

Economic Round-up: June 2023

Continued slowdown in global manufacturing activity in Jun'23 (at 6-month low of 48.8) and drop business optimism index to 7-month low, has reignited fears of global growth slowdown. Activity in China is losing momentum (PMIs, industrial production, retail sales), which is impacting Europe the most. In case of US, there are mixed signals. While manufacturing activity and consumer spending is getting impacted, real estate sector is seeing some revival and labour market still remains relatively tight. More cues on Fed's future rate action are awaited from the release of Fed minutes later this week. On the domestic front, after a delayed start, South-West monsoon has picked up pace and registered below normal rainfall at only 13% (below LPA) till 29 Jun 2023. This has resulted in overall improvement in sown area (+0.4% YoY as of 30th Jun). RBI in its Jun'23 policy kept the rates on hold as inflation has begun to come down. Our in-house BoB ECI index is showing that CPI will settle between 4-4.3% in Jun'23. We expect RBI to cut rates only in Q4FY24.

Global growth: Growth engines across regions seem to be losing steam with manufacturing activity faltering. Significant decline is noted in Europe and US. In case of Europe, both UK and Germany are facing headwinds as elevated prices are denting consumer demand and slowdown in China is hurting export of goods. Germany's Ifo business sentiment signals that GDP might contract in Q2. In China, following partial recovery made at the beginning of the year (supported by pent up demand and Lunar New Year celebrations), now weakness in activity has returned. While manufacturing activity is contracting (official PMI), non-manufacturing PMI has come down in Jun'23. More government is widely expected to stimulate growth.

Global Central Banks: In view of stickiness in inflation in UK, BoE is expected to hike rates at least 2 more times after delivering a surprise 50bps hike in Jun'23. ECB officials have also maintained that underlying inflationary trends are showing that the Central Bank will have to keep hiking rates this year and cuts can only begin in late CY24. US Fed paused in Jun'23 for the first time in 15-months, but signalled that this is not the end of the rate hike cycle. Fed Chair Powell has hinted at 2 more rate hikes this year, however, in view of recent economic print market participants are expecting Fed to pause after hiking for the final time in Jul'23.

Key macro data releases: India's **current account deficit (CAD)** increased to US\$ 67.1bn in FY23 from US\$ 38.7bn in FY22. This translates into a CAD of -2% of GDP in FY23 versus -1.2% of GDP in FY22. Trade deficit increased to a record high of US\$ 265.3bn in FY23 (7.8% of GDP) from US\$ 189.5bn in FY22 (6% of GDP).

On the Fiscal front, Centre's fiscal position in FYTD24 (Apr-May'23) seems be on track with its net revenue rising by 15.7%, following (-) 13.9% decline in Apr'23. Pace of contraction in direct tax collections has slowed, while that of indirect tax collections has improved. Overall expenditure of the government is however off to a slow start, mainly on account of dip in revenue spending, while capex on the other hand picked up pace.

On the industrial production side, Core sector output rose by 4.3% in May'23, which is impressive considering 19.3% growth last year. Continued traction in cement and steel (attributed to government spending) helped.

CPI inflation dropped to its lowest since Apr'21 to 4.3% from 4.7% in Apr'23, on the back of an elevated base, and dip in food inflation (2.9% in May'23 from 3.8% in Apr'23). Core CPI (excl. food and fuel) also came down, to 5.1% from 5.2% in Apr'23.

Global developments

Growth engines losing steam?

US economy is showing signs of moderation with manufacturing activity continuing to contract, consumer spending slowing, and surge in unemployment rate. US manufacturing ISM index fell further in Jun'23 to 46.0 from 46.9 in May'23, dragged by dip in production, employment, inventories and new export orders. Drop in price index in the ISM survey result was more of a relief. This was in line with the trend visible in Fed's closely tracked PCE index as well. Core PCE (ex-energy and food) prices rose by 0.3% in May'23 (MoM), easing from 0.4% gain in Apr'23. Even in YoY terms, prices were up by 4.6% in May'23 versus 4.7% in Apr'23. PCE (proxy for consumer spending) showed only 0.1% increase in May'23 following 0.4% increase in Apr'23. Retail sales growth in May'23 also moderated to 0.3% from 0.4% in Apr'23. Retail sales ex-motor vehicle & parts slowed more sharply (0.1% versus 0.4%). Labour market is also beginning to cool down with unemployment rate accelerating to 3.7% (7-month high) in May'23 from 53-year low of 3.4% in Apr'23. However, weekly initial jobless claims data is showing reversal in this trend. Jobless claims after rising at the beginning of Jun'23, fell again in the week ending 24 Jun, by 26k to reach 239k. The 4-week moving average still increased, by mere 1500, to ~258k (highest since 13 Nov'21). Housing starts in May'23 had hit a 13-month high of 1.63mn (1.8mn in Apr'22), led by single-family homebuilding projects. Possibility of Fed's less aggressive stance on rates is lifting the sentiment in the real estate market. However, sustainability of this trend will be key in determining whether real estate sector can offset losses in other sectors and avoid US from entering a recession (64% probability to enter a recession in the next 12 months).

Eurozone's (EZ) latest manufacturing PMI prints for Jun'23 show that economic momentum remains weak. EZ's PMI slipped to 37-month low of 43.4 in Jun'23 from 44.8 in May'23, dragged by fall in sales in Austria, Germany, and Italy. The decline was seen across board-consumer, investment, and intermediate goods. EZ's largest economy, Germany's PMI was also down to near 3-year low of 40.6 from 43.2 in May'23. Weaker than anticipated recovery in China is hampering demand for Eurozone goods. Effects of this are also visible in second consecutive decline in Germany's Ifo business sentiment index. It fell from 91.5 in May'23 to 88.5 in Jun'23. Sub-indices for current situation and future expectations, both declined significantly, indicating higher probability of GDP contracting in QCY23. UK also reported further contraction in manufacturing activity in Jun'23 (46.5 versus 47.1 in May'23). This comes in the wake of stickiness seen in the CPI data (8.7% YoY in Apr'23 and May'23), which is expected to put pressure on BoE to continue hiking rates, thus in turn further weakening the economic momentum. A part of the reason for high inflation is 10% increase in national minimum wage announced in Apr'23. Even as nominal wages remain high, real wages are declining and is beginning to impact consumption. A survey by Confederation of British Industries (CBI) shows that retail sales volume is expected to decline by (-)2% in Jul'23 after increasing by 1% in Jun'23 (-18% in May'23). BoE has tight rope to walk on in managing inflation and growth.

Economic momentum is continuing to fade away in China, as visible in its production and consumption data. Official manufacturing PMI shows that activity of large manufacturing companies continues to contract in Jun'23, albeit at a slower pace (49 versus 48.8 in May'23). In case of more export-oriented companies, Caixin manufacturing PMI also softened (50.5 versus 50.9), owing to increasing deflationary pressures and weakening global demand. Government data shows that industrial production in May'23 eased to 3.5% from 5.6% in Apr'23. Retail sales growth moderated to 12.7% (est.: 13.1%) from 18.4% in Apr'23.

RBI

In line with our expectation, RBI decided to remain on hold, and unanimously decided to keep the repo rate unchanged at 6.5%. Subsequently, SDF rate remains at 6.25% and MSF and Bank rate at 6.75%. The Governor in his statement emphasized that “that headline inflation still remains above the target and being within the tolerance band is not enough. Our goal is to achieve the target of 4.0%, going forward”. This signals that RBI is still uncomfortable with above 5% inflation in FY24. Also, the Central Bank expects inflation to peak in Q3FY24, thus making the possibility of the rate cut in Q3 highly unlikely. We now expect a cut in Q4. The stance was also left unchanged with a vote of 5-1, sighting that liquidity still remains in surplus and demonetization of INR2000 notes will further add to this. Thus, RBI is focused on “withdrawal of accommodation”. For the current fiscal year (FY24), RBI further lowered its projection to 5.1% from 5.2% in Apr’23. This was largely on account of sharp downward revision to Q1FY24 forecast (4.6% versus 5.1% in Apr’23), and slight change to Q2 projection (5.2% versus 5.4%). Estimates for Q3 and Q4 were left unchanged.

Global central bank decisions

In line with market expectations, US Fed opted for a pause (a first in 15 months) in its Jun’23 policy meeting, thus keeping the key policy rate unchanged at 5-5.25%. However, Fed’s statement cautioned that inflation still remains stubbornly above its targeted 2% and to cool it further down, 2 more rate hikes might be necessary this year. Following this, median expectation showed that rates may peak at 5.6%. However, latest incoming macro data (PMI, consumer spending) suggests that economic activity is slowing and inflation is cooling down, thus 2 more rate hikes might not be warranted, and Fed may opt for a prolonged pause after hiking for the final time in its Jul’23 policy. More cues will be available when Fed releases its minutes later this week.

Defying market expectations, Bank of England (BoE) in its Jun’23 policy meeting decided to lift the key policy rate by 50bps (est.: +25bps) to 5% from 4.5% earlier. According to the Central Bank Governor, the steep hike was warranted in view of persistently high inflation (CPI at 8.7% in May’23) and continued strength of the labour market (increase in employment and nominal wage growth). Market participants are expecting BoE to hike rates till it reaches the peak rate of 6% in CY23. Recent commentary by other BoE officials has also hinted at reduced probability of rate cuts this year.

ECB in its Jun’23 meeting, raised its key policy rate by another 25bps to 3.5%, much in line with expectations. Despite faltering economic activity (PMIs, industrial production) and slight dip in inflation, the Central Bank continues to maintain a tight vigil on monetary policy conditions. ECB also revised its GDP projection for CY23 and CY24 downward to 0.9% (1% as per Mar’23 projection) and 1.5% (1.6% earlier), respectively. On the other hand, headline HICP inflation estimates for CY23 and CY24 were revised upwards to 5.4% (5.3% earlier) and 3% (2.9% earlier), respectively. Reading into the commentary of various ECB officials, analysts are expecting at least 2 more rate hikes by ECB, one in Jul’23 and the other in Sep’23, to push the policy rate to 4%. Expectations of rate cuts has been now pushed to late CY24.

Reserve Bank of Australia also raised its policy rate by 25bps in Jun’23, following a similar increase in May’23. This was done keeping in view elevated inflation print (7% in Q1CY23; 6.8% in Apr’23). However, as inflation dipped to 5.6% in May’23, the Central Bank in its Jul’23 policy left the rates unchanged at 4.1% (est.: 4.35%), maintaining that this is not the end of the rate hike cycle and that the bank has paused to “assess” the impact of hikes so far. Market participants expect policy rate to peak at 4.5% by the end of this year, before coming down to 4.3% by mid-next year and further to 3.9% by the end of CY24.

Special studies

Tomato-nomics

Tomato prices are again on a spiral. On sequential basis, the average retail price of tomato went up by 38.5% in Jun'23. On wholesale basis as well, tomato prices rose by 45.3% in the same period. Against this backdrop, we attempt to capture the underlying demand supply dynamics.

- The production data shows that tomato production have moderated by 0.4% from 20,694 ('000 MT) in 2021-22 to 20,621 ('000 MT) as per 1st Advance estimates of 2022-23. State wise data reveal that Madhya Pradesh, Karnataka, Andhra Pradesh, Gujarat and Odisha comprise 51.5% of total production of tomato. For States such as Gujarat, production has fallen by 23.9%, and for Tamil Nadu and Chhattisgarh drop in production is ~20%.
- The Rabi harvest season of tomato is Dec-Jun. Thus that crop might be impacted due to heat wave or erratic rainfall, hence there is a sudden upward blip in prices. But with the Jul-Nov arrival of crop, some easing of the trajectory might be seen.
- Analysing the tomato inflation series in CPI shows that unanticipated price shock has resulted in an upswing in vegetable inflation. Further, the tomato price spiral is visible in months such as Jun, Sep and Nov; hence there is a seasonal trend in tandem with the harvesting and arrival of the vegetable. The cycles of price increase are also short lived not exceeding 4-5months generally. Hence, what comes as a comfort in this case is that, the current upswing may soon see a reversal.
- As per Department of Consumer Affairs data, the average retail price of tomato in Jun'23 is at Rs 32.6/kg, whereas wholesale price is at Rs 24.9/kg. Thus the gap between the two prices in Jun'23 translates to Rs 7.7/kg; higher than the long-term gap of Rs 7.2/kg. Thus, with wholesale price increasing, there is a possibility that temporary spike in retail price will happen with ongoing pass through. However, this will be a short-term phenomenon as price correction to mean reverting level will happen soon, as seen in past periods.

Conclusion:

- The recent spike in tomato (weight: 0.57% in CPI and 0.28% in WPI basket) prices have created quite a bit of uncertainty surrounding the trajectory of food inflation. The supply side story is bit worrisome as well since 2022-23 has seen moderation in production. Especially, the major tomato producing States (Gujarat, Tamil Nadu and Chhattisgarh) have seen drop in production. Further erratic rains and heat wave might have impacted the Rabi harvest.
- However, historical data shows that the recent spike is more of a seasonal nature and is generally the case that happens in months such as Jun, Sep and Nov, in tandem with the harvesting and arrival of the vegetable. Even the gap between retail and wholesale price of tomato is above the long run level, and hence some correction to the mean reverting level is expected to happen.
- Our analysis suggests that the cycle of this unanticipated shocks are also short lived (4-5 months generally). Hence with Jul-Nov arrival of crop, correction in prices might be seen in H2FY24.

Household savings move towards markets

Household savings are a critical part of the growth process as they provide the funding required for the same. In FY22 they were 10.8% of GDP and had come down from 16% in FY21 as per RBI data. In FY20, that is before the pandemic struck, it was 12%. FY22 was the period when the repo rate was kept pegged at 4% as the position taken was to do everything to preserve growth. As deposit rates were low, there was a movement away to the market.

Savings flows were of the order of around Rs 25.6 lakh crore in FY22, having fallen from Rs 31.62 lakh crore in FY21. Bank deposits remained the largest component of household savings though have been volatile with Covid-19 and lockdown pushing it up in FY21 and the ultra-soft monetary policy subsequently bringing it down.

Shares of the savings avenues in total shows:

- Share of bank deposits is the highest, but clearly the structure of interest rates does drive the flows. It may be expected that some ground would have been regained in FY23 when banks started increasing deposit rates. In FY23 increase in aggregate deposits (includes households and other savers) was Rs 15.78 lakh crore which is comparable to Rs 15.54 lakh crore in FY21. Therefore, the share of bank deposits should be increasing.
- Covid-19 did lead to households pitching for life insurance and hence the share of this component has gone up and will remain in this range.
- Currency holding peaked in FY21 during the lockdown but has normalized subsequently.
- The significant change in the profile of savings was the sharp shift to investments which include both mutual funds and equity. While the increase in share of equity directly is not much from 1.2% to 1.9%, this is indicative of better risk taking ability of households over time. The market was also quite buoyant to justify this optimism. This will continue to be a destination favoured. Mutual funds also witnessed sharp rise in the savings with households preferring both debt and equity schemes.
- Share of small savings also increased smartly at the cost of bank deposits as returns were higher on these instruments.

From the savers' perspective, interest rate is probably the most important factor when deciding on the avenue for savings. When rates come down sharply there is a tendency to explore other options, including the markets. The WADTDR on fresh deposits ranged between 3.71%-4.12% in FY22 which was much lower than the average inflation of 5.5%. At the same time, Sensex gave a return of 18.3% in FY22 on top of 68% in FY21. As often investors look at past returns to invest in equity, it was but natural that resources were deployed in this market.

How has India Inc fared in terms of investment?

It is often blurry when we speak of the investment picture of Indian economy. Different data points reveal mixed picture. The CMIE data which speak of investment intentions in the economy showed record high new project announcements in FY23, of Rs 29 lakh crore. The MoSPI data on proposed investment which is a bit lagged series (till Jan'23) on the other hand portrayed a flattened investment curve since Sep'22. GFCF which is the fixed investment in assets to GDP ratio on the other hand improved to 29.2% in FY23 from 28.9% in FY22.

Taking the cue of GFCF in GDP, in this note, an attempt is made to capture the investment (fixed assets) angle from the balance sheet of corporates. We have analyzed balance sheet of 3,420 corporates and looked into the sum of fixed assets and capital work in progress. Further, we segregated it on the basis of ownership pattern and industry, to get a closer look at the level of concentration. A view held is that the PSUs tend to invest more because of the nudge from the government. An industry-wise analysis would reveal which are the sectors that have been investing more in capital. This is a forward looking indicator as GDP data does not provide us with this information or rather the information is lagged (till FY22 this information is available).

Our study shows that the CAGR-5Y period (FY18-FY23) in fixed asset creation of corporates stands at 4.9%, lower than 9.8% CAGR in nominal GDP. Further, the concentration ratio is skewed towards only a handful of industries due to their inherent nature such as crude oil, power and telecom. Interestingly, 8 out of these major 15 industries have seen a CAGR below the 5Y industry total CAGR of 4.9%, which is also a concern reflecting slow pace of investment. House or ownership pattern data reveals that the share of PSU and non PSU companies have not changed much in the past 5 years. This seems to be in anomaly with what we have observed in the trend of capex data of Centre.

What to make out of the data:

- Fixed assets of companies have increased to Rs 38.3 lakh crore in FY23 from Rs 36.3 lakh crore in FY22, noting a YoY growth of 5.5% in the same period. However, the 5Year CAGR stands at 4.9%, which is far lower than the CAGR of 9.8% in nominal GDP during the same period.
- Even on an incremental basis, in the past 5 years fixed assets of corporates have increased by only Rs 8 lakh crore in our sample.
- The sectoral picture is skewed towards industries such as crude oil, power, telecom, iron and steel and automobile, dominating 65.3% of fixed asset creation in FY23. Even historically, major concentration was visible in these sectors, primarily due to their inherent nature of asset creation. But there was no significant change in share during this five-year period.
- Notably, ownership wise there has been no broad change in share of PSU and non-PSU companies, with PSUs having 38.7% share in fixed asset creation and the remaining 61.3% come from non PSUs.

Sector wise depiction of fixed asset accumulation:

- Industry wise it's a much skewed picture. Crude oil, power and telecom encompass 51% of the fixed asset creation space. The shares have not undergone much change since FY18. For sectors such as telecom and FMCG the shares improved, while for power, iron and steel and non-ferrous metal companies the shares have moderated.
- Interestingly, 8 out of this major 15 industries have seen a CAGR below the 5Year industry total CAGR of 4.9%. Especially for industries such as capital goods, textile, non-ferrous metals, iron and steel and power, 5Year CAGR have remained considerably lower, due to volatility in commodity prices and Covid induced slowdown.
- On an incremental basis in FY23 compared to FY22, fixed assets of power companies have fallen at the sharpest pace of Rs 16,830 crore. This was followed by fall in fixed assets of logistic (by Rs 1,870 crore) and IT (Rs 1,768 crore) companies.

- On the brighter side, fixed assets of crude oil (Rs 64,075 crore), telecom (Rs 59,638 crore), and automobile (Rs 11,164 crore) companies have increased.

Ownership wise structure:

- In our sample of 3,420 companies, 85 companies have been identified as PSU and the remaining 3,335 companies were classified as non PSUs. The share of both PSUs and non PSUs have not undergone major change since FY18. However, quite significantly these companies account for a large part of the assets of the corporate sector with share of 38.7%. Only between FY22-23, the share of PSUs moderated slightly to 38.7% from 39.7% whereas for non PSUs, the share inched up slightly to 61.3% from 60.3%.
- In 5Y CAGR terms, fixed asset creation of both PSU and non PSUs have remained in line with the total CAGR of 4.9%. However, on an incremental basis, growth in fixed assets of non PSUs were higher at Rs 1.6 lakh crore in FY23 compared to Rs 0.4 lakh crore in FY22, whereas for PSUs it was lower at Rs 0.4 lakh crore in FY23 compared to Rs 0.6 lakh crore in FY22.

The pace of growth in capital in the corporate sector has been uneven over the last 5 years with a CAGR of just 4.9%. PSUs account for around 38% of the total assets as they are concentrated in sectors such as crude oil, power, and banks. Important sectors that have witnessed a higher than average CAGR were crude oil, telecom, auto, banks, retail, chemicals and consumer durables. There is absence of broad-based growth across sectors. Sectors such as hospitality and media witnessed negative CAGR due to closures post lockdown.

Have states underperformed on capex?

Capex of government has been considered to be the prime driver of capex in the economy in the last few years. This is so as the private sector has not been in a position to invest for various reasons. These range from lower demand to excess capacity and high inflation. But how have governments done given that there are no profit related motives for such expenditure? The picture, as can be seen below, is mixed as while the centre has performed well, states have tended to disappoint in FY23.

Centre met its target both in terms of actual capex in various areas as well as the loans disbursed to states that were to be used for capex, showing remarkable commitment to this cause. The fiscal deficit target was also maintained in this year.

However, the states' performance has been disparate. Data was available for 25 states. A total of Rs 7.49 lakh crore was budgeted for by these states. However, they spent only Rs 5.71 lakh crore which is 76.2% of the total.

Only 4 states over-achieved and crossed the 100% mark: Karnataka, Sikkim, Arunachal Pradesh and Bihar. Two others came close at above 98% which were Jharkhand and MP. Eleven states had crossed the 80% threshold.

The other states had registered lower than average achievement rate. The two largest states in terms of planned capex, UP and Maharashtra had an outlay of Rs 2.19 lakh crore which is 29.2% of the total capex of these 25 states. Their combined achievement was just 70% which has brought down the average for the entire sample.

The lowest performance came from Andhra Pradesh at 23% followed by Tripura, Nagaland and Haryana which had less than 50% achievement rate. Out of these 14 states, Andhra Pradesh and Punjab were the only states

which had exceeded their fiscal deficit budgeted numbers and probably had some reason for under-spending on capex, though the two are not proportional.

There are several reasons for states not meeting their capex targets.

- They tend to wait towards the end of the year to see how their fiscal balances are faring and are not in a position to complete the same by March.
- There are not enough projects that can be undertaken by the states and hence a combination of lacunae in planning and execution. This ultimately leads to slippages.
- There can be too much preoccupation with items under the revenue expenditure that there is less attention paid here.
- There can be a case of over budgeting to begin with to create contingencies.
- Other extraneous factors at times such as uncertainties in political climate could come in the way of project execution.

The under-achievement phenomenon is not really new as in FY20 the rate was around 72% though in FY22 had improved in 95%. The states certainly have to improve their record here in order to push forward the investment cycle as the private sector will take some time before coming in a broad based manner. Presently, the heavy lifting is being done by the Centre which is not adequate as the budgeted expenditure of the two levels of government are almost similar. Hopefully, the push given in FY24 would be more decisive.

How important is USA for Indian economy?

India would be the fifth largest economy in the world in nominal terms coming after USA, China, Japan and Germany. The economic ties with USA have been firm over the years with the nation being a major partner for both trade and investment. Just how important is the USA?

Foreign trade

- India's exports of merchandise was \$ 447 bn in FY23 and USA had a share of 17.5% with an amount of \$ 78.4 bn.
 - In fact, CAGR of exports increased by 10.4% to USA as against CAGR of 8% for the economy as a whole in the last five years. Hence, USA has become a major export destination for us.
- The top most commodities in the export basket to the USA were: Drugs and pharma (\$ 7.5 bn), gems and jewellery (\$ 12.5 bn), petro-products (\$ 6.0 bn), agricultural products (\$ 5 bn) and electronics (\$ 6.2 bn) in FY23. Their share was around 47% of total exports to the USA. Other important exports were iron and steel, auto components, textiles, and electrical machinery that were valued at \$ 11.9 bn. There is definitely scope for pushing forward these exports in the coming years where there is some competitive advantage for India.

- India's exports of services were \$ 323 bn in FY23. Here too, USA has a large share. Based on data for FY21, USA had a share of over 60% followed by UK and EU. The contribution of the IT sector here has been very significant.
- In terms of imports, there is less dependency on the USA where they were valued at \$ 50.2 bn in FY23 which is 7% of total imports of \$ 713 bn.
 - In terms of growth in imports, those to USA increased at a CAGR of 13.5% against 8.9% for aggregate imports in the last 5 years. Clearly USA has also been a major import partner which is growing in importance over the years.
- In terms of major commodities that are imported from the USA the top products in FY23 were: POL (\$ 13.4 bn), engineering goods (\$ 9.5 bn), pearls and precious stones (\$ 5.4 bn), chemicals (\$ 4.8 bn), electronics (\$ 3.9 bn) and ores (\$ 3.9 bn). These six commodities had a share of 81% in total.

Foreign investment

FDI: USA has been an important source of FDI for India in the last few years, though the pattern has not been smooth. There had been two high investment years in FY21 and FY22 where the amount was 22% at the combined level. This was driven by specific deals in the telecom sector. Cumulatively since 2000 India has received \$ 635 bn of FDI in equity flows of which USA contributed around \$ 60 bn which is around 9.5%. In the pecking order, USA ranks third, behind Mauritius (\$ 164 bn) and Singapore (\$ 148 bn).

FPI: Here too, investment from USA has been very significant. As of May 2023, total assets under custody of FPI was Rs 52.95 lakh crore of which US had the highest share of \$ 20.84 lakh crore which is just about 40%. In 2012, the share was 26% in a total AUC of Rs 11.07 lakh crore. Intuitively it can be seen that the QE programme of the USA did lead to large flows of capital to the emerging markets and there were benefits drawn by India too.

All these indicators point to a strong economic relationship of India with the USA where there is scope of further advancement being made. These areas are of strategic value for India as they are components of the balance of payments which drive quite decisively the currency in global markets.

How have NBFCs fared vis-à-vis Banks

Using the data largely from RBI's report on Trend and Progress in Banking 2021-22, this study attempts to look at the performance of Non-Bank Financial Corporations (NBFCs) in the last few years and compares the same with scheduled commercial banks (SCBs). Specifically, we looked at the growth in overall balance sheet, credit growth and the sectors which have driven growth in credit.

Structure of NBFCs

NBFCs play an important role in the economy by providing a supplementary source of credit to borrowers. These firms usually specialize in niche areas such as real estate, retail and infrastructure etc. RBI classifies NBFCs in the following categories: a) Deposit taking NBFCs or NBFCs-D, b) Non-deposit taking NBFCs or NBFCs-ND, c) Asset reconstruction companies or ARCs and d) Housing Finance Companies or (HFCs). For this analysis, we are only looking at NBFCs-D and NBFCs-ND, more specifically systemically important NBFCs-ND-SI, with asset size of over Rs 500 crore.

Growth in balance sheet: NBFCs and SCBs

We first begin our analysis by comparing the growth in balance sheet of NBFCs and SCBs over the last five years. It can be seen that for NBFCs, balance sheet growth has been moderating. After registering a stellar growth of 27.6% in FY18, the growth momentum has fizzled out to just 9.6% in FY22. In comparison, balance sheet of SCBs has shown an increasing trend over the last 5 years, albeit the gains have remained modest. It is also interesting to note that except for FY22, the growth in balance sheet of NBFCs has been higher than SCBs. However, the gap has progressively narrowed and turned negative in FY22. On a CAGR basis, over the last 5 years, while NBFCs' balance sheet has grown by 15.8%, it has only expanded by 8.9% for SCBs.

Deposits accounted for around 79% of total liabilities for SCBs. On the other hand, for NBFCs, borrowings were the main source of funding with a share of around 2/3rds. It must be noted that NBFCs rely heavily on banks as well as markets to fund their operations. In FY22, bank borrowings, accounted for 75% of total borrowings by NBFCs, as interest rates were low.

On the assets side, loans and advances contributed to 56% of total assets for SCBs, while for NBFCs the corresponding share was higher at 75%. Share of investments for banks was 27%, while for NBFCs it was lower at 13%.

In terms of overall sizing the NBFC segment is around 18% that of scheduled commercial banks.

Growth in credit: NBFCs and SCBs

Next, we analysed the trend in overall credit growth in both SCBs and NBFCs and compare the same. It can be seen that credit by NBFCs has declined sequentially over the last five years. In fact, credit by NBFCs grew at a solid pace of 32.3% in FY18 and has since moderated.

On the other hand, credit outstanding by SCBs has shown varied trends. After growing by 10% in FY18, credit growth of SCBs improved to 13.3% in FY19. Thereafter, it moderated to 6.1% in FY20, and further to 5.6% in FY21. After this, credit growth of SCBs improved to 8.6% in FY22. It must be noted that in four out of the last 5 years, credit offtake by NBFCs was higher than SCBs. Overall on a CAGR basis, credit growth for both SCBs was much lower at 8.7% versus 14.4% for NBFCs.

In terms of ratio of credit by NBFCs to credit by SCBs, the ratio has improved from just 22.8% in FY18 to a high of 24.7% in FY21. In FY22, the ratio stood at 24.5%.

Composition of credit disbursed: NBFCs and SCBs

Breakup of credit disbursed by both SCBs and NBFCs in FY18 and FY22 presents the following results:

- While agriculture and allied activities accounted for 13.3% of total credit disbursed by SCBs in FY22, its share in the credit portfolio of NBFCs was very small at just 2.1%.
- Industry is a major sector being serviced by both SCBs and NBFCs alike with a share of 28.5% and 46.5% respectively in FY22.
 - Within industry, large companies form the bulk of lending for both SCBs and NBFCs.
 - Furthermore, while share of large companies in total credit to industry has come down for SCBs (76.4% in FY22 from 82.3% in FY18), for NBFCs the share has improved to 80.3% compared with 55.5% in FY18.
 - Share of MSMEs in total industry credit has improved for SCBs to 23.6% versus 17.7% in FY18. The comparative figure for NBFCs has shown some moderation from 7.1% in FY18 to 5.8% in FY22.
- Services sector accounted for 27.2% of total credit disbursed by SCBs in FY22 (26.5% in FY18), and 16.8% of credit by NBFCs in FY22 (17.4% in FY18).
 - Within services, NBFCs and trade account for a major share of credit disbursed by SCBs. In fact, while the share of trade in SCB credit to services has remained unchanged at around 23% in both the periods, share of NBFCs has gone up from 10.7% in FY18 to 12.4% in FY22. This can be attributed to lower interest rates offered by banks vis-à-vis corporate debt market, as also support provided during COVID through the TLTROs.
 - For NBFCs, the major head under services is transport operators with a share of 25.5% in FY22. Interestingly, its share in FY18 was only 6%. On the other hand, share of commercial real estate which accounted for 38.9% of services credit in FY18 has dipped to 21.9%.
 - Share of miscellaneous services in service credit for both SCBs and NBFCs has declined in FY22 compared with FY18. However, it still accounts for more than 30% of the share for both NBFCs as well as SCBs.
- Retail sector is an important lending sector for both SCBs and NBFCs. The share of retail loans in SCBs total loan portfolio has improved from 24.7% in FY18 to 30.6% in FY22. For NBFCs, the increase has been much more, rising from 19.4% in FY18 to 34.6% in FY22.
 - In this sector, SCB credit is heavily concentrated in the housing loan segment. Share of home loans has remained stable at ~50%.
 - For NBFCs, vehicle loans form the bulk of credit disbursed in this segment. However, share of vehicle loans has moderated from 45.7% in FY18 to 40.4% in FY22. NBFCs have faced competition from SCBs in this segment as the share of auto loans in SCBs retail portfolio has increased from 9.9% to 11.9% in FY22.

- Another important inference is that gold loans have gained significant prominence for NBFCs, accounting for 14.3% of total retail loans in FY22. The corresponding figure for SCBs stands at 2.2%.

Growth in credit disbursed by sector: NBFCs and SCBs

Data for sector wise growth in credit disbursed by both SCBs and NBFCs in FY22 and also the CAGR over the last 5 years (FY18 to FY22), helps us make the following observations:

- In FY22, agriculture credit from NBFCs rose by 33.6%, while growth for SCBs was lower at 9.9%. However, over the last 5 years on a CAGR basis, SCBs outperformed NBFCs.
- In case of industry, while SCBs performed better than NBFCs on a YoY basis, on a CAGR basis NBFCs performed somewhat better.
 - Within industry, SCBs did much better than NBFCs in case of micro and small and medium industries on both YoY as well as CAGR basis. Surprisingly, growth in NBFC credit to these industries was negative on a CAGR basis.
 - On the other hand, credit to large industries by NBFCs remained higher than SCBs on both a YoY as well as CAGR basis.
- For services, NBFCs credit increased by 21.8% in FY22, while SCB credit trailed at 8.7%. Even on a CAGR basis, growth in NBFC credit rose by 11.4%. The similar figure for SCBs stood at 10.8%.
 - Under services, NBFCs outperformed SCBs in FY22 for all major sub-segments.
 - Over the last 5 years however, NBFCs credit to transport operators has seen a sharp increase, rising by 46.6%.
 - On the other hand, credit to commercial real estate has declined.
- In personal loans segment, while SCBs outpaced NBFCs in FY22, the same story does not hold on a CAGR basis. NBFCs retail loans expanded at a compounded annual rate of 26.1% in the last five years, for SCBs it was much lower at 15.9%.
 - Within this, in almost all the major sub-segments SCBs have performed better than NBFCs in FY22. The exception to this are: education loans, credit cards and loans against jewellery.

On a CAGR basis however, NBFCs outpaced SCBs in segments such as consumer durables, education and vehicle loans.

How has Monsoon and Kharif fared in the past?

The onset of South West monsoon was delayed this year by more than a week against expectation (1st Jun). While there is an expectation of normal rainfall, there is an upside risk of El Nino conditions forming which poses significant risk. However, severity of El Nino has to be taken in to account based on past years data. The result of normal and spatially distributed rainfall would be evident on sowing of Kharif crops as well on their prices in the coming months.

Kharif sowing season begins in Jun-Sep and interlaces with the South-West Monsoon. Kharif crops are harvested in the months of Oct-Dec and accounts for roughly 50% of the food grains production in the year. With the recent

turn of events led by climate change, likelihood of a normal monsoon and the spatial distribution of the rainfall has become quite challenging with frequent fluctuations being evident. Notably, higher and lower production of food grains have some relation to the excessive or deficient monsoon in the respective year.

In the last 2-years, India has seen a normal rainfall after receiving excess rainfall consecutively in the previous 2-years. Additionally, the world has witnessed the formation of La Nina conditions in the last 3-years. However, this year, there are higher chances of the EL Nino conditions forming which might adversely affect rainfall bringing to the fore drought like conditions and even patchy monsoon. This in turn might have some effect on sowing of Kharif crops and on overall output. Despite all these challenges, IMD expects a normal monsoon this year at 96% of LPA. On the other hand, SKYMET, a private forecaster has projected a below normal monsoon of this year at 94% of LPA. The range for normal monsoon is between 96-104% of LPA.

The year of 2015-16 was typified by deficient monsoon and El Nino conditions which had resulted in drought like conditions and thereby kharif production took a beating in the given year.

Moreover, it is also important to understand the severity of El Nino conditions and whether it translates into normal monsoon or not. In the past, barring one-year, there have been several instances where despite the emergence of El Nino drought like conditions did not emerge. Hence, despite the threat one needs to be watchful and track the ongoing condition. The intensity of such conditions and its overall impact on crop yield remains pertinent. All the three years with El Nino impact, had witnessed negative growth across crop categories.

It should be noted that having a normal monsoon does not rule out the possibility of crop production declining, as can be seen in 2021-22 and 2022-23 for pulses and cotton.

MSP

Government of India announced higher MSP for Kharif crops for the year FY24 (marketing season). The hikes across the crops had been in the range of 5.3% to 10.4%, with moong registering the biggest jump and urad the lowest. However, compared with other years, the range of increase has been much higher for all the crops. Paddy has registered the largest increase (Rs 2183/quintal) in the last 5-years. In addition to Moong, crops such as cotton (10%) and sesamum (10.3%) have also registered double digit hike in FY24. The objective of much higher MSP has been to encourage crop diversification and to allow fair remunerative prices to farmers.

The question of liquidity

There have been some interesting developments that have taken place in the banking space in the last month or so which has changed the landscape of liquidity in the market. There was talk at one time of the central bank infusing liquidity in the system through the repo or V2R window; or at the extreme even OMO purchases to ensure stability in bond yields. However, things changed when the RBI announced the withdrawal of Rs 2000 notes from the system as this led to an increase in bank deposits as holders relinquished their holdings of these notes. The situation looks very comfortable today.

The liquidity situation in banks can be assessed using incremental credit and deposits for the first two months ending June 2nd. It can be seen that the increase in deposits this year has been of the order of Rs 6.59 lakh crore against Rs 2.68 lakh crore last year. Hence even though incremental credit has been higher at Rs 3.33 lakh crore

as against Rs 2.52 lakh crore in 2022 the net surplus has increased even after adjusting for higher incremental investments. Against a deficit of Rs 1 lakh crore last year, it was in surplus of Rs 1.33 lakh crore.

The higher growth in deposits can be attributed to two factors. The dominant factor was the exchange of the Rs 2000 note as the last fortnight witnessed an increase of Rs 3.26 lakh crore (the exact amount cannot be known as deposits have also been rising smartly before this announcement). The second is the higher interest rates being offered by banks. Households are aware that the present rate cycle is over and that there would be no further rate hikes by the RBI. This being the case there has been urgency shown to lock into higher interest rates at this point of time.

The above phenomenon also led to excess liquidity in the system which was absorbed by the RBI through the SDF and reverse repo windows.

However after peaking at Rs 3 lakh crore on June 1st, there has been a decline in these surpluses as banks have held on to the surplus cash to address issue of decline in deposits as companies moved in to pay their advance tax. The GST payments are also due towards the end of the month and hence the interest in banks in the V3R had been very limited of late. Advance tax payments would have a temporary effect on liquidity until such time the government starts spending the money which would bring the funds back into the system.

We also looked at the outstanding reserve money as on March 24th, followed by May 19th, and subsequently all following weeks. The major component of reserve money is 'currency in circulation' which accounts for around 78% of the total. As it was seen, reserve money rose in the normal course from Rs 43.14 lakh crore as on March 24th to Rs 44.60 lakh crore on May 19th, which was the last date before the announcement of the withdrawal of the Rs 2000 note. The increase was of the order of Rs 1.46 lakh crore. However, subsequently, there had been a fall of around Rs 75,000 crore in reserve money with currency in circulation coming down by Rs 70,000 crore. It may be pointed out that as of March 2023, there was Rs 3.62 lakh crore of currency in the Rs 2000 note denomination.

Interest cover of companies over the years

Interest cover is a good indication of the solvency of companies as it gives an idea on their ability to service their interest payments. The last few years have been quite volatile. At the policy level, the RBI brought down interest rates sharply to protect growth; and last year reversed the direction as inflation increased. Corporates too have been through similar phases with curbs on operation, demand getting truncated, supply chain issues, high inflation, sudden rise in pent up demand etc. which have had an impact on their profits.

Interest cover (IC), defined here as PBIT to interest provides some indication of how companies have faced these challenges. To get a clearer perspective the following analysis traces this indicator for the last 10 years for a set of 1,523 non-BFSI companies. The longer time period gives one an idea of how things looked in the past before Covid-19 set in.

The interest cover ratio for this set of companies showed varying trends over this period. It fell in FY15 and FY16 and then rose till FY18. It came down marginally in FY19 and dropped sharply in FY20 before recovering in the next two years. In FY23 there had been a drop again in the interest cover ratio.

To get a better idea of how interest rates moved during these years, we mapped the interest cover ratio with both the repo rate and the weighted average lending rate on outstanding loans for the sample companies. The repo rate had followed generally a downward path starting from FY14. There was one spike by 25bps in FY19 and then a major push in FY23 by 250 bps. The trend suggests a downward path for the policy rate.

The WALR on the other hand came down continuously during this period until FY22. In fact, the descent was quite sharp from 12.17% in FY14 to 10.12% in FY20 and then to 8.88% in FY22 as the RBI keep the repo rate at a low of 4% for 2 years.

There is hence no clear relation between the IC and WALR as the latter has been coming down quite continuously while the IC has varied over time. The IC has hence been more affected by the growth in profits which are linked directly to the business and wider economic environment.

If we juxtapose the IC with growth in PBIT, a better relation emerges in this case. A simple coefficient of correlation here works out to 0.63 which means that higher growth in PBIT is associated with higher levels of interest cover. When the same is done with WALR, a negative coefficient is seen which is however lower at -0.25. (Using the concept of coefficient of correlation for a small sample of 10 observations has limitations). It may be concluded that IC has been affected more by the growth in PBIT than interest rates as the latter has been coming down continuously during the period of study.

On the whole, IC has been fairly good over the years. While a regime of higher interest rates can affect interest costs, aggregate financial performance is expected to be better in FY24 and hence this ratio should remain stable. Telecom industry can be disregarded as it has specific issues relating to tax. There are 3 industries which have an IC of less than 2 which are retail, media & entertainment, and infrastructure. In case of the first 2, the pandemic has come in the way and posed challenges while for infra it has traditionally had low IC.

Power is another sector which has an IC in the range of 2-3 and has crossed 3 in the last two years. Iron and steel, construction material, textiles and realty are the other sectors with IC of less than 4. These industries would depend a lot on how the economy does especially in investment while for textiles it would be related to a large extent on exports.

Hence on the whole the picture on debt servicing ability of companies does look satisfactory and the levels attained in FY23 are more or less than at those before the lockdown. While interest costs will play a role, overall profitability will be the critical factor which drives this ability.

Corporate Performance: Q4-FY23

The corporate sector recorded a fairly steady performance in Q4 of FY23, though growth in sales and net profits slowed down relative to last year. The sector was affected by various forces. On the positive side, pent up demand in several areas helped to push up turnover. The correction in prices also helped to bring down input costs in the latter part of the year. However, on the downside the crisis in Ukraine led to high commodity price inflation in the first part of the year. While inflation did temper down, companies started passing on the higher input costs from Q3 onwards which affected demand in some sectors. Hence, inflation had a mixed effect on the prospects on industry. Export markets were weak, which was expected as the global economy slowed down. RBI kept increasing the repo rate which also put pressure on interest costs of companies. Therefore, these factors had a differential impact on the performance of companies.

Growth in sales had slowed down from 21% in Q4-FY22 to 12% in Q4-FY23 for the sample of 2,096 companies while that in net profits had moved from 26.1% to 17.3% during this period. There had been improvement in net profit margin in both the years.

If we exclude BFSI companies, then the performance was relatively muted with sales growth of 8.8% and net profit of 7.5%. The higher base effect as well as dilution of pent up demand in some sectors contributed to this slower growth. The net profit margin however had been falling over the last two years of this quarter, though the dip in Q4-FY23 had been very marginal.

A significant observation here was that the interest cover ratio for the sample of 1,797 companies came down to 5.82 from 6.45 last year after witnessing an improvement in FY22. This was a result of both lower growth in PBIT as well as higher interest costs due to the lending rates increasing in the banking system. PBIT had grown by just 4.8% this quarter compared with 9.4% last year. However, interest costs increased sharply by 16.3% compared with 4.7% in Q4-FY22.

Industry-wise performance

Growth had not been even across sectors and a differential picture was observed. Sectors had been impacted by different sets of factors as demand and supply conditions varied.

Sales growth was 12% for the aggregate sample companies.

- The industries which grew at a higher rate than the average were: banks, insurance and Finance in the BFSI sector. Services received a boost from the pent up demand which got reflected in hospitality, diamonds and jewellery, logistics, IT, retail, and trading. Within manufacturing auto did well on the consumer oriented front while construction material, power and industrial gases performed positively on the industrial front.
- Low growth was witnessed in case of textiles, alcohol, plastic products, mining, gas transmission and iron and steel.
- Food based products and health care had maintained their sales growth at the average level which was also the case with paper.
- Industries like electricals, FMCG, chemicals, infra, capital goods, media, telecom, realty, consumer durables registered single digit growth. Price pressures did come in the way of demand; and rural demand was less robust than expected across some of these industries.

The industries which were under pressure in Q4-FY23 would need to be watchful in FY24 as overall economic growth is poised to be lower and export market (to the extent that the industry is dependent on foreign markets) less accommodative.

In terms of growth in profit the matrix was different. For the sample companies, growth was 17.3% driven by the BFSI sector and 7.5% if this segment is excluded.

- The industries where growth in profits was higher than 17.3% were banks, insurance, crude oil, insurance, trading, retail, FMCG, auto, infrastructure, durables, health care, paper, electricals and hospitality.
- The industries which witnessed a drop in the growth in PAT were iron and steel, IT, chemicals, non-ferrous metals, textiles, trading, agri products, realty, alcohol, capital goods, mining and plastic products.
- Those that were more moderate were power, mining, gas transmission.

Interest cover ratio

FY23 was characterized by an increasing rate regime as the RBI increased the repo rate by 250 basis points to control inflation. This led to an increase in the lending rates of banks. The WALR (weighted average lending rate) on fresh loans increased from 7.63% in March 2022 to 9.32% in March 2023. The median value of MCLR for 1 year increased from 7.25% to 8.60% during this period. Clearly, the cost of borrowing had increased sharply. At the same time, growth in credit for the system was higher at 15% compared with 9.6% last year. Therefore, a combination of higher borrowings at a higher cost added to interest expenses. Profits, as seen have not risen across the board and hence there was some pressure on the interest cover ratio (defined as PBIT to Interest).

Telecom and media were the only two sectors will very low or negative interest cover mainly due to profits being down. Industries like power, textiles and realty witnessed a decline in interest cover where the ratio was less than 5. Therefore, the situation does appear to be fairly comfortable.

Size-wise view

While the sample size is tilted heavily towards the larger companies which have annual turnover of above Rs 250 crore, the picture is still interesting. Small and micro firms have witnessed negative growth in sales while the medium sized companies have registered positive growth, albeit marginal, in Q4 of FY23. This comes after a decline in turnover in FY22. Therefore, there has been some semblance of recovery which is not visible for the small and micro enterprises. While the number of companies in these groups is small, this could nonetheless be representative of the overall picture.

Data Releases

Currency outlook: INR expected to trade with appreciating bias

Buoyant FPI inflows and a weaker dollar pushed INR 0.8% higher in Jun'23. Range-bound oil prices also offered some comfort. Uncertainty over the Fed's future course of action amidst moderation in US core PCE and consumer spending led to a fall in DXY in Jun'23. More clarity on Fed's rate action will come from macro data scheduled in the month including PMIs, non-farm payrolls, CPI etc. We expect INR to trade with an appreciating bias in the range of 81.5/\$-82.5/\$. Positive FPI flows as well as weaker oil prices are likely to support INR.

Bond Market Round-up

The reiteration of hawkish tone by central banks in US, Eurozone and UK have led to sell off in the bond market. The OIS curve (EUR-1Y: 3.7% at GBP-1Y: 5.4%) also point that peak in policy rate is not yet over. Even India's 10Y yield rose in consonance with global yields. The domestic yield curve noticed one striking change. The yield on 6month paper moderated while for longer end curve it continued to inch up. Similar thing is noticed in the borrowing cost of these papers. The short end curve was supported to an extent by RBI's pause on interest rates. Liquidity got comfort from RBI's fine tuning operation despite advance tax payments and maturity of debt security of Rs 0.13 lakh crore. We expect India's 10Y yield to trade in the range of 7.05-7.15% in Jul'23. It is expected to trade sideways with upside risk from global yields and downside risk from a comforting inflation print.

BoB ECI: How prices look in Jun'23

BoB Essential Commodity Index (BoB ECI) showed a slight uptick by 1.2% in Jun'23 on sequential basis, however, much of it is attributed to seasonality. On YoY basis, it continued to moderate. Component wise picture shows edible oil prices are on a downtrend. But some unanticipated shock in terms of vegetables such as onion and tomato prices and upward spiralling of pulses might be forthcoming. We expect CPI to settle between 4-4.3% in Jun'23, before a slight reversal in trajectory from next month onwards owing to fading base. In Jun'23, BoB ECI rose by 1.2% from 0.4% increase in May'23. The sequential momentum is attributed to some degree of seasonality, as on a seasonally adjusted basis, BoB ECI inched up by only 0.2% in Jun'23. However on a YoY basis, BoB ECI moderated to 1.2% in Jun'23 from 1.4% in May'23, supported by a favourable base.

But the breakdown of the index, shows a mixed picture with regard to movement of prices. Amongst the administered 20 commodities, 10 commodities have noticed YoY moderation in prices. The notable ones among them include edible oils such as Sunflower (-28.7% in Jun'23) and Soya oils (-21.6%). Amongst vegetables, potato prices have seen sharp moderation. So is the case with Atta, masoor dal and milk. Price pressure on YoY basis was visible in case of tomato, all other pulses component (except masoor) and sugar. The sequential increase is driven by vegetables such as tomato and onion where prices increased by 28.6% and 3.7% respectively in Jun'23.

Developments in India's BoP in FY23

India's current account deficit (CAD) increased to US\$ 67.1bn in FY23 from US\$ 38.7bn in FY22. This translates into a CAD of -2% of GDP in FY23 versus -1.2% of GDP in FY22. Trade deficit increased to a record high of US\$ 265.3bn in FY23 (7.8% of GDP) from US\$ 189.5bn in FY22 (6% of GDP), as imports increased sharply by 16.6% in FY23. In contrast, merchandise exports rose by only 6.3%. Support came from the surplus in invisibles account which improved to US\$ 198.2bn, primarily led by services (US\$ 143.3bn). Within services, exports of software services increased to US\$ 146.8bn. Private transfers, which include remittances from Indians living abroad also increased to US\$ 112.5bn in FY23 versus US\$ 89.1bn in FY22. On the other hand, outflows on account of investment income picked up pace.

Capital account surplus narrowed from US\$ 85.9bn in FY22 to US\$ 59bn in FY23. This was on account of lower FDI inflows which moderated to US\$ 28bn in FY23 from US\$ 38.6bn in FY22. FPI outflows were at US\$ 5.2bn, even though it was lower than outflows of US\$ 16.8bn in the same period last year. With higher global interest rates, even ECB inflows were lower. In fact, there was net outflows in ECBs at US\$ 3.8bn. Even short-term credit moderated to US\$ 6.5bn in FY23 from US\$ 20.1bn in FY22. On the other hand, inflows on account of banking capital increased to US\$ 21bn in FY23 versus US\$ 6.7bn in FY22. In FY23, India's foreign exchange reserves saw a depletion of US\$ 9.1bn versus an accretion of US\$ 47.5bn in FY22.

For FY24, we expect CAD in the range of -1.2% to -1.6% of GDP. Even in capital account, some improvement is expected as FDI and FPI inflows pick up. This should keep INR range bound.

Core industries

Core sector growth for May came in at 4.3% which is quite impressive considering that last year growth was 19.3%. There was continued traction in cement and steel which can be attributed to government spending. In June the centre had given an additional instalment to states as part of state transfers to enable higher capex. Further, a loan was also extended to expedite the same; Coal growth was 7.2% which can be related to higher steel production. Electricity production declined marginally by 0.3% mainly due to high base effect of 23.5% growth last year. It was otherwise a very hot month where demand had gone up as demand for cooling increased; Fertilizers production was up by 9.7% and will continue to remain robust for the next two months to keep pace with the kharif sowing requirements; The oil basket however continued to disappoint with negative growth for crude and natural gas. Lower global crude prices normally is associated with lower domestic production. Refinery products did relatively better with 2.8% growth with exports also contributing to the same. We expect IIP growth to be in the region of 3-3.5% for May.

Fiscal

Centre's fiscal position in FYTD24 (Apr-May'23) seems to be on track with its net revenue rising by 15.7%, following (-) 13.9% decline in Apr'23. Pace of contraction in direct tax collections has slowed (-4% versus -9.2%), while that of indirect tax collections has improved (+0.5% versus -1.9%). Non-tax revenues also jumped sharply owing to favourable base. Overall expenditure of the government is however off to a slow start. Following 10.6% rise in Apr'23, it has now eased to 6.9% in FYTD24. This is mainly on account of dip in revenue spending (-4.3% versus 15.2%), while capex on the other hand picked up pace (56.7% versus -0.6%).

CPI inflation cools

CPI inflation dropped to its lowest since Apr'21 to 4.3% from 4.7% in Apr'23, on YoY basis. This is slightly below our estimate of 4.5%. The significant moderation in CPI was on the back of favourable food inflation and also supported by an elevated base of 6.95% in May'22. CPI food index moderated to 2.9% in May'23 from 3.8% in Apr'23, on YoY basis. Amongst major food items, oils and fat, vegetables, fruits, and cereals have noted considerable drop in inflation. However, 5 out of 10 major food items still remain above 6%, with cereal and spices inflation remaining in double digits. Going forward, the outlook on food inflation seems murky and contingent on the evolution of El Nino. However, government's efforts to assuage supply side concerns would provide some degree of comfort.

Core CPI (excl. food and fuel) came down to 5.1% from 5.2% in Apr'23. Fair degree of moderation was visible in clothing and footwear inflation (6.6% in May'23 from 7.5% in Apr'23). Within miscellaneous component, except personal care and effects, moderation were visible across all items, with considerable drop visible in case of household goods and services component (6.1% from 6.5%). Core excluding transport and communication and personal care and effects have moderated considerably to 5.5% in May'23 from 5.7% in Apr'23, on YoY basis. Even abridged core (core excluding pan, tobacco and intoxicants) eased to 5.2% from 5.3%.

The latest CPI reading have provided some comfort especially with regard to moderation in food prices. Even in Jun'23, high frequency price indicators for pulses component (Gram, Moong and Masoor), sugar, salt, milk and potato have shown a respite on MoM basis. On the other hand, risks may emanate from cereal prices especially we need to be vigil with regard to price of rice, which is showing a sequential momentum in Jun'23. Further, the vagaries of monsoon might downplay any correction in cereal prices in the near term. For Q1FY24, we expect headline CPI at 4.5% against RBI's trajectory of 4.6% and our full year forecast stands at 5.0-5.5%

WPI cools down further

Headline WPI fell more than expected in May'23. It was down by (-) 3.5% versus our estimate of (-) 1.7% and (-) 0.9% in Apr'23, to reach its lowest point since Dec'15. Food inflation eased considerably and entered deflation in May'23 (-1.6%) for the first time since Jan'21 (-0.3%) and was down from 0.2% in Apr'23. Within food, most significant decline was noted in price index for vegetables. In addition, food grain inflation slowed, mainly due to cereals, while inflation in pulses was seen going up. Within cereals, wheat inflation led the decline, while paddy prices continued to inch up, in line with the trend seen in international prices.

Fuel and power inflation also entered deflation in May'23 (-9.2%), for the first time since Jan'21 (-3.8%), as it came down drastically from 0.9% in Apr'23, owing to favourable base (49% in May'22 versus 38.8% in Apr'22). In May'23, deflation in mineral oil index continued for the second consecutive month. Inflation index for electricity (9.7% versus 20%) and coal (2.5% versus 3.2%) also cooled down.

Core inflation remains in deflation for the 3rd consecutive month in May'23 as it fell to (-) 2.2% from 1.8% in Apr'23. Manufactured products inflation also declined to (-) 3%—lowest in the current (2011-12) series, and down from (-) 2.4% in Apr'23. Of the 22 commodity sub-indices, 14 indices rose at a slower pace in May'23 than Apr'23 led by textile, paper & products, other non-metallic mineral products, chemicals & products. Inflation index for basic metals declined less sharply (-9.2% versus -9.8%).

IIP growth improves

IIP growth came in higher than our expectations (1.2%) and surprised positively, firing up the growth cylinder as it registered a growth of 4.2% in Apr'23 against 1.7% in Mar'23. The jump in growth was led by manufacturing sector (holds highest weight) as it registered a growth of 4.9% in Apr'23 compared with 1.2% in Mar'23. Within manufacturing, a stronger outlook was noticed with 14 of 23 subdivisions improving in Apr'23. The sharpest improvement was noticed in pharma, computer, electronic, other manufacturing, other non-metallic minerals and food products. However, manufacture of furniture and beverages, witnessed steep contraction.

Within use-based, mixed outlook was seen across sectors. Output of primary goods slowed down to 8-month low of 1.9% in Apr'23 against 3.3% in Mar'23. Even output of capital and intermediate goods output moderated down to 6.2% and 0.8%. However, Infra goods registered a healthy output, clocking double digit growth to 5-month high of 12.8% in Apr'23. Consumer durables output contracted at a much slower pace. FMCG output outshined across all the sector scaling upwards with a growth of 10.7% after declining by (-) 3.1% in Mar'23.

Domestic demand has been lately showcasing recovery with steady credit growth, improvement in port cargo, higher manufacturing PMI and toll collection offering some respite. However, risk to inflation due to El Nino, along with patchy monsoon or any lagged effect due to policy tightening might have adverse impact on overall growth. Exports demand will continue to face headwinds amidst the fears of global economic slowdown.

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