry which can be used for both investment as well as short term purposes.

RBI (Report on trend and Progress in Banking) had indicated that around 86% of the lending to industry is for infrastructure and hence once again it can be linked with companies working in related sectors like metals, machinery, cement etc. which have benefited from the push provided by the government.

Hence, signs of investment picking up based on information from the debt market are not yet visible on a large scale though extrapolating from the lending pattern of NBFCs it can be said with a fair degree of confidence that the infrastructure sector is borrowing a fair amount.

Impact of India’s inclusion in JP Morgan bond index

After a long wait, India was finally included in JP Morgan’s global bond market index. This will be undertaken over a period of 10 months, starting from 28 Jun 2024. India’s weight in the GBI-EM Global Diversified Index (GBI EM GD), is expected to reach 10% by Mar 2025. The AUM of GBI-EM-GD stands at US$ 213bn. Additionally, India will also be included in other indices under the GBI-EM suite, with total AUM’s of US$ 236bn. We expect inflows of US$ 20-30bn from India’s inclusion in the index to begin with. In case India is also included in other indices such as Bloomberg and MSCI, inflows would be even higher. This can have a positive impact on domestic bond yields and INR in FY25, when the actual inflows materialize. However, as FPI flows tend to be volatile, it also leaves India vulnerable to greater financial sector volatility which will require regular monitoring and intervention by the RBI.

Introduction

India has been included in JP Morgan’s global bond index-suite for emerging markets (GBI-EM). The AUMs benchmarked to the suite are worth US$ 236bn. Of this, almost 90% is earmarked to the GBI-EM global diversified index (GBI-EM GD), in which India is expected to have a weight of 10%. Only two other countries i.e. China and Indonesia have a weight of 10% in this index, and their weights have been kept unchanged. While their weightage in the index will see some reduction, Mexico, Malaysia and Brazil still have a weight of ~9% in the index. To accommodate India, Thailand, South Africa and Poland will see the most sizeable decline in their weightage in the index.

It must be noted that India had made remarkable progress in promoting foreign participation in the domestic market due to which India was put on the index positive watch. Some of these measures included introduction of fully accessible route (FAR) for investment in G-sec markets. A total of 23 Indian government bonds (IGBs) under the FAR are eligible with a notional value of Rs 27 lakh crores or US$ 330bn. Furthermore, the inclusion will take place over 10 months starting from Jun’24, at the rate of 1% per month over this period.

How much debt inflows are expected?

India is expected to receive about US$ 20-30bn index related inflows. While a major part of these inflows will come directly from India’s 10% weight in the GBI-EM index, there might be additional inflows due to higher interest in government securities by foreign investors.

Despite government reforms, ownership pattern of government securities shows that the share of FPIs still remains negligible. The debt utilization statistics also show that the utilization rate by foreign investors is considerably lower. For the general limit (where RBI mandates FPI investment in G-sec and SDLs at 6% and 2% respectively) FPI holdings in G-sec is at 23.51% for general foreign investors and for long term foreign investors at 5.59% (as of 25 Sep 2023). Even for FAR holdings, the holding share in outstanding is considerably lower. For the 23 securities which are eligible under the index, the holding ratio of outstanding position as of 25 Sep 2023 is in the range of 0.15-5.43%.

The inclusion of securities is obviously a game changer, leading to widening of investor base. This will give the desired push by increasing the demand for these securities and bringing down the cost of capital. This is just the first round impact. The second round impact will be felt as favourable yield on these indices will in turn attract security specific interest to the wider investor base.

Which part of the curve will notice change?

Tenor wise data shows that securities in the range of 5-10 years are likely to get the maximum benefit as in terms of the outstanding amount as of 25 Sep 2023, these bucket range within the FAR holdings have the maximum share. So we may witness downward shift of the entire yield curve in this segment.

If we look at the movement of India's yield curve post the announcement of India's inclusion in the global bond index, it is interesting to see that 5-7 year part of the curve noticed a drop in yield (between 1-4bps) as the share of this bucket range is maximum as explained earlier.

Going forward, the impact on different tenor papers will be contingent on a host of other factors. Post inclusion, it will be important to see how the liquid the papers will be. As per CCIL data, major concentration in terms of liquidity is the 2033 paper. So while expanding the investor base is important, it is also necessary to ensure the liquidity of the papers to make this a successful venture.

For benchmark 10Y paper, already the initial drop in yield post the announcement has undergone a correction. We do not foresee much change in 10Y yield in FY24 and expect it to remain in the range of 7.15-7.25%. However, post FY25, depending on flows, a downward bias towards the 7% range seems feasible, ceteris paribus.

Impact on BoP and INR

FPI inflows into debt are expected to increase with India's inclusion in the JP Morgan GBI-EM index. Positive sentiments around the index inclusion could lead to some inflows in the remainder of FY23. With current account deficit (CAD) expected in the range of 1.5-1.6% of GDP, these flows will help to augment India's BoP surplus.

However, actual inflows are expected only post Jun'24, when the bonds are formally included in the index. We expect inflows of US$ 20-30bn in FY24. These will be crucial as India's CAD in FY25 is expected to reach~2% of GDP, amidst a pickup in global and domestic growth and higher commodity prices. In such a scenario, index-related inflows will help in funding the higher CAD and buildup foreign exchange reserves. This will require more rigorous monitoring and intervention by the RBI, suggesting that some of the forex reserves accumulated due to index-related inflows will be required to keep the currency range-bound.

We expect USD/INR in the range of 82-84/$ in FY25.

Impact on Liquidity

Pressure on liquidity is likely to persist in the near term. Currently, the gap between incremental credit and deposit is still around Rs 0.2 lakh crore. Apart from this, the drag would also come from higher pace of increase in currency in circulation (CIC). Historically, as well CIC picks up pace in H2. The actual comfort on liquidity would come in the medium term, post FY25. However, it remains crucial how RBI balances the same. OMO sales might be on the cards, if the inflows actual matches the desired expectation of US$ 20-30bn. Apart from this, for daily management, the frequency of higher tenor reverse repos might be increased.

What are the challenges?

The inclusion of India in global bond index will definitely be productive in terms of increasing domestic liquidity but it also comes at a cost of macro prudential risk. While higher foreign inflows are ceteris paribus positive for currency and bond markets, there are some caveats which need to be considered.

FPI flows tend to be volatile and are highly dependent on exogenous factors. In case of any adverse external shock, investors tend to move away from riskier EM assets which can lead to a capital flight. This will leave India's financial markets prone to heightened volatility. Both bond markets and the domestic currency will be impacted. Historically, there have been a few instances when capital outflows have resulted in a rapid depreciation in the rupee. Hence, inclusion in the index entails that we become susceptible to higher financial sector volatility. This would require robust monitoring and intervention by the RBI. As such, RBI will have its task cut out to ensure stability in the financial markets and prevent spillovers from financial markets in the real economy.

In conclusion

- On the whole the inclusion of India in the bond indices is a positive development.
- Once JP Morgan has included India in its indices, others like Bloomberg, Barclays etc, will follow. This is plain market logic.
- Funds will also gauge relationships between components of the index and trade separately in them thus increasing the volume of demand.
- Inclusion means more dollars coming in which is good for balance of payments.
- More dollars means there is greater FPI participation in the bond market which will lessen pressure on domestic institutions.
- As a corollary, there will be more to lend to companies at a time when investment cycle picks up.
- Bond yields should ideally soften as demand for paper rises. But this will be contingent on the interest rate regime as well as the overall borrowing programme of the government – centre and states. Hence softening cannot be taken for granted, though is a distinct possibility.
- While it will be good times for the country and economy, we must be cognizant that any withdrawal due to global factors not related to India can lead to volatility in the market.
- The RBI will need to be on double vigil all the time.

The CD market in FY24

To augment funds, banks have relied on alternative sources, one of which is through issuance of **Certificate of Deposits or CDs**. In recent times, there was a strong revival in credit demand, with credit growth registering double-digit growth. A revival in industrial activity along with government's capex push have contributed to an increase in credit. Retail credit also has been growing at a steady rate. However, there has not been a commensurate increase in deposit growth notwithstanding the increase witnessed due to the exchange of Rs 2000 notes. As a result, banks had to increase their reliance on other sources of funds to meet the growing credit demand. In this study, we are looking at the trends in CD issuances in FYTD24 (upto Aug'23). We also attempt to calculate the imputed yield on CDs that the banks are paying.

It can be seen that CD issuances increased steadily from Rs. 25,813 crore in Apr'23 to a high of Rs. 72,785 crores in Jun'23. Thereafter, there was some moderation in Jul'23. It is to be noted that liquidity in the system remained in surplus mode at above Rs 1 lakh crores in Jul'23. In Aug'23, with RBI mandating banks to maintain an incremental CRR of 10% of NDTL, and the resulting squeeze on liquidity, CD issuances once again increased and rose to Rs. 57,170 crore. In FYTD24 (till Aug'23), CD issuances stand at Rs. 2.62 lakh crores, higher compared with Rs. 2.5 lakh crores in the same period last year. With the upcoming festive season and tax outflows this trend is likely to continue in the near future.

In FYTD24, public sector banks (PSBs) were the major borrowers through the CD route. In fact, PSBs accounted for over 65% of all CD issuances in this period. Compared with last year, CD issuances by PSBs are ~30% higher on a YoY basis. PSBs, such as Canara Bank, Punjab National Bank, Bank of Baroda and Indian Bank account for 52% of the CD issuances this year. Private Banks (PVBs) accounted for another 26% of total CD issuances this year. On a YoY basis, CD issuances by PVBs is however lower by 25% when compared with the same period last year. Major borrowers within PVBs are Axis Bank and IDFC First Bank with a large share in total CD issuances in FYTD24. This is followed by ICICI Bank.

In terms of maturity pattern, there is a clear preference for shorter term CDs. A majority of CD issuances have maturity period of less than 4 months. In fact, out of the total issuances of Rs. 2.62 lakh crores in FYTD24, the share of CDs with maturity period below 4-months was 72.5%. CDs with maturity of between 11-12months accounted for 13.4% of total issuances in FYTD24. However, over the last few months, issuances under this tenure have seen a sharp dip.

We also calculated the imputed cost to the banks on an annualized basis across different tenures. It is interesting to note the movement in CD rates across tenors. In Aug'23, CD rates have moved higher compared with Jul'23, due to higher issuances. The steepest increase in CD rates in Aug'23 was seen in CDs maturing in 4-5-months.

It is interesting to note that CD rates have been higher across all tenures when compared with the Weighted Average Domestic Term Lending Rates (WADTDR) on both outstanding as well as fresh term deposits in each of the respective months. Even so, banks have preferred raising funds through CDs rather than fixed term deposits. The main reason is that banks have been able to raise large amounts to meet business requirements at one point of time rather than wait to gather bulk or retail deposits.

To conclude, it can be said that CDs have been a very useful source of funds for banks. The market has been used more by PSBs relative to private banks. The cost of CDs has been higher than that on term deposits with the margin being as high as 100 bps in April though it has come down to 68 bps by July. Tenures tend to be shorter with less than 4 months being preferred which ensures that banks don't get locked in at higher rates for long tenures.

Corporate employment in FY23

One way of looking at organized employment in the country is the total headcount in the corporate sector. Data is based on annual reports of companies where it is mandatory to publish the number every year. This study puts together data on 1,601 companies which had sales of around Rs 97 lakh crore in FY23. The progress in headcount has been tracked over the last 4 years. The numbers would tend to be distorted as there was considerable distress during the lockdown time in FY21. Hence growth rates would look better in FY22 and FY23.

Our study shows that growth in employment was 5.5% in FY23 on top of growth of 6.7% in FY22. However, in FY21, growth was virtually flat while in FY20 there was an increase of 2.1%. On a cumulative basis, the growth for the 4 year period FY19-FY23 was 3.6%, which is still below the potential that goes with an economy growing at 6.5-7% per annum. For this, 4-years period GDP growth averaged 3.6%. But a recovery is definitely apparent post Covid-19 and the lockdown.

Total headcount for FY23 was at 67.42 lakhs and increased from 63.89 lakhs in FY22. In terms of overall share in employment, the top 10 sectors accounted for around ¾ of the total. This was driven by IT (24.4%), banking (18.3%), healthcare (6.9%), textiles (5.5%) and finance (5.1%) which together have share of 60%. The next five are auto, mining, iron and steel, insurance and agri.

Some interesting observations are the following:

- CAGR growth was 3.6% for the entire sample companies.
    - 16 of the 36 sectors had positive CAGR which means that the majority of industries are still to get back to the pre-covid situation.
    - Within these 16 sectors 6 registered CAGR of above sample average. These are banks, IT, finance, retail, infrastructure and the miscellaneous group.

- When FY23 is compared with FY22, the following points emerge:
    - Overall growth was 5.5%.
    - Only 9 sectors witnessed negative growth meaning thereby that most sectors have recovered in terms of adding to headcount.
    - The leaders in the pack include banks, finance, IT, retail, hospitality, media, diamonds and jewellery, insurance, telecom, trading and miscellaneous group of companies.
    - In FY23 there was a net increase in headcount by 3.53 lakhs across all 36 sectors. There was an increase of 3.96 lakhs in 27 sectors and decline of 0.43 lakhs in the other 9 sectors. Interestingly 75% of the increase (of the 3.96 lakhs) was from three sectors, i.e. banking, finance and IT. There were 5 sectors which added over 10,000 in employment count which are: hospitality, media, insurance, healthcare and the miscellaneous group. The miscellaneous group is driven mainly by one company in the security, logistics etc. space.

   - Textiles and mining saw sharp declines in their employment in FY234 and accounted for nearly 68% of the overall decline in headcount in the remaining 9 sectors. Again, 8 out of the 9 set barring realty are in the manufacturing sector.

Hence, the picture is quite mixed with some sectors doing very well on adding to employment, while the others have lagged.

The commonality which comes out is that the main drivers of employment have been industries in the services sector. The manufacturing sector has not been a lead runner here in terms of adding to the employment level in the corporate sector.

How has compensation moved?

Another aspect of employment is the remuneration for those who are working. Here, what has been done is that the average salary per employee is worked out based on the data on salaries and wages provided in the Profit and loss account. These numbers would be largely indicative of the pay structures across industries and the increase witnessed in FY23. The amount on salaries and wages given in the accounts would include not just salaries but also benefits as defined by the company and hence would tend to be on the higher side relative to what is actually received by employees. Also as the head count is taken to be as of March-end, given that there are attritions as well as new employees joining, there would be some differences across companies. But it can be assumed that these even out across companies and sectors.

Points that stand out are:

- Average compensation increased by 10.1% from Rs 11.32 lakhs in FY22 to Rs 12.47 lakhs in FY23.
- 21 sectors had compensation of over Rs 10 lakhs. Three had above Rs 20 lakhs and include industrial gases, insurance and crude oil. The next set between Rs 15-20 lakhs are: power, gas transmission, IT, alcohol, telecom, capital goods, durables, ship building and iron and steel. As can be seen from the earlier table most of these industries were not the ones which were adding significantly to their employment levels.
- The lowest average compensation was in mining, followed by textiles and agriculture based industries. These three industries are labour intensive and do have a high share of blue collared workers where the salaries are at a lower level.
- Hospitality, retailing and finance along with healthcare were some major contributors to employment but have had lower average compensation per employee compared with the other sectors. Here too there has been high hiring at the lower levels covering sales in particular which does not offer high salaries as the qualification required tends to be more modest.

Concluding observations

- There has been improvement in growth in employment in FY23 even though it was lower than that in FY22. Only 9 sectors witnessed negative growth on a y-o-y basis.

- However over a 4 year period starting pre-pandemic, only 16 of the 36 sectors witnessed positive growth. CAGR growth in employment was broadly the same as the growth in GDP for this period which was 3.6%.
- Services sectors like IT, banking, retail and finance led in terms of increase in employment. Infrastructure from the non-services side also did well.
- Growth in average compensation at around 10% in FY23 covers well the inflation impact.
- 21 sectors had double digit average compensation which is impressive. Textiles, mining and agri however had the lowest average compensation in the entire set of industries.
- It may be expected that with the economy recovering in FY24 and some private investment taking off, there would further traction in employment.

How serious a threat are mutual funds to bank deposits

Mutual funds have an inherent advantage when it comes to investing as they offer a variety of products depending on the preferences of the investors. Hence there are equity schemes besides conventional debt options. For those who are less conservative, there are hybrid schemes; while index funds and ETFs provide more aggressive avenues for putting funds for investment. However, all of these investments carry a certain degree of risk as they are market oriented, and to that extent are less predictable.

Bank deposits have the advantage of being safe and offer conservative but assured returns. In the period of the pandemic when interest rates were lowered significantly by the RBI which caused deposits rates to come down, investors – both retail and corporates, put more funds in the mutual funds schemes. This has led to a remarkable increase in the AUM (assets under management) of mutual funds. While banks still dominate the financial landscape, the growing share of mutual funds cannot be ignored.

For August 2023, y-o-y growth for bank deposits was 12.3% (excluding HDFC merger) while that for mutual funds was 18.6%.

How has the share of mutual funds in sum of AUM of mutual funds and deposits with banks moved?

Taking 2019-20 as the base year after which there was a sea change in the financial landscape with rates being kept at an all-time low, there was a sharp increase in growth in AUM of mutual funds in the next three years. There was a CAGR of 24.8% from Rs 20.26 lakh crore to Rs 39.42 lakh crore in this period. In case of bank deposits growth was just 10% from Rs 135.67 crore in FY20 to Rs 180.44 lakh crore in FY23.

The share of mutual funds is now close to 20% against 13% before the pandemic set in. Clearly there has been a shift in the investor preference to mutual funds and the returns can be considered to be the foremost consideration. The Sensex had moved from almost 30,000 in March 2020 to 58,992 in March 2023 with a CAGR of almost 26% per annum. As of August the Sensex was at 64,831. Debt instruments especially in corporate bonds give higher return than bank deposits and also carried advantage on taxation on long term capital-gains.

What is the picture in FY24 so far?

We looked at various categories of investments in mutual funds for August 2023 over August 2022. During this period the growth in bank deposits was 12.3%.

Interestingly the highest growth rates in mutual fund schemes was in equity and 'others' category. This is indicative of higher risk taking appetite of investors who have preferred to invest in growth oriented schemes as well as indices and ETFs in anticipation of higher returns especially at a time when inflation has been high. Cumulative inflation has been 18.3% in the three years ending 2022-23. Growth in AUM under debt was the lowest at 7.4% this year so far.

There has also been hence a shift within mutual funds across different schemes which comes out in the chart below. Debt or income schemes have lost a bit of momentum which may be attributed partly to the fact that banks have also started increasing deposit rates thus lowering the difference in yields. Another factor militating against these schemes has been the government's decision to remove the long term indexation benefit for debt schemes which hence removes the tax advantage which was hitherto there.

The decline in share of debt and income schemes in AUM was shared by equity schemes and the 'others' category.

Concluding remarks

With time there has definitely been a change in the composition of funds channelled to deposits and mutual funds. The pandemic can be considered to be a turning point where under the force of circumstances, investors took more risk via the mutual funds route. And with the markets being supportive as the economy has only been showing signs of recovery along with the India Growth story spreading, the returns have been impressive. In this environment preference for market oriented savings avenues has increased.

The question of state debt

An issue that has been irking policy makers is the rising level of state debt. In FY23, based on the budgeted numbers, total liabilities of all states put together was projected at 29.5% of GDP. In FY21 it had peaked at 31.1% (RBI). Hence there has been some improvement. However, this level is still a long distance away from the 20% mark which has been proposed under the revised FRBM. In this context, it would be interesting to see how states have positioned their debt levels for FY24. Information available was for 27 states, from the data analysed by PRS Legislative Research.

We note relationship between debt to GSDP levels of various states against the fiscal deficit ratios. The two are inter related as the fiscal deficit in any time period adds to the level of borrowing as well as the outstanding debt of the entity. Therefore, typically as states run higher fiscal deficits, the level of outstanding debt also increases (after adjusting for repayments). For FY24, the coefficient of correlation between the two for 27 states was high at 0.74. This means that states with higher fiscal deficit ratios also tend to have higher debt/GDP ratios which sounds logical.

Some of the state-wise observations include:

- There are only 3 states which have a debt-GSDP ratio of less than 20%. Hence when the country is aiming to bring down the aggregate ratio to 20% intuitively it can be seen that this will take a lot of time. Odisha, Gujarat and Maharashtra are the prime performers here.

- There are another 4 states, Karnataka, Telangana, Assam and Chhattisgarh which are at a level of less than 25%, while 5 others, Tamil Nadu, Haryana, Jharkhand, Uttarakhand and MP have ratios between 25-30%.
- The balance 15 states have ratios above 30% and would need very strict fiscal monitoring to bring down the debt levels. This would require both lower fiscal deficits as well as higher growth in GSDP.
- 4 states have levels which raise a red flag: Manipur, Nagaland, Punjab and Arunachal Pradesh. Of these Punjab has the highest size of the budget.
- On the side of fiscal deficit, 11 have targeted ratios of up to 3% which indicates that they are confident of their finances and are also within control of their future debt levels. Gujarat has the lowest at 1.8% and Maharashtra follows with 2.5%.
- 3 states have fiscal deficit of 5% and above. These are Punjab, Manipur and Arunachal. If this is juxtaposed with the debt ratios, it can be said that these states will have a challenging time in reducing their debt as they are still to rein in their deficits.
- There are 3 states that have fiscal deficit ratio of between 4-5.5% and include Goa, Himachal and Sikkim. The balance 10 have ratios between 3-4% (Rajasthan and MP are at 4%), where it may be assumed that the additional space linked with reforms as laid down by the centre are being implemented.

While debt levels are the ones that are monitored on a regular basis, the contingency liabilities of government are also important. State run utilities especially in the areas of power, transport and irrigation are the ones relevant here. These units tend to subsidize their consumers in conjunction with the government and run high debt levels that are in turn guaranteed by the government. These would be only contingency liabilities of the state as the entities are independent companies which borrow money.

Information for 21 states pertaining to outstanding guarantees-GDP for the latest period (FY21, FY22 or FY23) was analysed. It results showed that the states of Andhra and Telangana have been most aggressive here and post the carving of two states have dealt actively outside the Budget. UP, Tamil Nadu, Rajasthan and Kerala also have high levels of guarantees with concentration in the power sector (UDAY has been partly successful in migrating contingent liabilities on to the books of the state). Punjab, Mizoram, Sikkim are other states that have given high levels of guarantees to their commercial entities.

This is another aspect of debt that has to be monitored because while the probability of invocation of guarantees is low, it pressurizes the states nonetheless and is not looked upon positively in the context of fiscal prudence.

Impact of high debt

The rising debt levels put pressure on the state finances in terms of servicing commitments. As debt increases so does the interest outgo, which in turn puts pressure on the revenue account as a larger part of the revenue receipts are used to pay interest which means that less is left for other purposes. The interest to revenue receipts ratio (debt servicing ratio) is provided for the 27 states.

There is significant variation in this ratio across states from 22.2% in case of Punjab to 3.4% for Manipur (which also has high debt ratios). The median for this set is 10% for Madhya Pradesh. Here, interestingly the smaller states have low debt servicing ratios compared to the larger ones. Punjab, TN, West Bengal have ratios of above 20% while Haryana and Kerala are almost at 20%. Clearly, the larger states are more pressurized than the smaller states in this context.

Putting all the pieces together

Odisha is probably the best placed state when it comes to debt. The debt to GDP ratio is the lowest and there are low contingent liabilities. The fiscal deficit too has been within the FRBM norms and the debt servicing ratio very low. This is a position of both comfort and strength.

Gujarat and Maharashtra have ideal debt ratios with the fiscal deficit being reined below the 3% mark. Gujarat has lower guarantee ratio compared with Maharashtra which is also at a low level of 1.3%. The debt servicing ratios, though above the median level, are manageable.

Punjab is probably the one state that is pressurized on all scores - debt ratio, fiscal deficit, guarantees and debt servicing. Manipur and Arunachal have high debt ratios but are comfortable with the servicing aspect. Himachal Pradesh is however more vulnerable as the debt servicing ratio is high. Andhra Pradesh and Telangana have the highest guarantee levels which stands out more for the former where the debt levels are also high. This has kept the debt servicing ratio at 14%. West Bengal too has been working with high debt levels which has pushed up the debt servicing ratio. Tamil Nadu on the other hand has debt levels of around 26% which is more reasonable but has a high servicing commitment. This goes along with high levels of guarantees.

There is definitely need for reforms at the level of state finances. To begin with the guarantee system needs to be relooked at again as such assurances do keep entities less responsible for their business. Second, the fiscal deficit ratio of 3% has to be maintained with greater firmness as the present dispensation of allowances being given for various purposes has tended to also put burden on debt levels and debt servicing. Ideally, the debt to GDP ratio should also be pegged to 25% as a short term goal and the interest to revenue receipts ratio targeted at around 15%. This can be a good beginning with roadmaps drawn up for various states.

Data Releases

Currency outlook: Rupee continues to be better placed on global scale

The rising price of crude has become a worry once again and the immediate impact is being felt on the rupee which has been under pressure in the last few sessions. The recent BoP numbers for Q1 indicate that the forex situation was steady; but amidst rising crude price meaning thereby higher imports and trade deficit there can be pressure on CAD. FPIs have also turned negative of late and hence, there may have to be more adjustment on the currency front. Add to this, the global factor where the dollar is strengthening and there can be some volatility in the rupee. Fed's stance on rates and indication of another hike as well as the fact that the USA is not doing too badly has made the dollar stronger. In fact, instead of a deceleration that was expected there has been steady acceleration. Strong U.S. economic data has continuously defied investor expectations for a slowdown. Going forward, crude oil price is probably the critical factor that can affect our fundamentals. Trade deficit will tend to widen as prices go up. However, given the state of capital account, there could be smaller accretions to our reserves on the whole, and hence stability in currency may be expected and a range of $ 82.75-83.50 will prevail in the coming weeks.

Bond Market Round-up

Global yields witnessed quite a bit off sell off both in Sep'23 and in Oct'23 (till 3 Oct 2023). This was led by sharp increase in US 10Y yield which rose to its level seen last in 2007. Tighter labour market conditions, uncertainty over the trajectory of inflation and mixed signalling on demand front, all contributed towards expectation of a tightening policy response from Fed. India's 10Y yield has still been immune to that increase compared to its major peers. The positive news from inclusion in the JP Morgan Bond Index and stable demand from PSBs and mutual fund have arrested its increase. Going forward we expect however some pressure on India's yield to persist. It is expected to trade in the range of 7.15-7.25% in the current month. The upward bias exists as there is fair degree of correlation between the movement of India and US 10Y yield. Liquidity is also expected to be in deficit in the current month in the range of 0.1-0.3% of NDTL. RBI's tools will also lend support.

India's Balance of Payments for Q1FY24

On expected lines, India's current account deficit for the first quarter of FY24 came in at 1.1% of GDP as against 2.1% last year. In absolute terms the deficit was almost half of that last year at $ 9.2bn ($ 17.9bn in Q1FY23). The improvement in CAD was mainly due to a lower trade deficit of $ 56.6bn as against $ 63bn last year. This improvement was mainly due to the declining commodity prices globally which continued in this financial year. This will change track given the recent increase in crude oil prices which has been above $ 90/bbl in Sep'23 and is nearing $100/bbl in the coming days.

The invisibles account remained steady at $ 47.3 bn ($ 45.1 bn last year). The contribution of software services was significant at $ 33.9bn ($ 30.7bn last year). This is a positive sign which has been helped by the fact that the US economy has done much better than expected which has kept demand for such services buoyant. Remittances remained flat at $ 22.9bn.

On the capital account side differing trends were witnessed across components. FDI was lower in net terms at just $ 5.1bn ($ 13.4bn). FDI to India declined by almost $ 9bn this quarter. FPI in net terms were high at $ 15.7bn compared with an outflow of $ 14.6bn last year. Loans in net terms were lower at $ 2.2bn. ECBs were high at $ 5.7bn while short term loans fell by $ 5bn.

Going ahead we need to watch for the following: 1) Trade deficit will be pressurized by higher oil prices; 2) FPIs have been volatile and negative this month. Their future course will drive the capital account; 3) ECBs may be less attractive given the higher interest rates in USA; 4) FDI should hopefully pick up in the next three quarters as they have been major supports for the BOP. We expect CAD to be in the region of 1.5-1.8% of GDP for the year, but will hinge a lot on the oil economics).

Fiscal update

Centre's revenue position in FYTD24 (Apr-Aug'23) improved significantly as its net revenue rose by 24.1%, from 0.7% increase till Jul'23. Gross tax collections have shown the most improvement with receipts rising by 16.5% from 2.8%. This was on account of steady jump in direct tax collections (26.6% versus -1.1%) and sustained pick up in indirect tax collections (7.8% versus 6.9%). On the spending front, overall expenditure growth slowed to 20.3% from 22.5% as of Jul'23. This was due to moderation in both revenue spending (14.1% versus 15.9%) and capex (48.1% versus 52%).

CPI inflation

CPI inflation came in at 6.8% in Aug'23 (YoY basis) broadly in line with our estimate of 6.9% and far lower compared to 7.4% print observed in Jul'23. The likely comfort came in from 157bps drop in food inflation which moderated to 9.9% from 11.5% in Jul'23. Amongst broad categories, 5 out of 12 of them noticed moderation in inflation. Amongst them, vegetable inflation edged down significantly to 26.1% in Aug'23 from 37.4% in Jul'23. Government supply side initiatives such as subsidizing sale of those vegetables whose prices were increasing, target release of stocks and imposing export duties have actually resulted in controlling food inflation of these items to a certain extent. Other than vegetables, cereals (-118bps fall), milk (-61bps) and pulses (-29bps) have witnessed fair degree of moderation in inflation.

Core CPI (excl. food and fuel) moderated to 4.8%. All sub-components of core noticed a drop in inflation in Aug'23. Amongst them, considerable impact was visible for demand side components such as personal care and effects (-78bps, YoY drop), and household goods and services (-45bps). Drop in international gold prices (-1.7%, on sequential basis) also contributed towards this decline. It can be said that the impact of past transmission of higher rate is shaping up, and is resulting in softening demand conditions. Even inflation in clothing, footwear, recreation, amusement and education have edged down.

CPI in Sep'23 is showing impact of contained food prices especially vegetable prices. Even the Sep'23 high frequency price data has been on a downtrend. 16 out of 20 commodities tracked by us are showing reduced pace of sequential increase in prices. Notably, prices of tomatoes had fallen by 48% in Sep'23 (till 11 Sep'23). Our in house BoB-ECI had fallen by 1.7% on a sequential basis and was running at a slower pace of at 3% on YoY basis. According to our forecasts, Q3 and Q4 headline CPI print seems to remain well anchored to the 6% target band.

Upside risks do persist from erratic monsoon which is already reflected in the sowing data, where pulses and oilseeds amongst major food crops pose concerns. Oil is also playing a spoilt sport. Compared to previous Monetary Policy Report projections of US$ 85/bbl, crude has firmed up considerably to ~US$ 90/bbl on account of production cuts and export curtailment. However, the pass through to domestic retail prices is unlikely as per our assumption.

WPI inflation

Headline WPI came in line with our expectations in Sep'23. It was down by (-) 0.5% versus our estimate of (-) 0.5% and (-) 1.4% in Jul'23, to reach its highest point since Mar'23. Food inflation rose, but at a slower pace again (5.6% in Aug'23 versus 7.7% in Jul'23). Within food, moderation in inflation was visible in case of vegetables, milk, food grains, and deflation in fruits accelerated. However, within vegetables, prices of tomato and onion, continue inch up. Price growth in cereals eased, led by wheat. On the other hand, paddy, pulses and spices, continue to put upward pressure on inflation. On the international level also, as indicated by World Bank's pink sheet, paddy prices have risen by 44.7% in Aug'23 following 28% increase in Jul'23, while wheat prices have fallen at a faster pace.

Deflation in fuel and power inflation has begun to slow as it fell by (-) 6% in Aug'23 from (-) 12.8% in Jul'23. This was on account of slowdown in deflation in mineral oil index (-9.6% versus -19.6% in Jul'23. Electricity index fell by (-) 0.1% from 0.1% gain in Jul'23, while coal prices eased to 2.5% from 5.1% in Jul'23. Within mineral oils, apart from LPG and lube oils, all other sub-indices posted an increase in Aug'23 compared from last month. In case of bitumen and furnace oil, price index came out of deflation and posted 1% and 10% increase in Aug'23, respectively. Build-up of price pressure could also be noted in case of ATF, Kerosene, Naphtha and Petrol. The movement is broadly in line with international crude prices which jumped from US$ 80/bbl in Jul'23 to US$ 85/bbl in Aug'23. Even on YoY basis, decline in oil prices was only (-) 13% in Aug'23 compared with (-) 24% decline recorded in Jul'23. Oil prices continue to exert pressure in Sep'23 (so far) as they have risen to US$ 91/bbl. if prices to continue to inch up, it will have a significant on headline WPI in the coming months.

Core inflation remains in deflation for the 6th consecutive month in Aug'23 as it fell to (-) 2.1% from (-) 2.2% in Jul'23. Manufactured products inflation also fell by (-) 2.4% in Aug'23 following (-) 2.5% decline in Jul'23. Of the 22 commodity sub-indices, 10 indices rose at a faster pace in Aug'23 than Jul'23 led by, basis metals, leather, tobacco, textiles and motor vehicles. Within basic metals, price index for copper (5.8% versus 5.2%) and lead (2.6% versus 1.7%) inched up in Aug'23, while that of zinc (-9.9% versus -7.8%) and aluminium (-3.5% versus -2.1%) continued to decline. On an international level, as reflected in World Bank's pink sheet, prices of copper (4.6% versus 12.4%) and lead (3.9% versus 6.2%) increased, but at a slower pace. on the other hand, prices of aluminium (-12.1% versus -10.3%) and zinc (-32.9% versus -22.6%) fell even more.

Growth in Industrial Production accelerates

IIP growth expanded to a 5-month high to 5.7% in Jul'23, above our expectations (5%) and compared with a growth of 3.8% in Jun'23. This was largely led by broad based improvement across all sectors. Growth in manufacturing and electricity sector expanded to 10.7% and 8% against a growth of 7.6% and 4.2% respectively in Jun'23. Output of manufacturing moved up to 4.6% in Jul'23 against a growth of 3.1% in Jun'23. Amongst manufacturing sectors, at least 15 out of 23 subdivisions have registered higher growth in Jul'23. Manufacture of pharma (12% versus 4.1% in Jun'23), motor vehicles (8.9% versus 7.6%), other non-metallic minerals (6.5%

versus 4.9%) and coke and petroleum products (4.2% versus 3.2%) recorded highest improvement. Slower pace of contraction was registered in manufacture of food products (5.2% versus -3.0%), computer, electronic (-16.8% versus -32.3%) and wearing apparel (-22.5% versus -23.3%) amongst others.

Within use-based, barring intermediate and infra goods output, other sectors registered much higher growth in Jul'23. Growth in primary goods jumped up to 7.6% against a growth of 5.3% in Jun'23. Even capital goods output doubled in Jul'23 at 4.6% against 2% in Jun'23. Consumer durable output declined albeit at a slower pace to (-) 2.7% compared with (-) 6.7% in Jun'23. FMCG output rose to 7.4% in Jul'23 after easing down to 0.3% growth in Jun'23. However, moderation in output of intermediate and infra goods was noticed with growth decelerating to 1.9% (4.6% in Jun'23) and 11.4% (12.9% in Jun'23) respectively in Jul'23.

Going ahead, domestic demand continues to showcase a mixed picture with strong GST collections, manufacturing PMI and steady credit growth. However, erratic South-West Monsoon might have some impact on inflation and on rural demand, thereby requires careful monitoring. Uneven distribution of rainfall along with lower reservoir levels might impinge on the overall output levels and even impinge on Rabi sowing. Slower export demand due to weaker global demand economic also remains watchful.

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