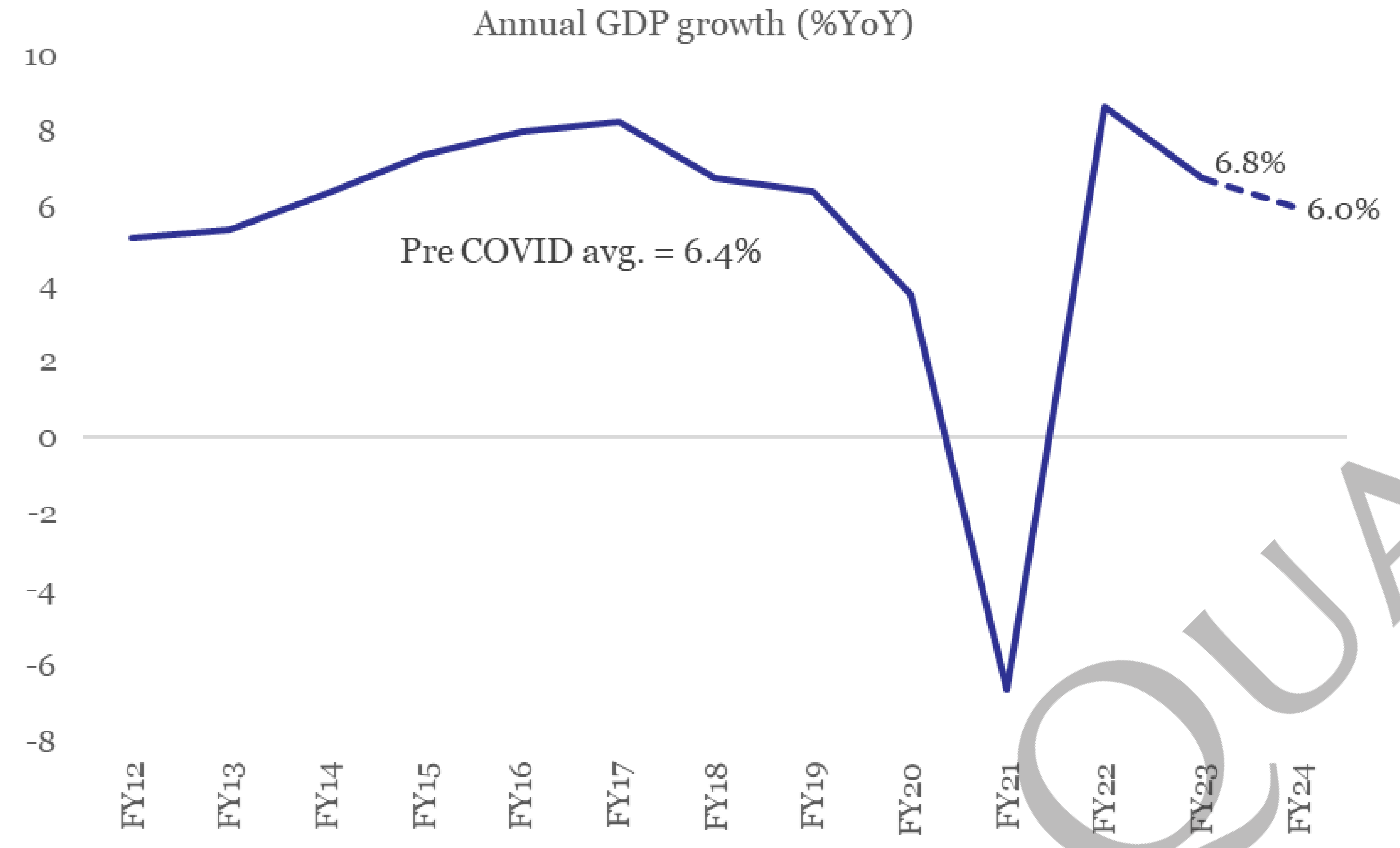
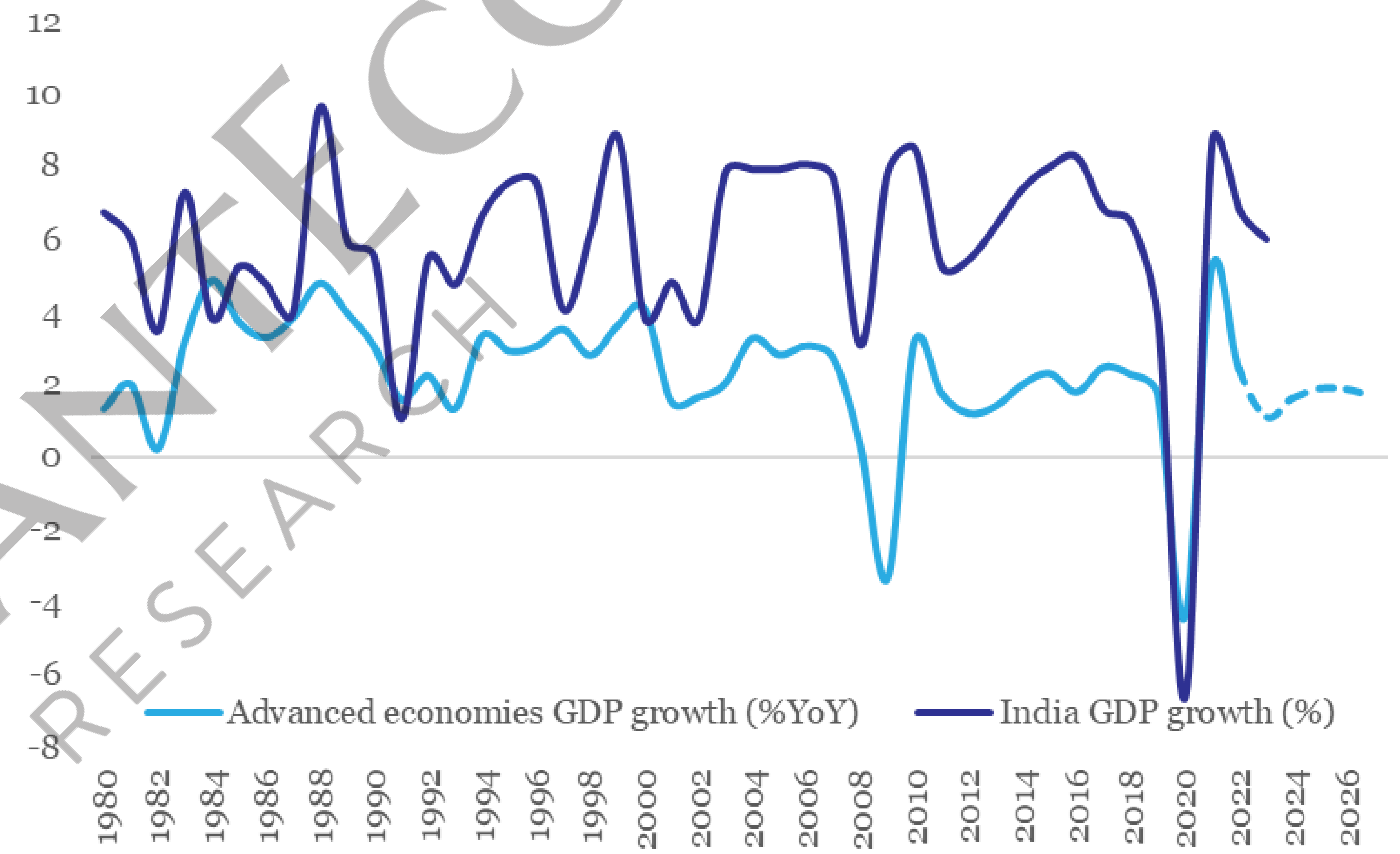
India Economic Outlook

Jan 6, 2023

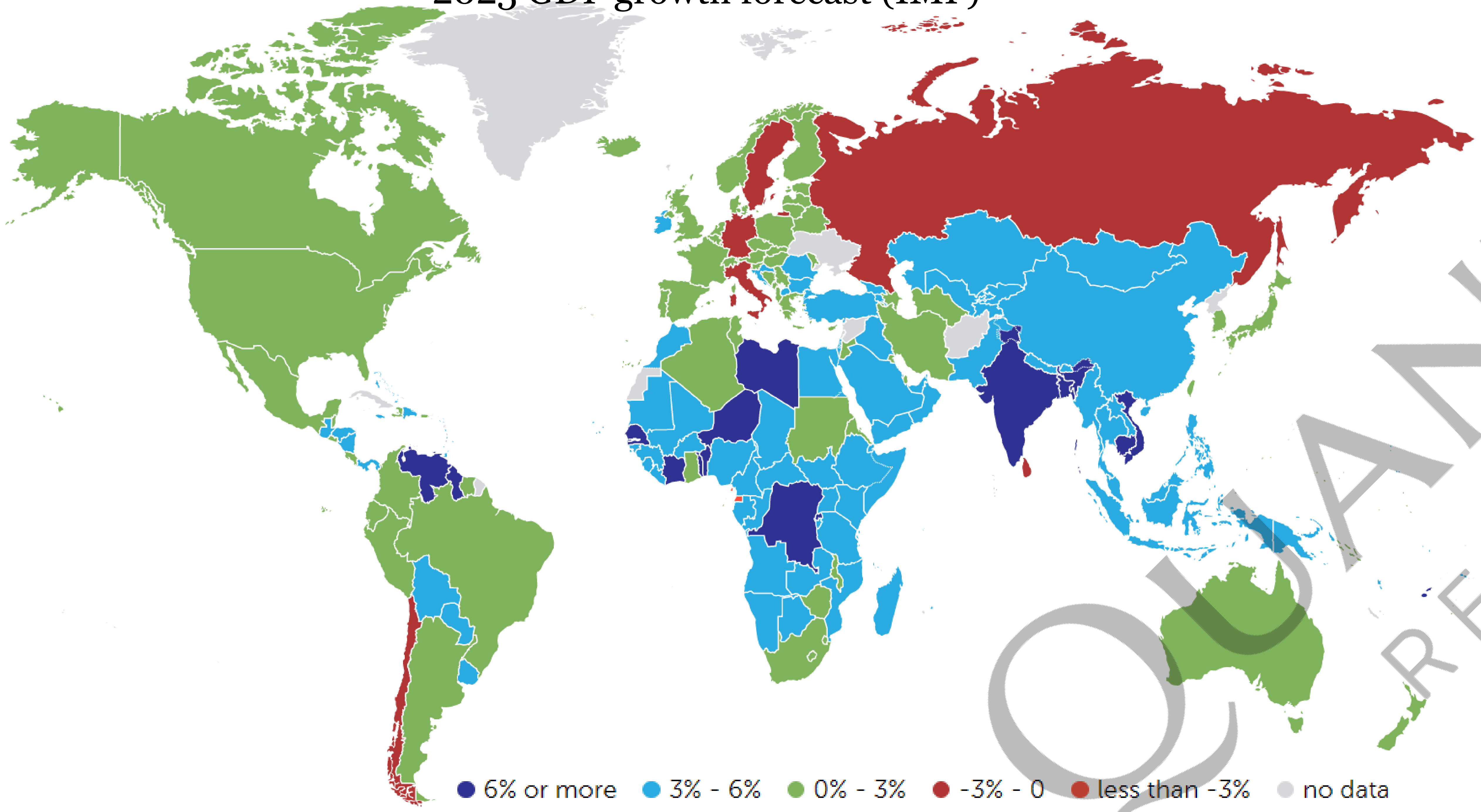
FY24 GDP Growth: 6.0% reverting to pre-COVID 'Normal'





- As per Quanteco estimates, India's GDP growth in FY24 is expected to slow down further to a level of 6.0% from an estimated level of 6.8% in FY23
- Global headwinds from geopolitical uncertainties, financial tightening and slowing growth are expected to weigh more materially as India exhibits synchronisation with global growth cycles
- After lowering its growth forecast for 2023 World GDP and World Trade by 20 bps and 70 bps in Oct-22, IMF head has warned that 2023 will be "tougher" than last year as the US, EU and China see their economies slow.
- Moderation in urban levered consumption and sluggishness in private investments could weigh additionally on domestic growth

Global growth slowdown could shave off ~50 bps from India's GDP growth

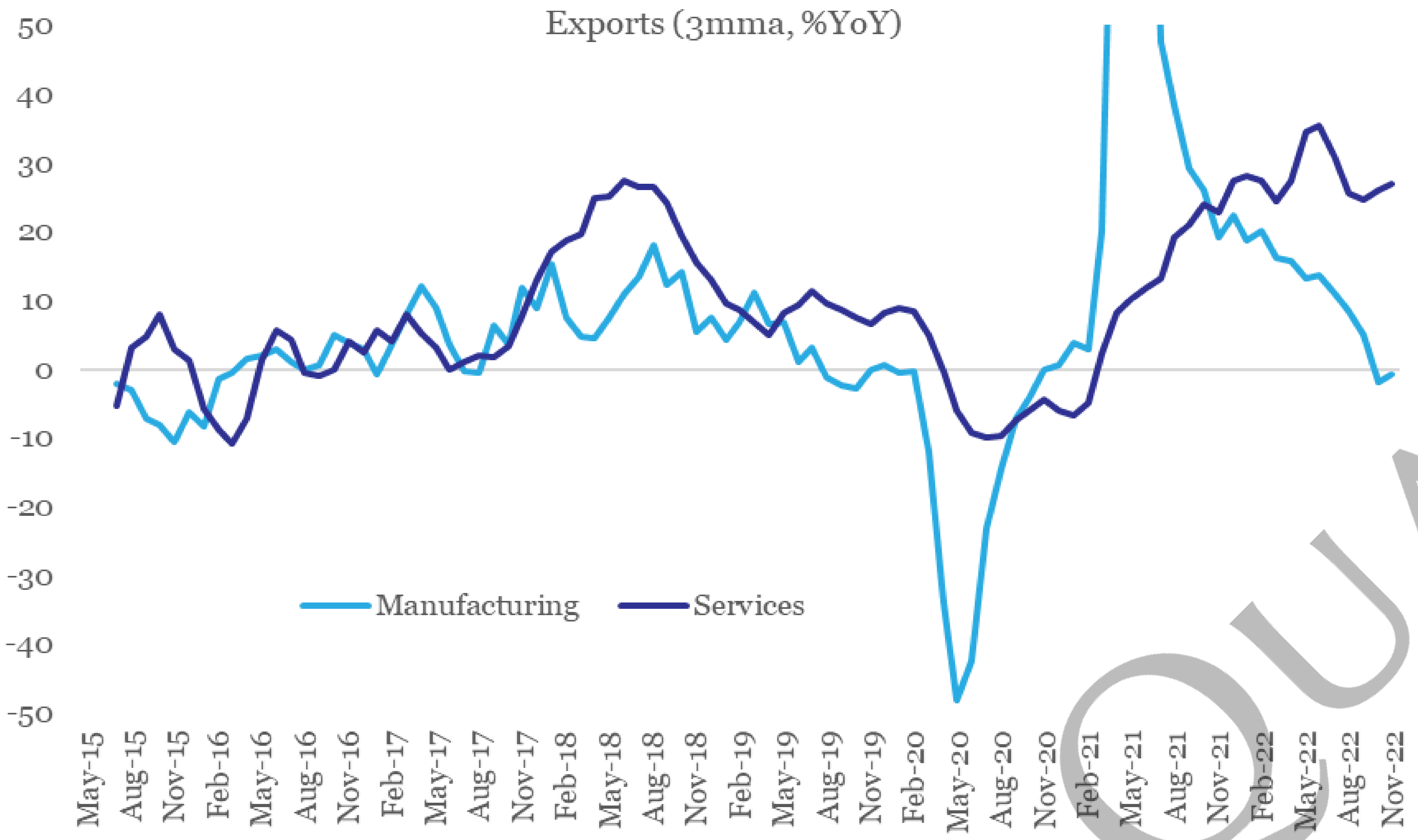


Corelation Matrix					
	Global GDP growth	Global export growth	US GDP growth	EU GDP growth	China GDP growth
India Exports Growth	0.69	0.79	0.55	0.54	0.59

Using annual data, FY01-FY23

- India's export growth displays a high corelation with global export growth as well as global GDP growth to the tune of 80% and 70%
- As per the IMF estimates, GDP growth in India's two biggest trade partners – US and EU (which together account for 44% of India's export share), is projected to slow to 1.0% and 0.3% respectively in 2023 from 1.6% and 3.1% in 2022
- This could mean a muted export growth for India in FY24 and potential shave-off nearly 50 bps from its GDP growth in FY24

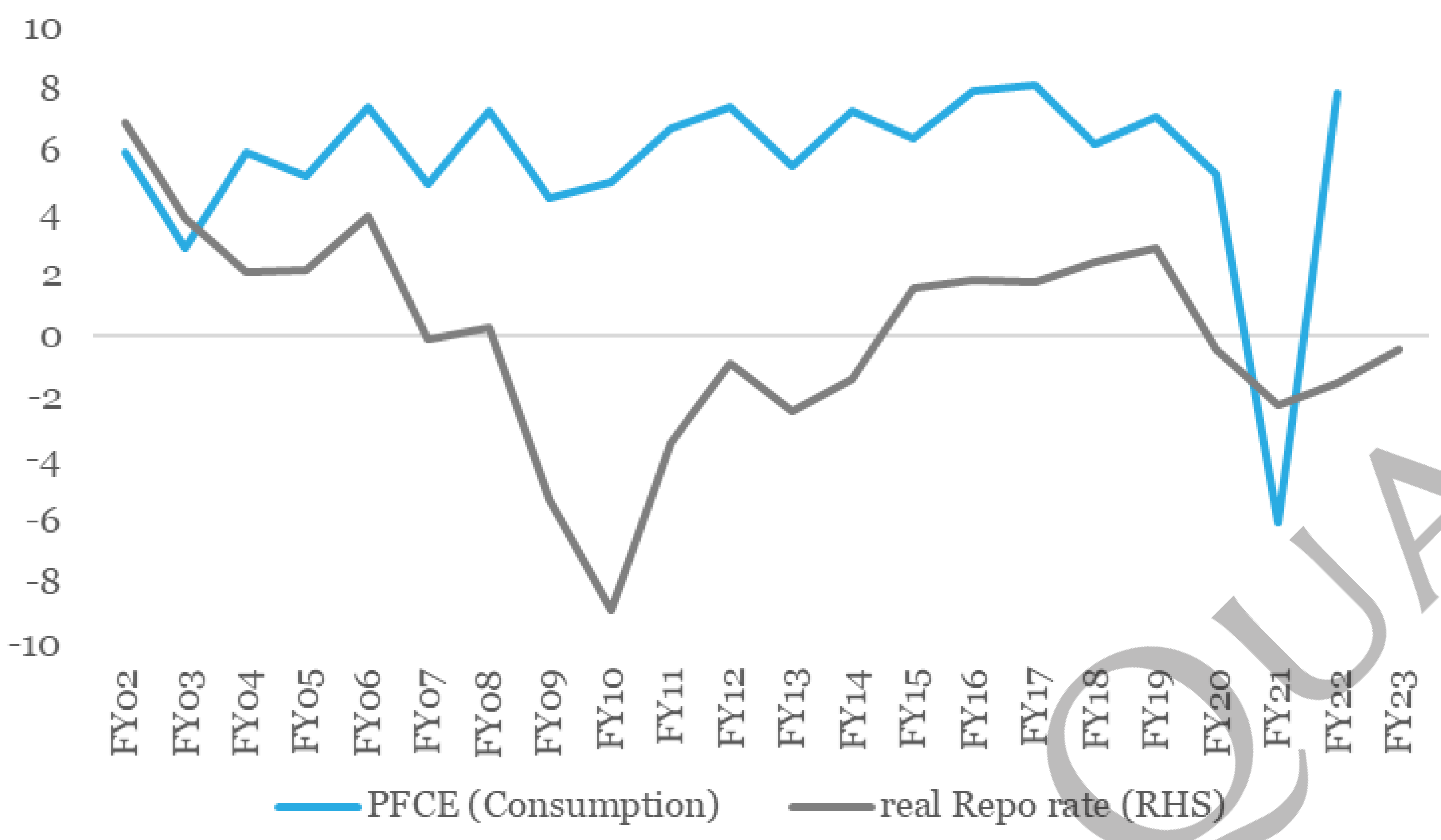
Manufacturing exports to bear the brunt

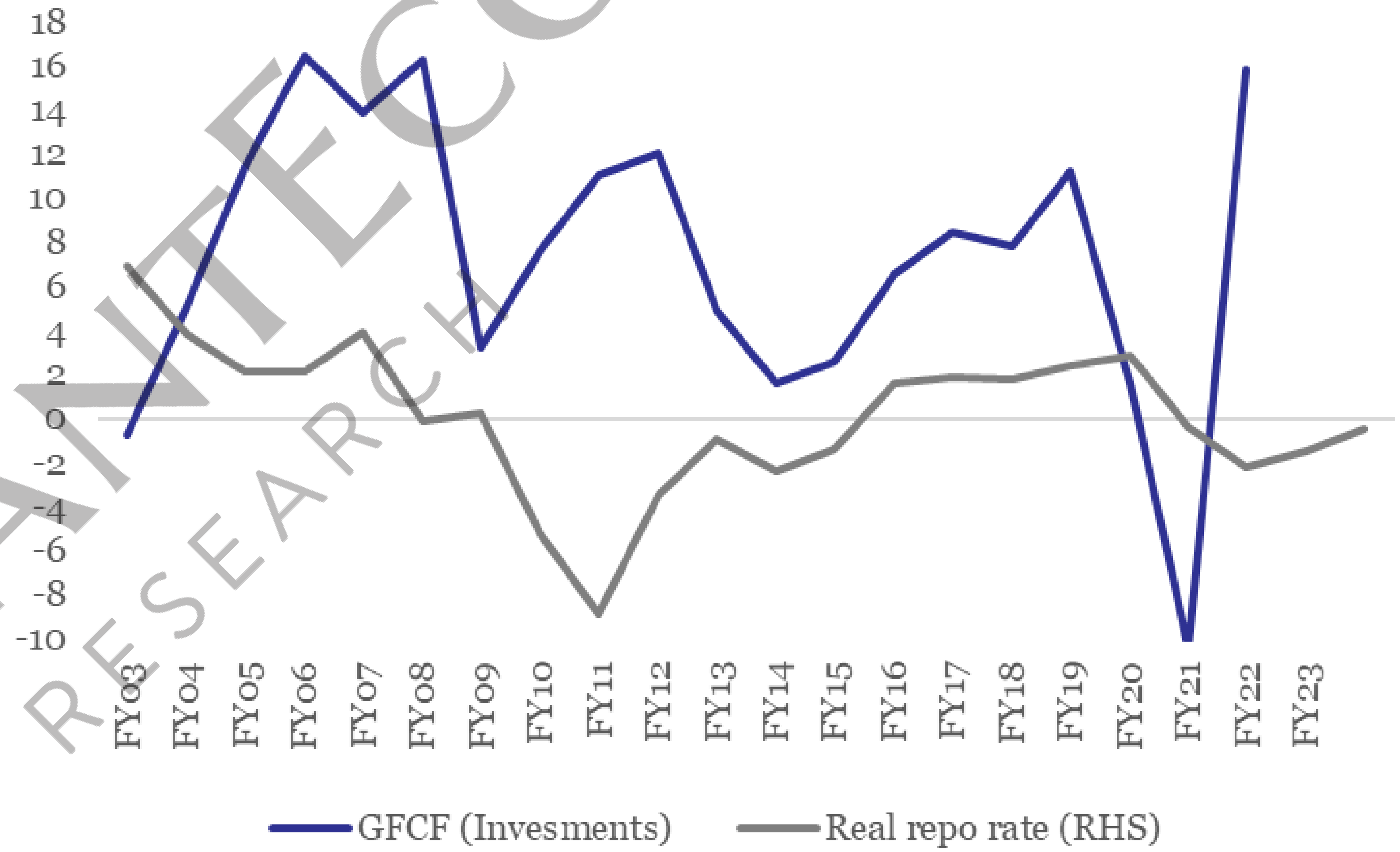


Performance of manufactured exports during 2008-09 downturn (%YoY)			
Sub-sectors	FY08	FY09	FY10
Cotton Raw incluude Waste	51.6	-68.4	218.0
Handicrafts include Handmade Carpets	6.2	-24.8	-11.5
Dyes Intermediates and Coal Tar Chemicals	22.1	-13.0	-4.6
Paints, Enamels, Varnishes	55.0	-10.7	-2.2
Plastic and Linoleum Products	0.8	-6.7	10.4
Project Goods	5.0	-2.4	-27.4
Leather and Manufactures	16.2	3.2	-6.1
Petroleum and Crude Products	41.4	4.5	2.3
Manufactured Goods: Paper, Wood Products	11.7	5.2	-2.6
Agri and allied	45.5	5.9	-8.0
Chemicals Products: Glass, Glassware, Ceramics, Refractories, Cement	7.4	6.7	-9.7
Textile and textile products	9.9	7.6	0.5
Sports Goods	4.4	10.1	-3.0
Chemicals Products: Rubber Manufactured Products	14.6	17.0	-10.4
Residual Chemicals and Allied Products	24.1	17.6	-5.2
Drugs, Pharmaceuticals and Fine Chemicals	24.3	19.4	2.1
Engg goods	25.9	22.5	-19.6
Inorganic, Organic, Agro Chemicals	29.8	26.0	0.2
Cosmetics, Toiletries	21.5	41.8	3.0
Gems and Jewellery	23.3	44.1	2.4
Electronic goods	17.1	104.3	-20.2
Computer Software: Physical Form	72.7	133.2	-47.5

- Growth in manufacturing exports has seen a steady decline in FY23, slipping into contraction over months of Oct-Nov-22. In contrast, services export growth has remained resilient in FY23, despite a strong base.
- Manufacturing exports could remain on a weaker turf in FY24, as global growth slowdown weighs.
- Looking at 2008-09 phase of global slowdown, traditional sectors of raw cotton, handicrafts, along with Chemicals (Dyes, Paints etc.) and Plastic products were the first ones to feel the pressure of global meltdown. Thereafter, negative impact expanded to Project Goods, Engineering goods, Electronic goods and physical form of Computer software
- Services exports too are likely to feel the heat in FY24 from the global demand moderation

Interest rate tightening impact – It could be different this time!





- Historically, for India we find that real interest rates have a stronger (negative) bearing on investments than consumption (see next slide for differentiated sectoral sensitivities)
- However, stronger balance sheets and lower debt, is likely to help private sector withstand the lagged impact of interest rate pass-through in FY24
- On the other hand, levered urban consumption could see some moderation, not just owing to pass through of higher rates but also with waning of pent up demand for discretionary goods

QuantEco Research

Interest rate sensitivity – Differentiated impact on sectors

Interest rate senstitivity of manufacturing sub-sectors

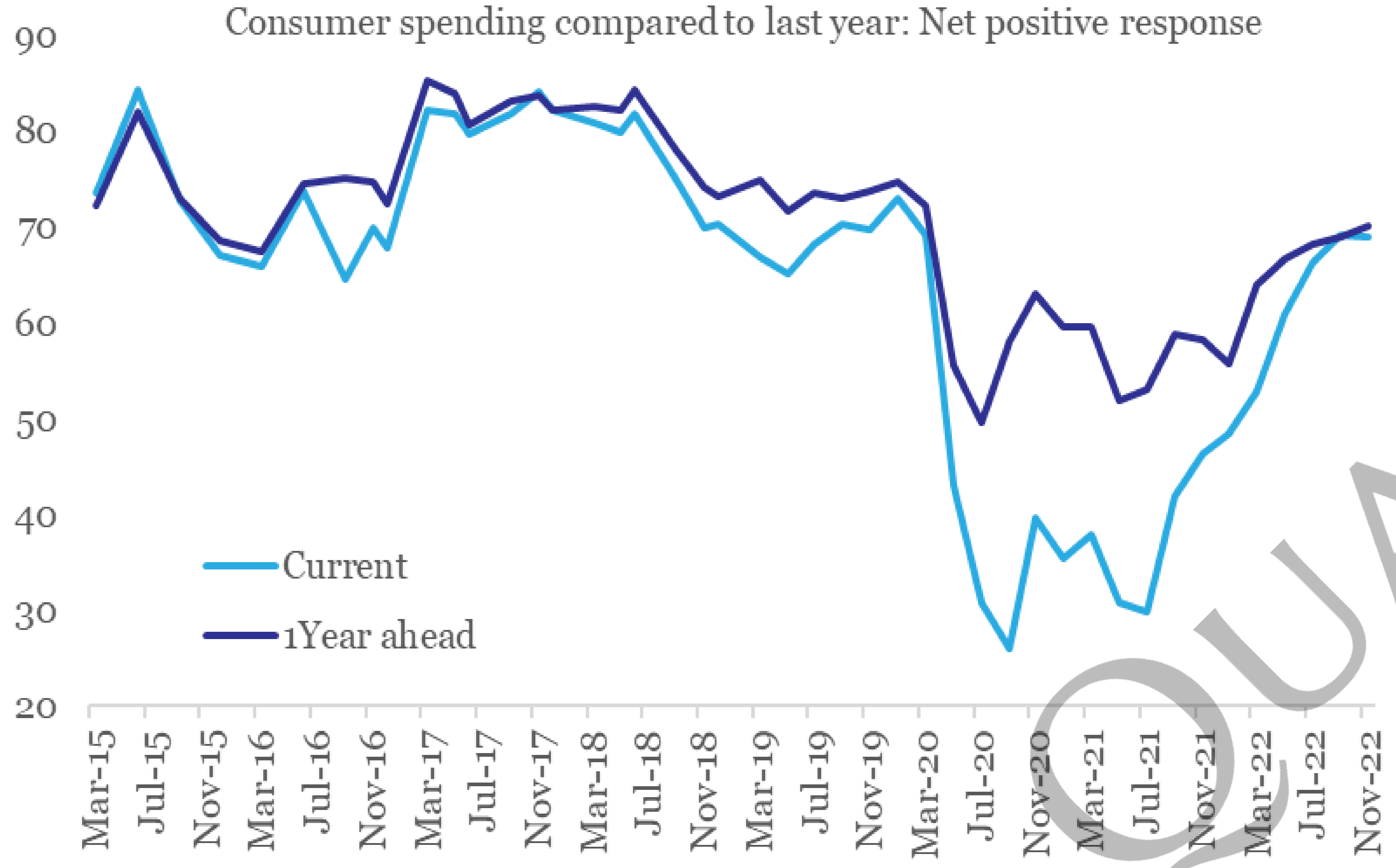
Manufacturing sub-sector	No lag	1 year lag
High impact sectors		
Rubber and Plastics Products	-0.27	-0.43
Paper and Paper Products	-0.14	-0.39
Printing and Reproduction of Recorded Media	0.07	-0.33
Fabricated Metal Products ex Machinery and Equipment	-0.09	-0.26
Basic Metals	-0.02	-0.23
Food Products	0.25	-0.22
Chemicals and Chemical Products	-0.01	-0.21
Other Non-Metallic Mineral Products	0.05	-0.18
Textiles	-0.05	-0.18

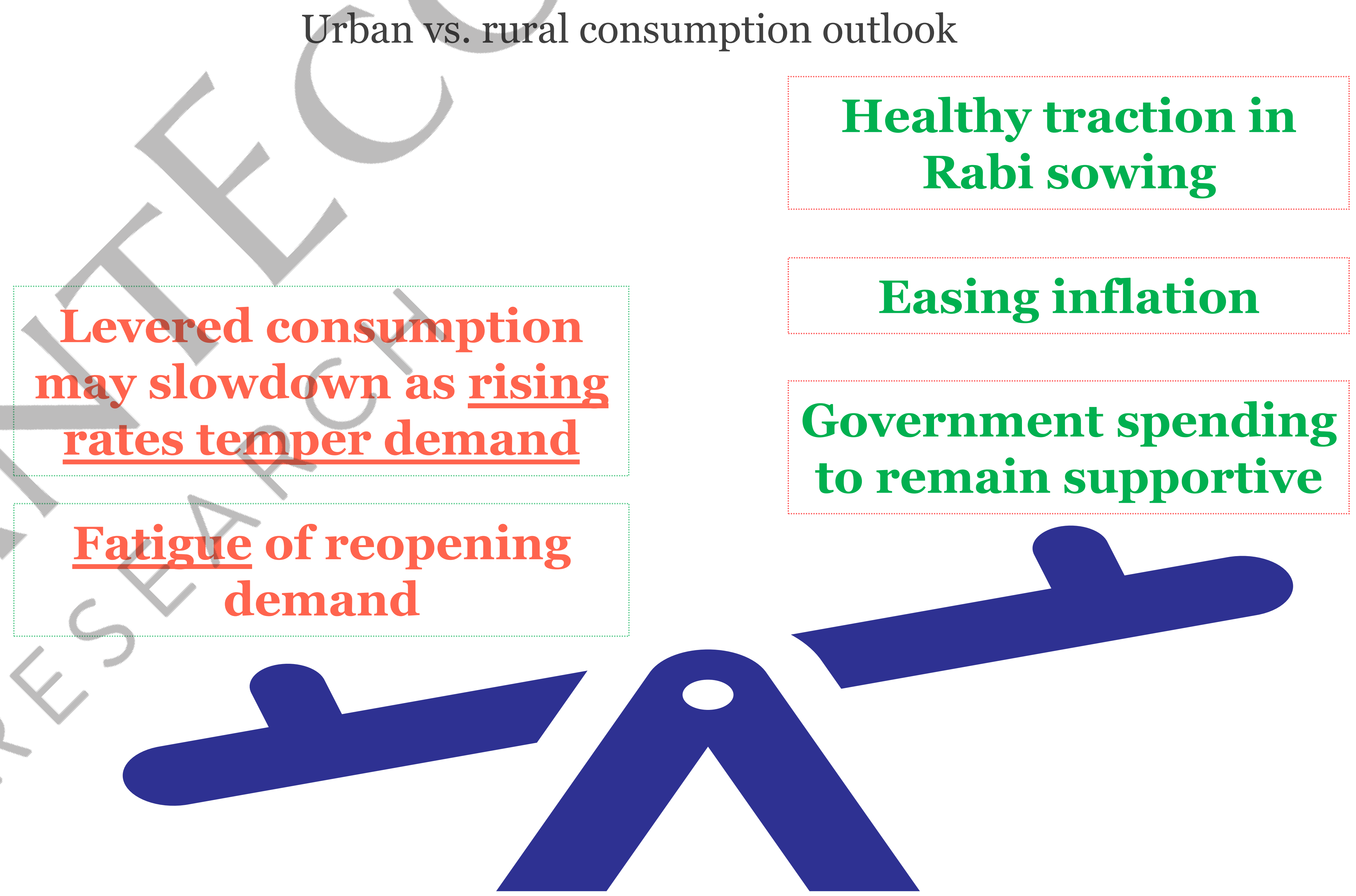
Manufacturing sub-sector	No lag	1 year lag
Medium impact sectors		
Furniture; Manufacturing N.E.C.	-0.05	-0.13
Leather and Related Products	-0.04	-0.12
Other Transport Equipment	-0.05	-0.11
Tobacco Products	-0.05	-0.11
Motor Vehicles, Trailers and Semi-Trailers	-0.03	-0.11
Wearing Apparel	0.11	-0.10
Low impact sectors		
Wood and Wood Products	-0.01	-0.07
Other Manufacturing	-0.03	-0.06
Electrical Equipment	0.01	0.02
Pharma, Medicinal Chemical and Botanical	0.09	0.07
Machinery and Equipment N.E.C.	0.06	0.08
Coke and Refined Petroleum Products	0.25	0.09
Computer, Electronic and Optical Products	0.18	0.11

Using annual data, FY07-FY23

- At a granular level, sub-sectors that display high interest rate sensitivity historically include – Rubber and Plastics, Paper, Recorded Media, Basic metals and Fabricated metal products, Chemicals and Textiles among others
- The impact of higher interest burden costs is likely to be more pronounced on MSME sector in FY24, which could get exacerbated by the slowdown in exports
- Private sector capex, could remain somewhat sluggish and uneven incrementally in FY24, despite capacity utilisation levels soaring to pre-pandemic levels at around ~75%

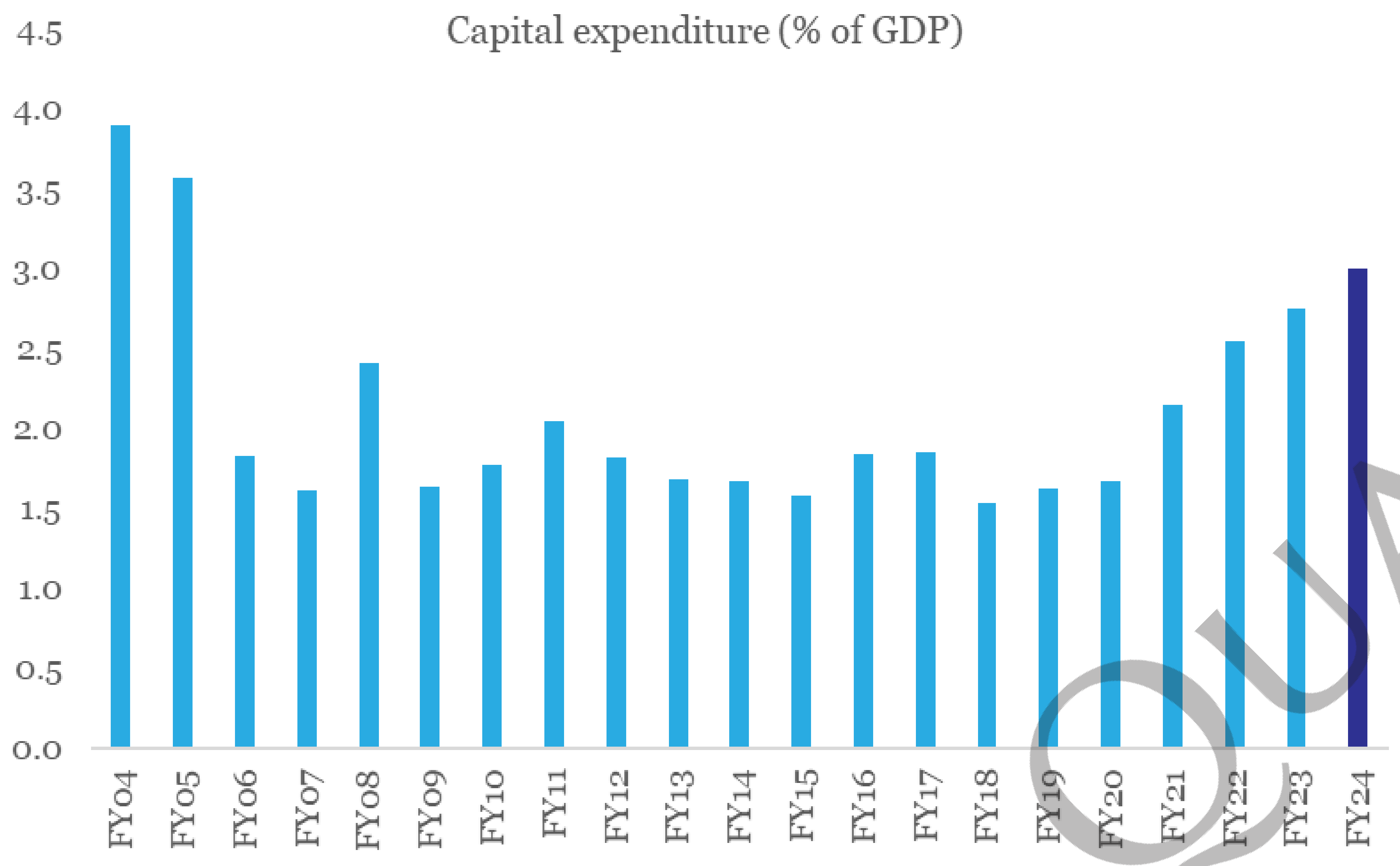
Rural India can heave up consumption momentum

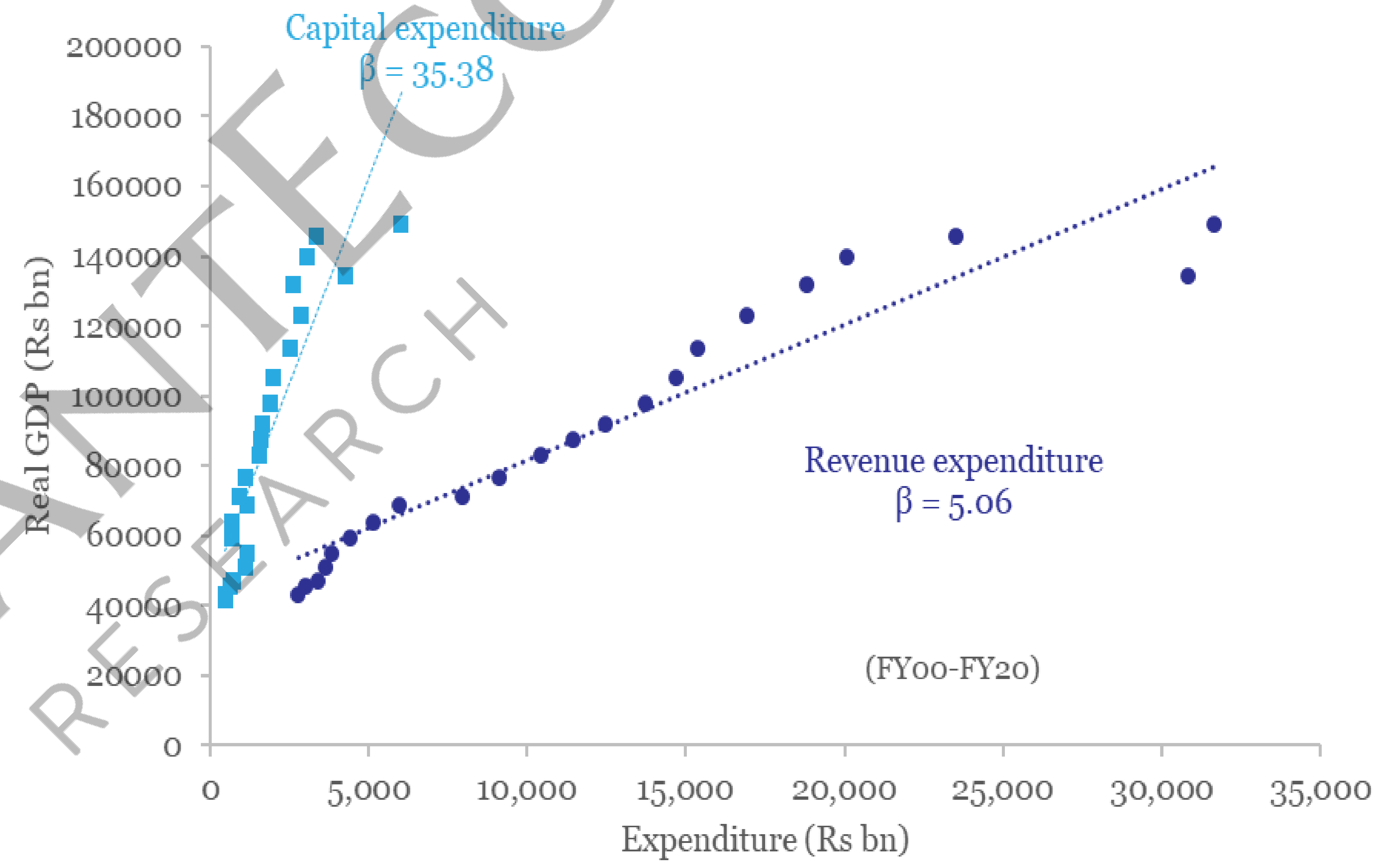




- For the first time since the onset of the pandemic, net response of households on consumer spending (compared to last year) for current and 1-year ahead timeline equalised as of Nov-22. This is yet another reflection of consumption having normalised in 2022.
- Having said so, rural consumption could see better traction in 2023 amidst healthy Rabi sowing, easing rural inflation and continued support from Government spending.

Strong Government capex-GDP growth multiplier

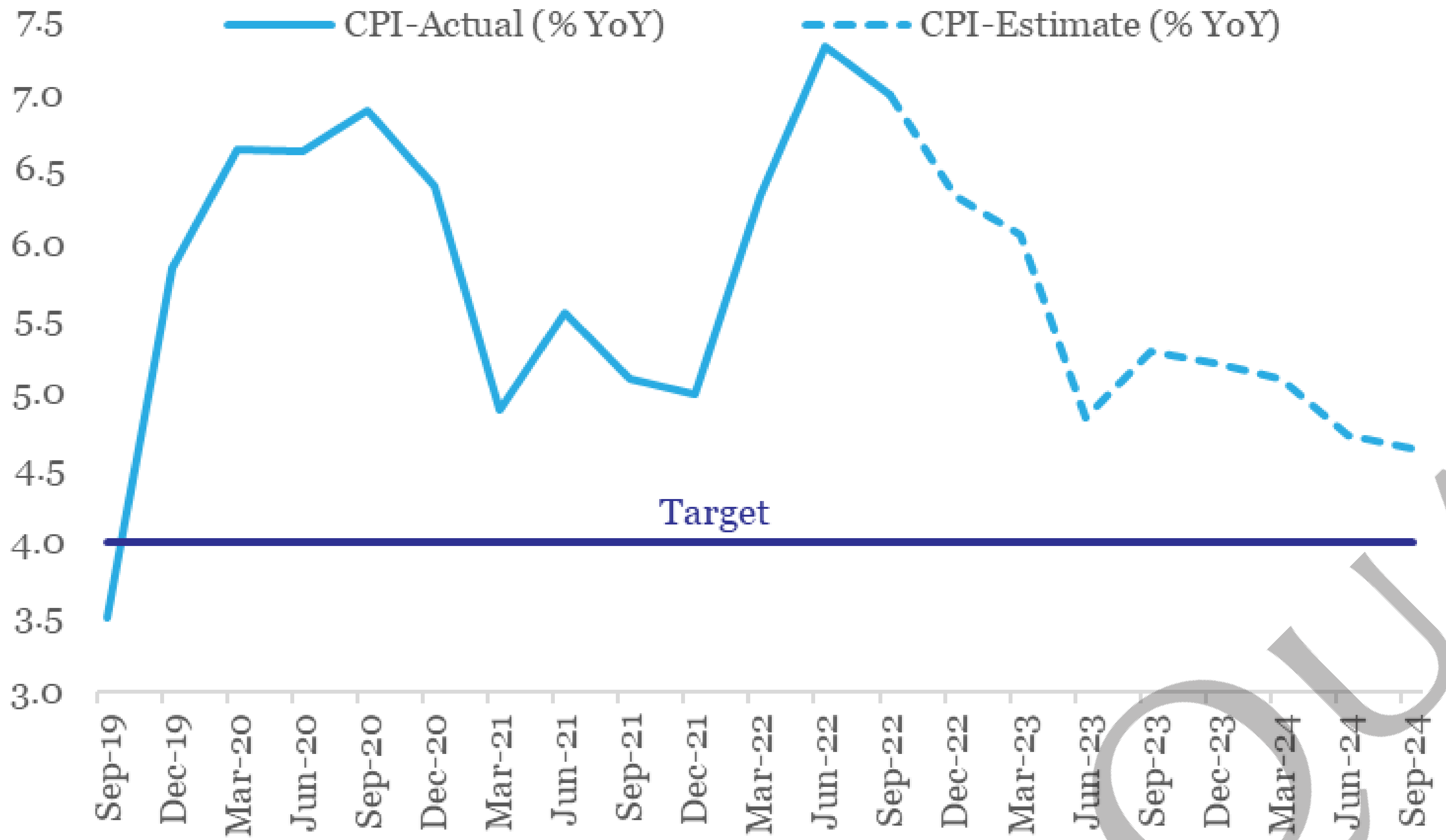




- Government's capital spending registering a growth of over 60%YoY over Apr-Nov FY23 marks the fastest pace of growth on record
- As a % of GDP, capex spending could exceed 3.0% in FY24, after a gap of nearly two decades
- This augurs well from growth perspective, given that capital expenditure has a much higher multiplier (7x) compared to revenue expenditure

QuantEco Research

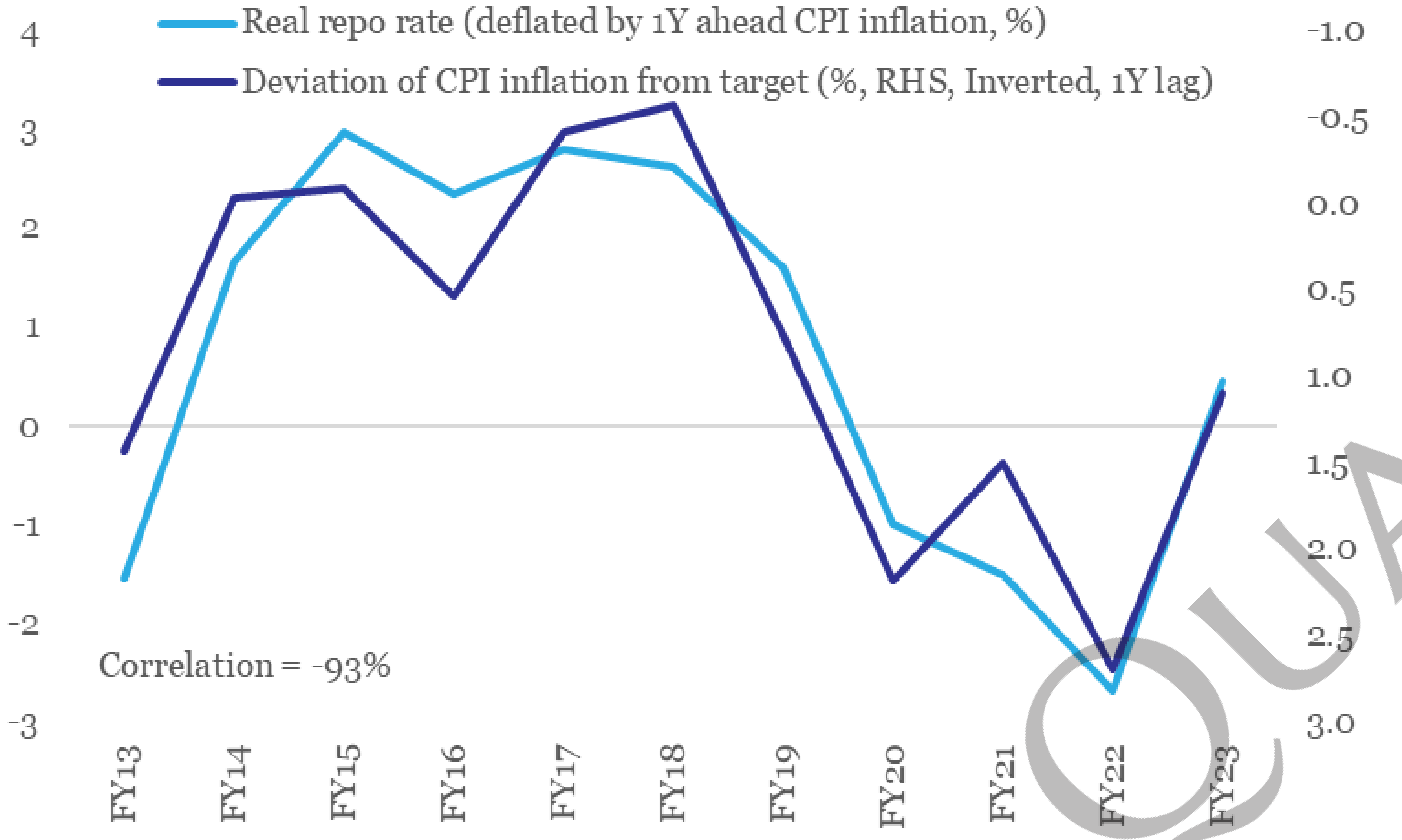
CPI Inflation to glide lower to 5.3% in FY24

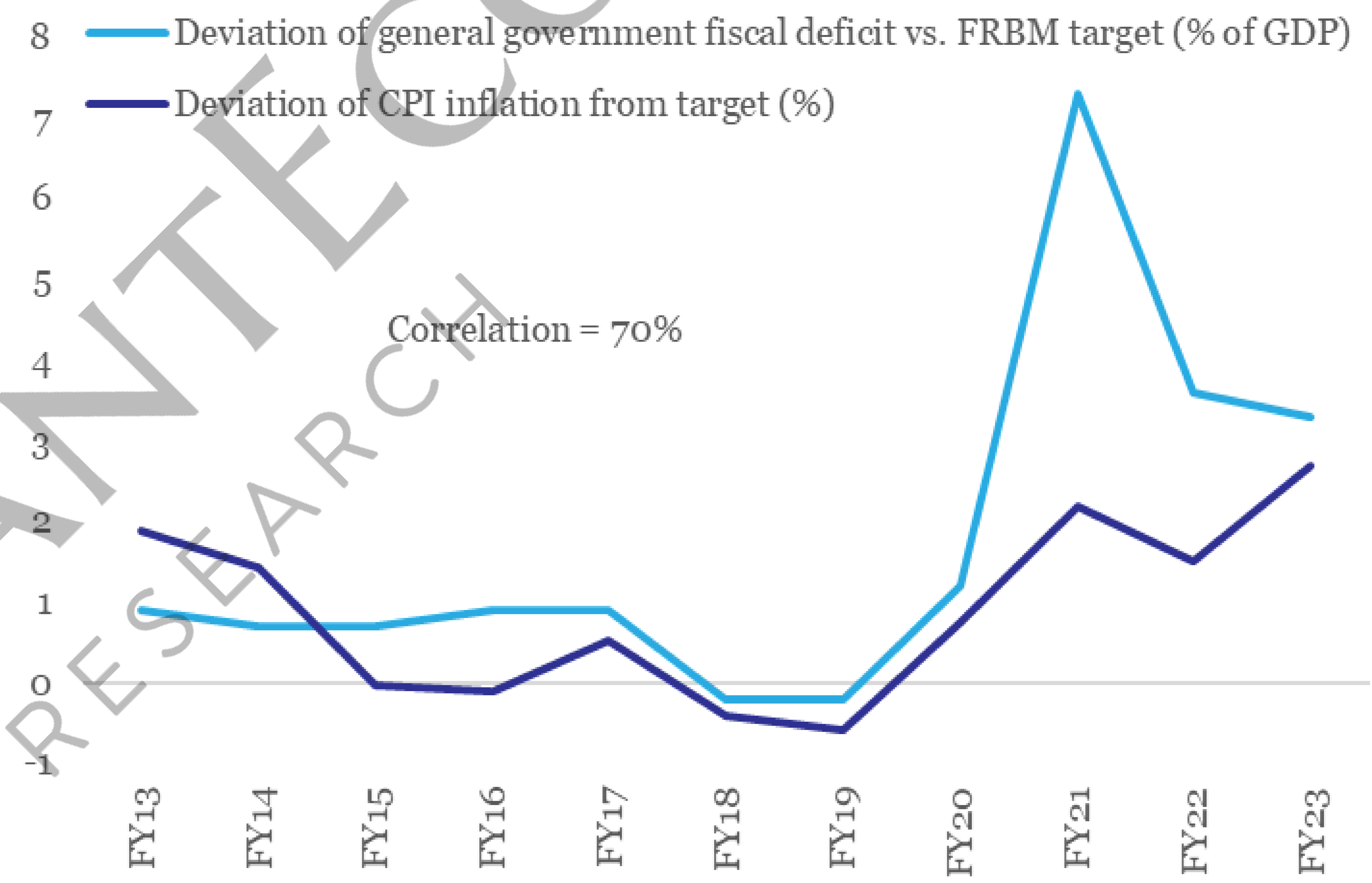


Key assumptions			
	FY23	FY24	FY25
Indian Crude Basket ($/bl)	100	85	90
USDINR (Avg.)	80.0	82.0	84.0
Monsoon	Normal	Normal	Normal
Fiscal Deficit (% of GDP)	6.4	6.0	5.4
Global Growth (%)	3.1	2.8	3.2

- Basis key assumptions enumerated in the table above, we estimate CPI inflation to moderate from 6.7% in FY23 to 5.3% in FY24
- Bulk of the moderation in FY24 is expected to be on account of lower inflation in case of Fuel & Light, Food & Beverages, Clothing & Footwear, and Miscellaneous items
  - In contrast, inflation in case of Pan, Tobacco & Intoxicants and Housing is expected to firm up a bit in FY24, amidst a move towards trend after a supportive base effect resulted in less than trend inflation in FY23
- Average inflation over FY23 and FY24 is estimated to be 6.0%, higher vs. 4.8% average inflation seen since the commencement of flexible inflation targeting regime in FY15. However, this would be in line with last 10-year average inflation of 5.8%.

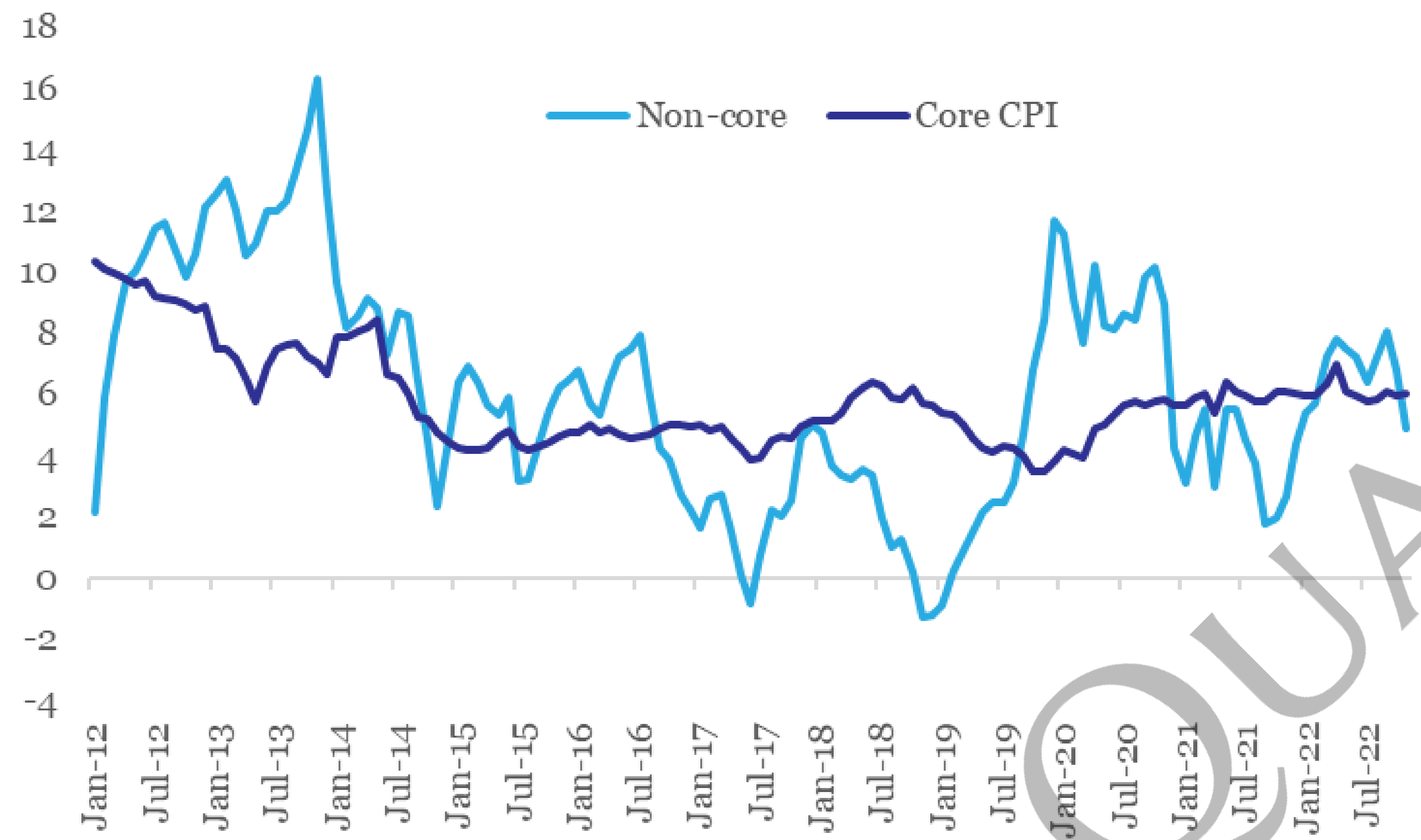
The policy cross-currents

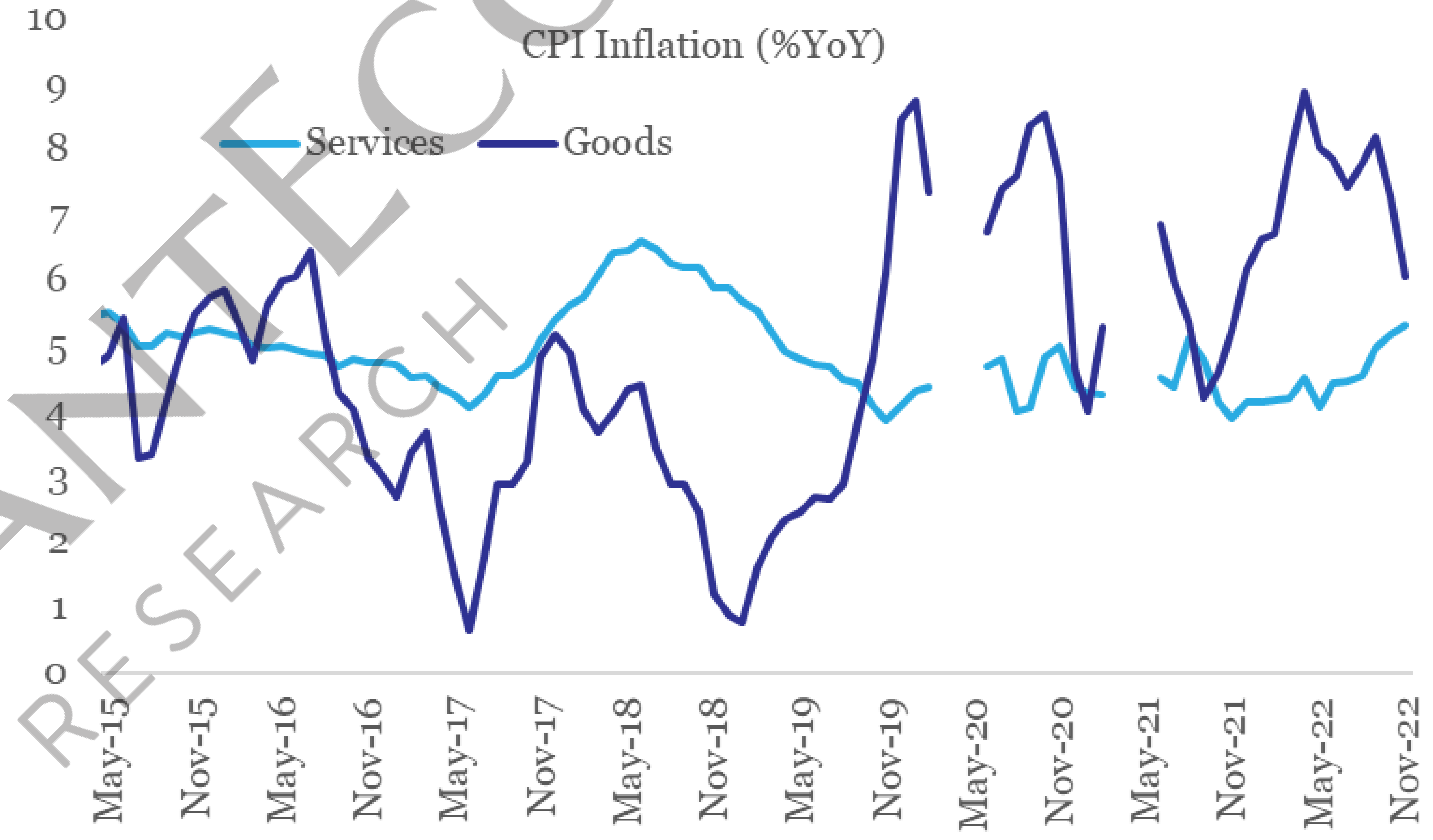




- After remaining significantly accommodative between FY20 – FY22, the ex ante real repo rate is creeping back to positive territory in FY23. This will have a lagged impact on lowering inflation.
- Nevertheless, CPI inflation touching 4% on a steady state basis in FY24 (or FY25) remains a low likelihood event due to sizable fiscal deviations in last 3-years. While the output gap could move towards closure in FY24, the level of fiscal deficit would still be much higher (even accounting for 0.5-0.6% correction in fiscal deficit in FY24) than its pre pandemic levels (as well as vs. the erstwhile FRBM threshold of 6.0% of GDP for general government). This could potentially continue to impart an upside bias to inflation.

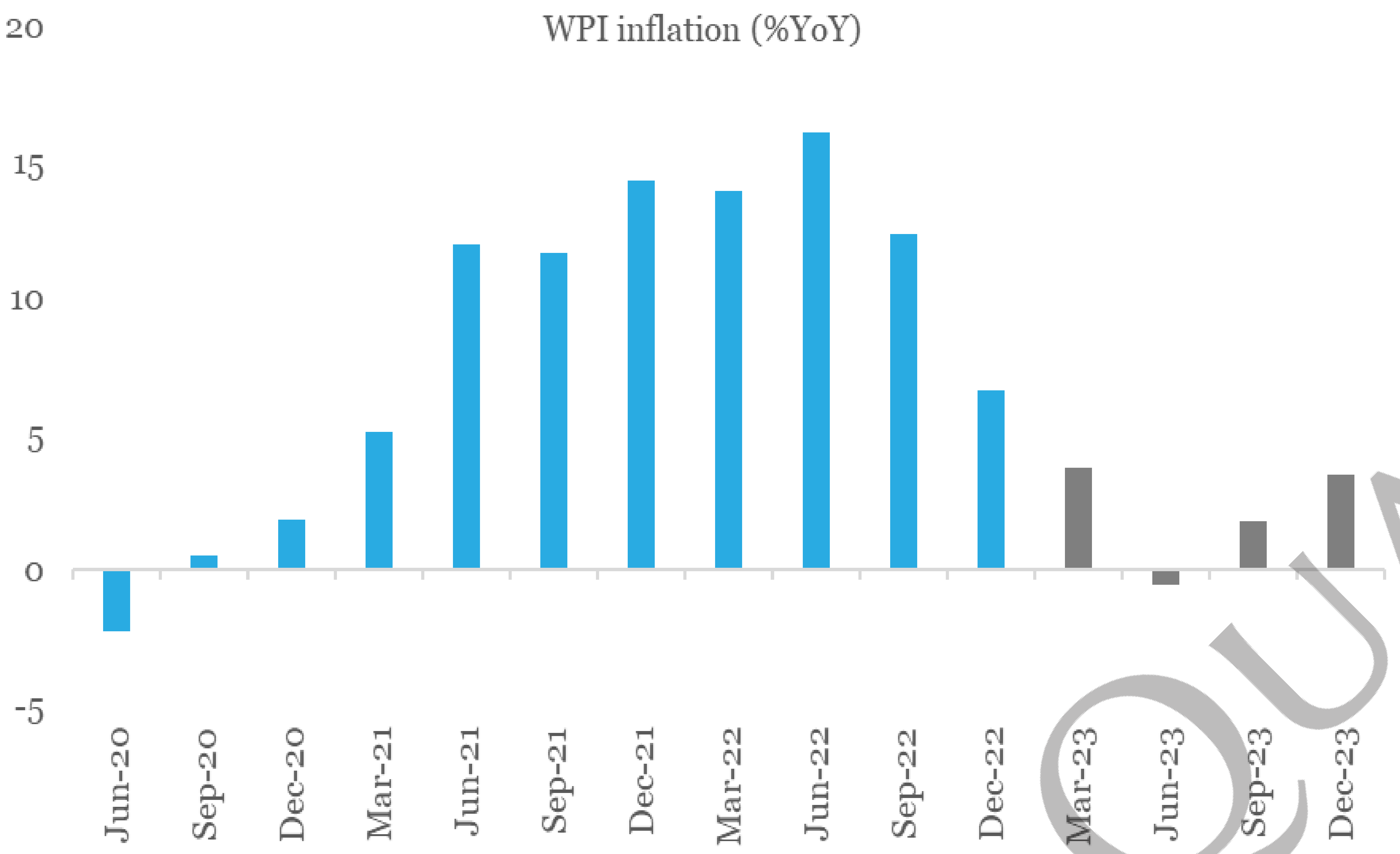
Core inflation to descend slowly

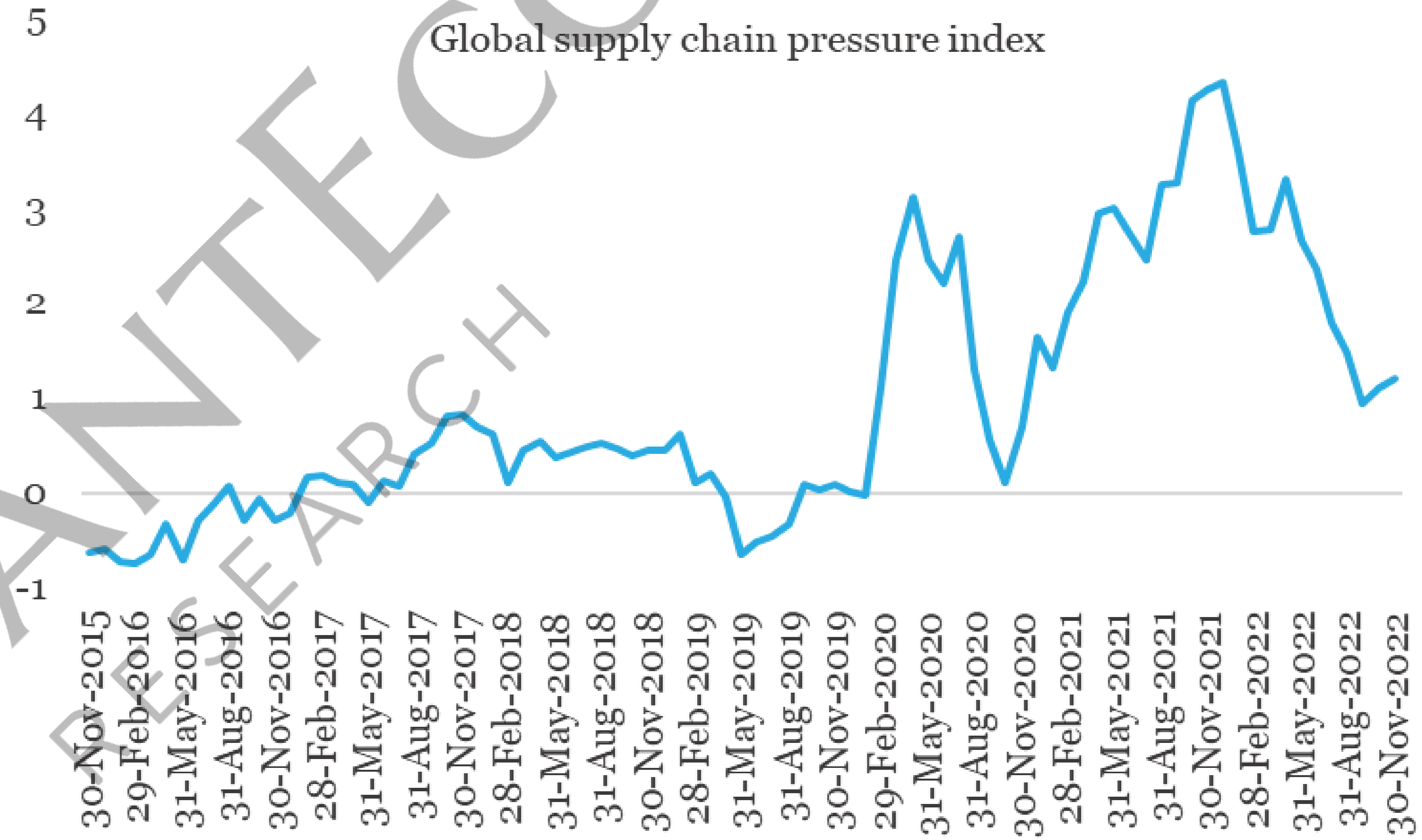




- We find transmission from non-core to core CPI inflation to be moderate. The correlation coefficient stands at 40% with peak impact taking 6 months to translate.
- In FY23 so far, non-core CPI inflation has moderated from a peak of 8.0% in Apr-22 to 5.0% as of Nov-22, Core inflation has remained sticky in 6.0-6.5% range
- The moderation in non-core inflation can be expected to get transmitted to core-inflation gradually in H1 2023
- However, given the recent recovery in services and upside in services inflation, the transmission can be somewhat prolonged this time around

WPI inflation to average at 2.0% in FY24

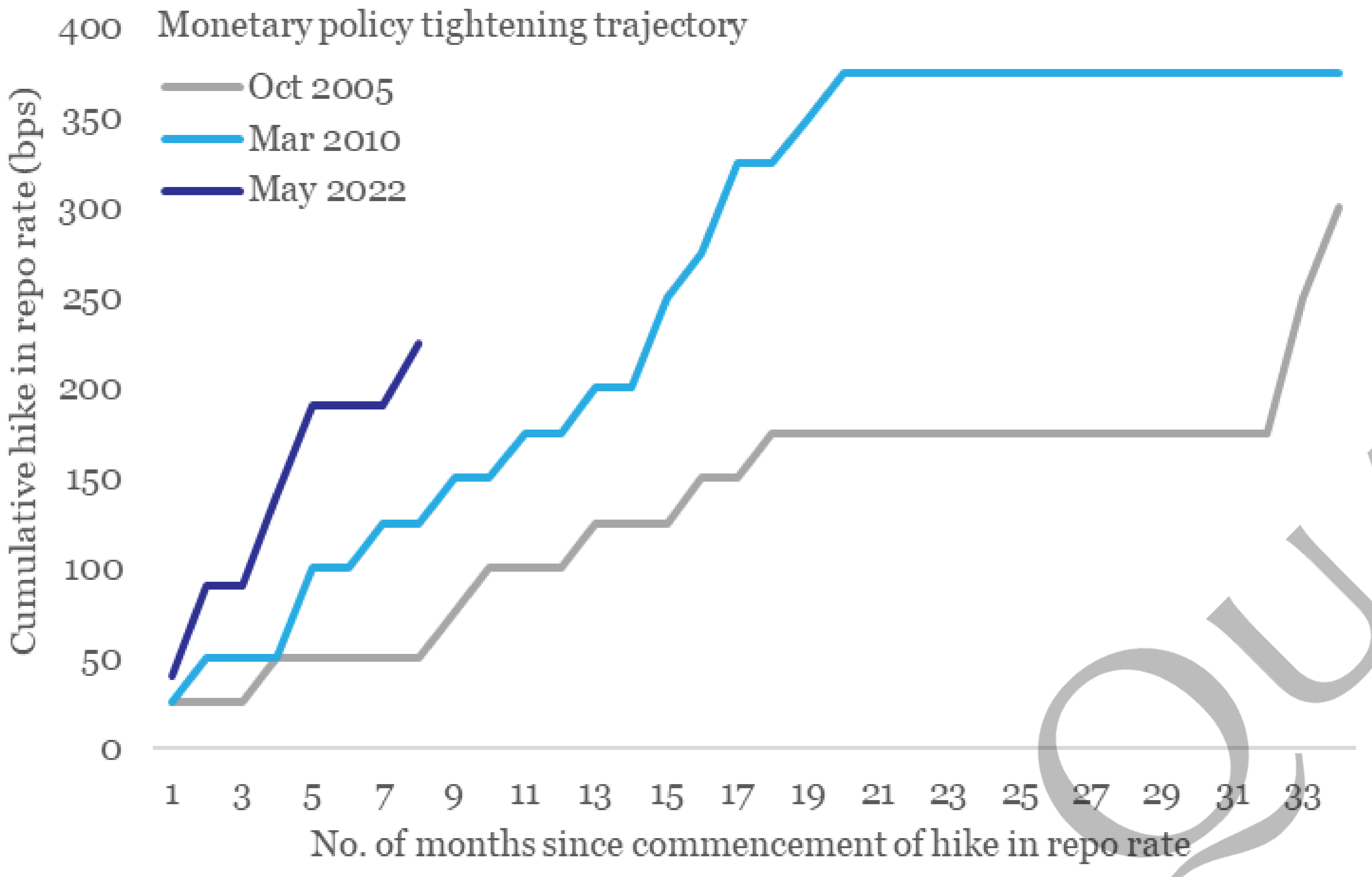


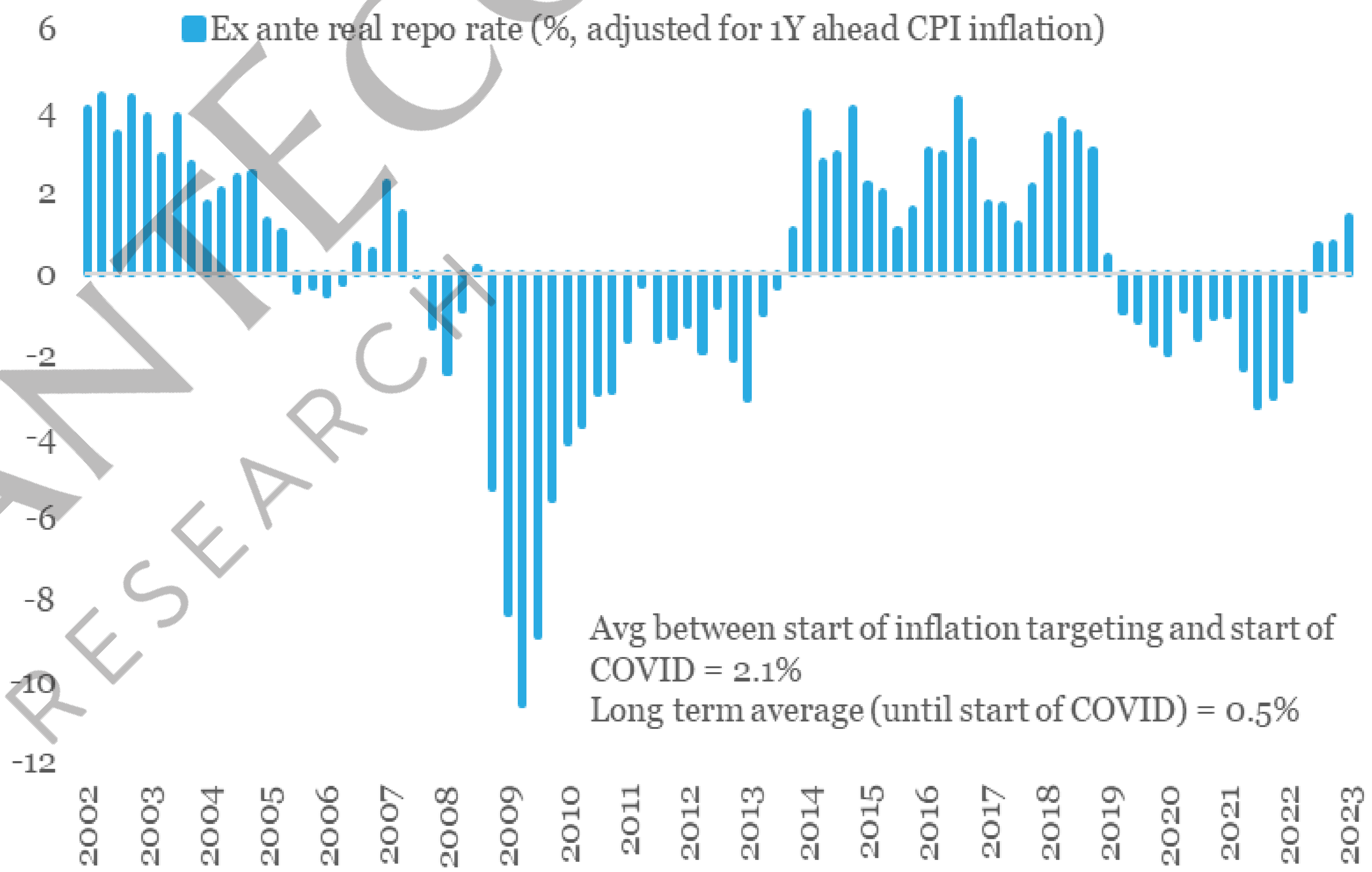


- We foresee WPI inflation to moderate to an average of 2.0% in FY24 compared to 9.7% in FY23
- The decline in commodity prices and likelihood of price pressures remaining subdued as global growth wanes, supports this outlook
- In addition, continued normalisation in global supply chain bottlenecks will aid WPI inflation lower, likely to slip into negative in Q1 FY24

QuantEco RESEARCH

Front loaded hikes take policy rate towards 'neutral'

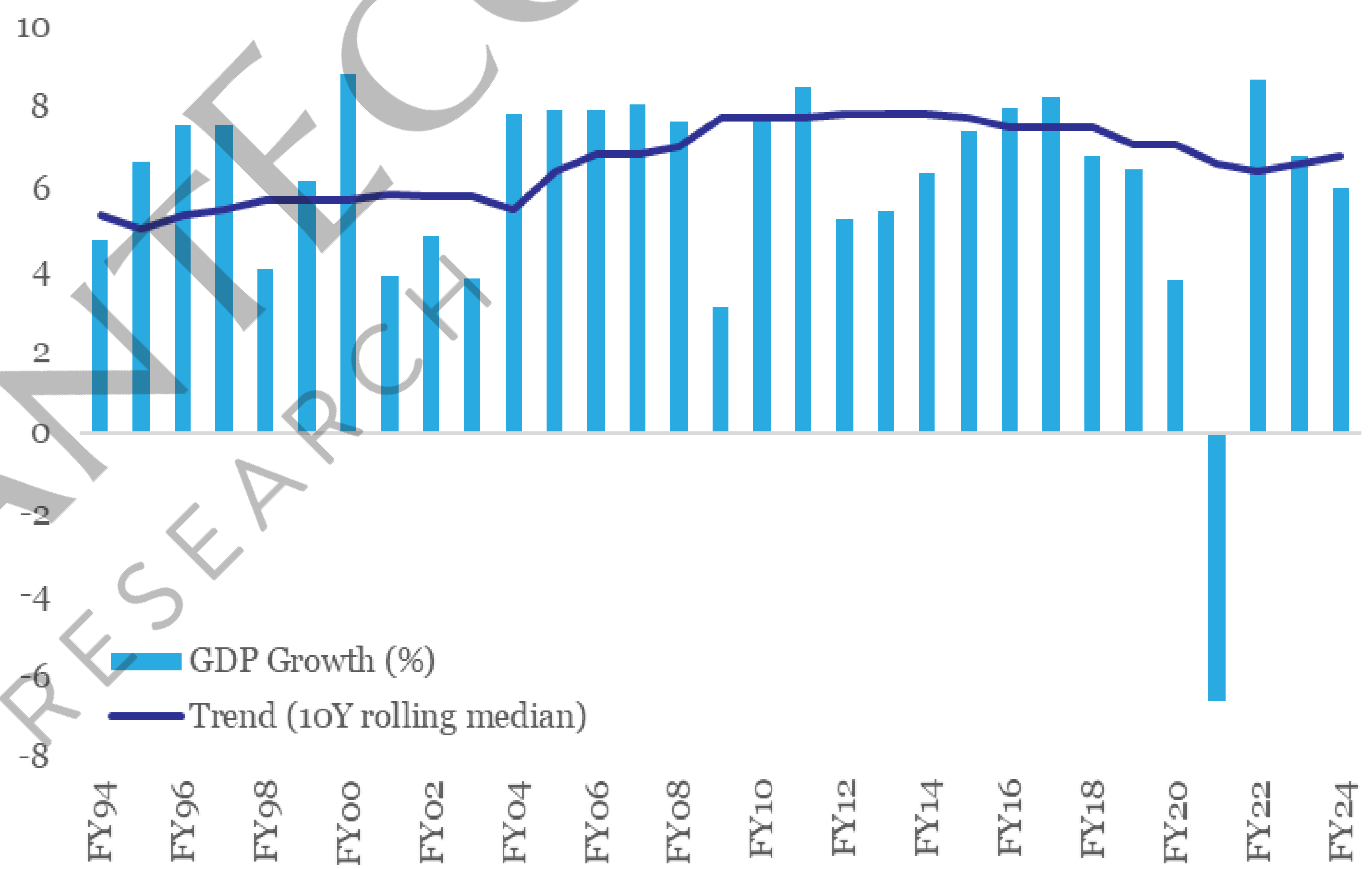




- The MPC has raised repo rate by a cumulative of 225 bps since May-22
- Effective policy tightening stands at 290 bps after taking into account the introduction of SDF in Apr-22
- Since then, both realized and expected inflation has moderated
- As such, the neutral real policy rate has now crossed 1% (assuming FY24 CPI inflation close to 5.3%) and is at its highest levels since Q3 FY19

Would monetary policy look beyond inflation in FY24?

Central government's fiscal deficit (% of GDP)	
Pre COVID 5Y average	3.8
FY21	9.2
FY22	6.7
FY23 (QR E)	6.4
FY24 (QR E)	5.8-5.9



- With CPI inflation (the legally binding remit for the MPC) expected to revert to the target band in FY24, MPC members would need to consider the following variables in assessing the overall economic situation along with their second order impact on inflation
  - Continuation of the gradual withdrawal of fiscal policy accommodation would be viewed constructively along with superior quality of adjustment
  - With GDP growth expected to moderate towards 6% in FY24, the MPC would need to assess the output gap, especially in case of manufacturing and exports

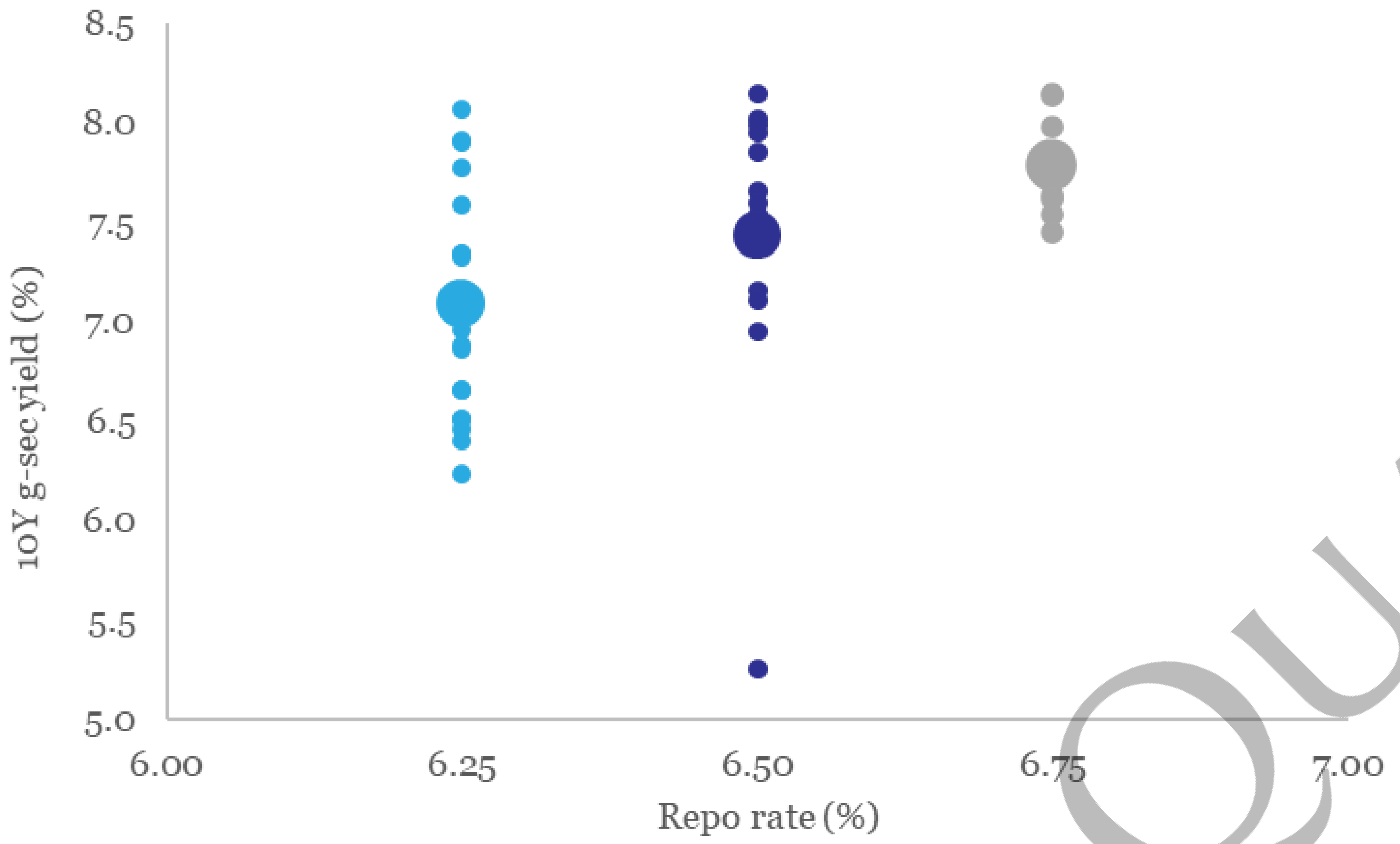
Gradually shifting avian profile of the MPC

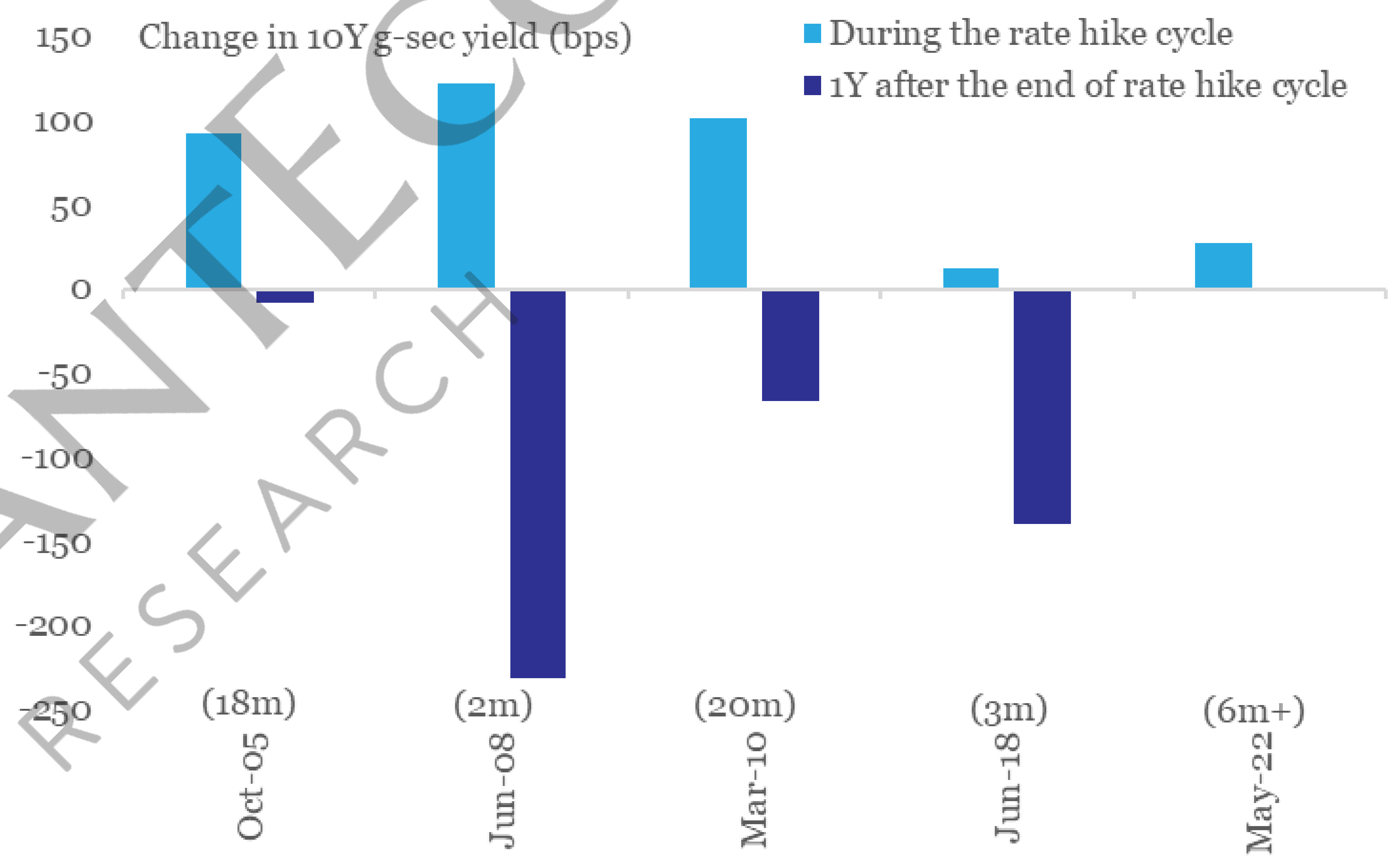
Recent MPC actions							
		Aug-22		Sep-22		Dec-22	
Name	Type	Repo rate	Policy stance	Repo rate	Policy stance	Repo rate	Policy stance
Shashanka Bhide	External	Hike 50 bps	WoA	Hike 50 bps	WoA	Hike 35 bps	WoA
Ashima Goyal	External	Hike 50 bps	WoA	Hike 35 bps	WoA	Hike 35 bps	Neutral
Jayanth Varma	External	Hike 50 bps	WoA	Hike 50 bps	Neutral	Pause	Neutral
Rajiv Ranjan	Internal	Hike 50 bps	WoA	Hike 50 bps	WoA	Hike 35 bps	WoA
Michael Patra	Internal	Hike 50 bps	WoA	Hike 50 bps	WoA	Hike 35 bps	WoA
Shaktikanta Das	Internal	Hike 50 bps	WoA	Hike 50 bps	WoA	Hike 35 bps	WoA

Note: WoA stands for Withdrawal of Accommodation; Shaded cell represents non-consensus decisions

- 2 out of 6 MPC members have turned dovish
  - We expect Ashima Goyal and Jayanth Varma could abstain from a rate hike vote in the next policy review in Feb-23
- However, we expect the remaining 4 members to continue to sound somewhat hawkish – however, they are likely to step down further on policy aggression and opt for 25 bps, i.e., a lower quantum of rate hike vis-à-vis the 35 bps increase in Dec-22

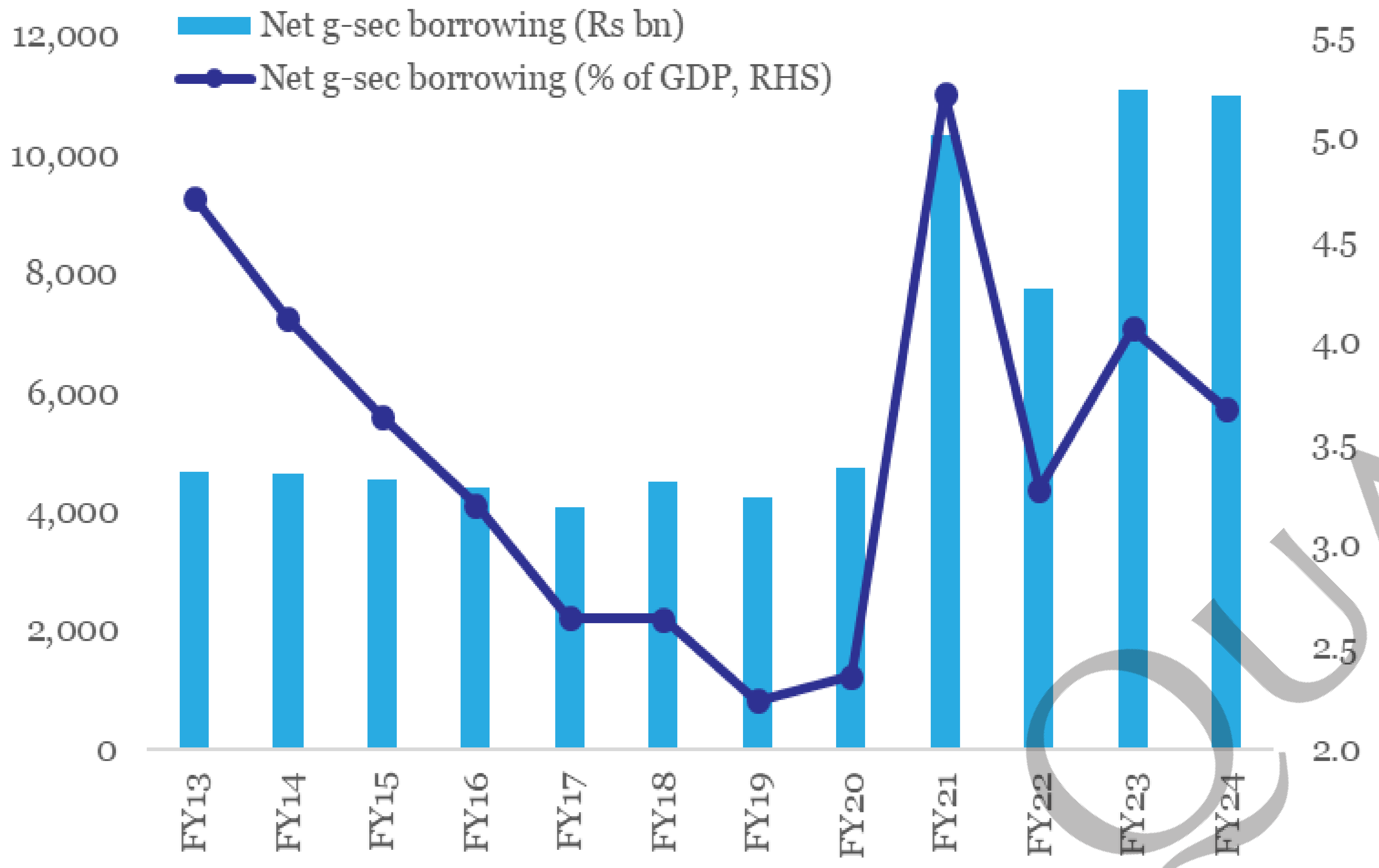
Rates outlook: Impact of monetary policy pivot

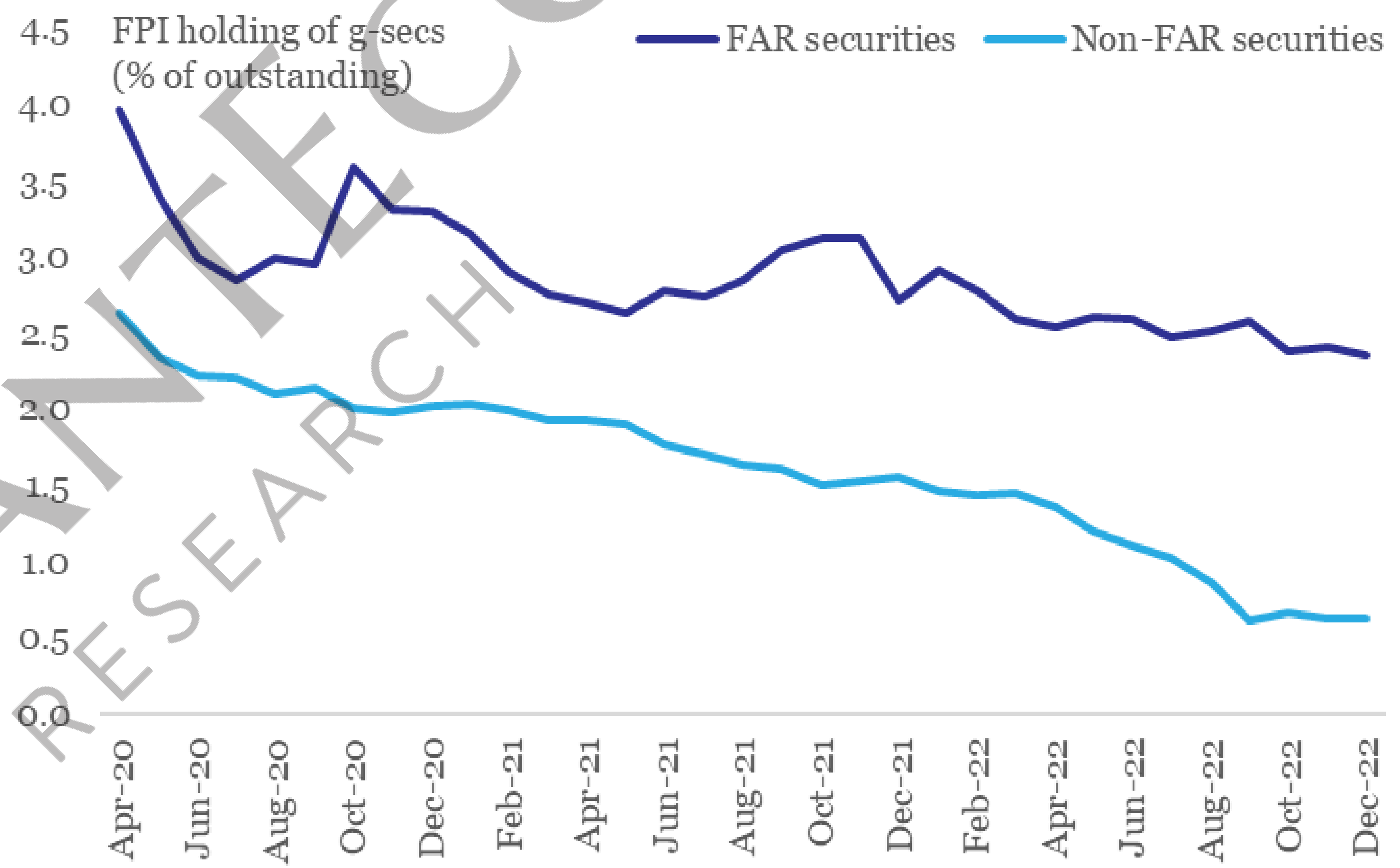




- The current level of repo rate of 6.25% has historically coincided with an average 10Y g-sec yield of 7.08%. A 25 bps hike in repo rate (in Feb-23 as per QuantEco forecast) will shift the historical average 10Y g-sec yield to 7.43%. We believe the current 10Y g-sec yield of 7.32% is fairly priced taking into account one more rate hike from the RBI. However, in the risk scenario of one more round of rate hike (with repo rate at 6.75% by Apr-23), there could be additional upward pressure of 20 bps on the 10Y g-sec yield.
- While the MPC as a group may continue to sound hawkish (as long as the fed funds rate does not reach its terminal level), we believe Feb-23 rate hike by the RBI to be the final one in the current cycle
  - Historically, post a pause in monetary policy hike cycle, the 10Y g-sec yield declines by ~100 bps over 12m

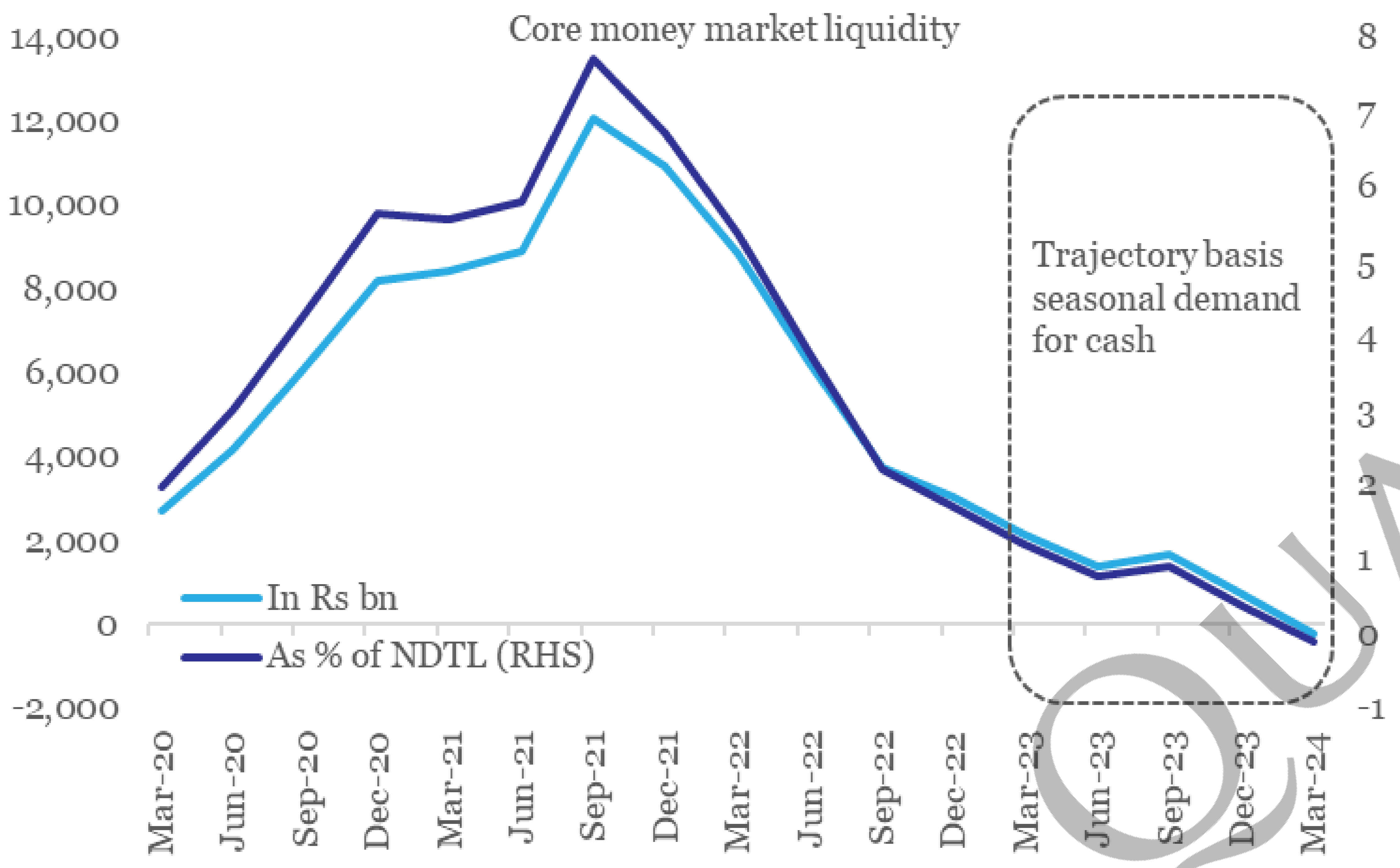
Rates outlook: The supply perspective

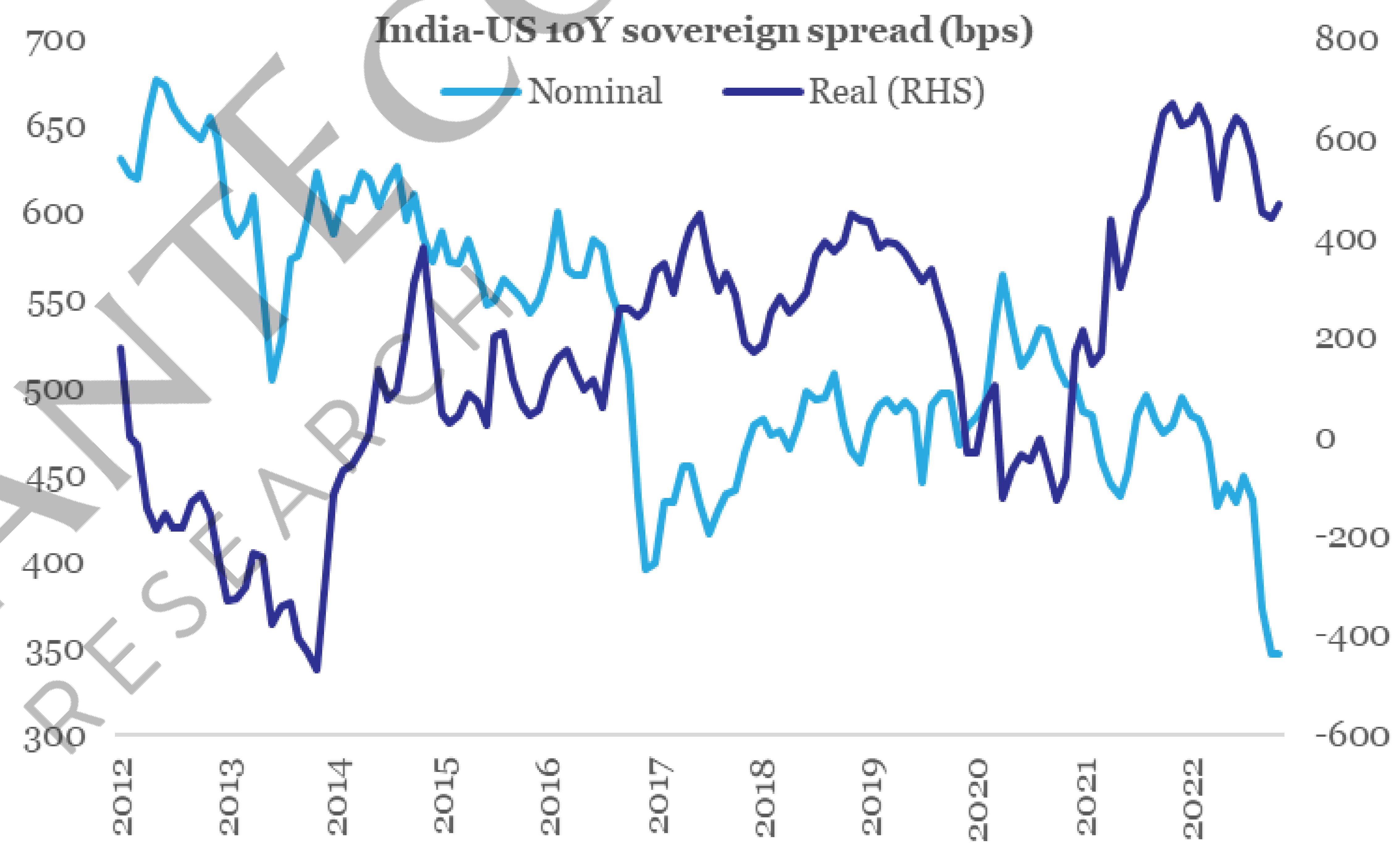




- Assuming fiscal deficit glides lower to 5.8-5.9% of GDP in FY24 from the budgeted level of 6.4% in FY23, the net market borrowing figure could potentially get pegged to Rs 11 tn in FY24 – similar to FY23 levels in rupee terms
    - While the likely quantum of borrowing at 3.7% of GDP in FY24 will be lower than the 4.1% seen in FY23, it will continue to remain much higher than the pre pandemic levels of 2.2-3.2% (5Y range)
- Policymakers need to consider expanding the pool of creditors by getting India listed on the global bond indices – this could pave way for USD 25-30 bn passive index flows in a span of 2-years. In the absence of any such announcement, the RBI might strategically use OMO purchases in FY24 to stabilize the market.

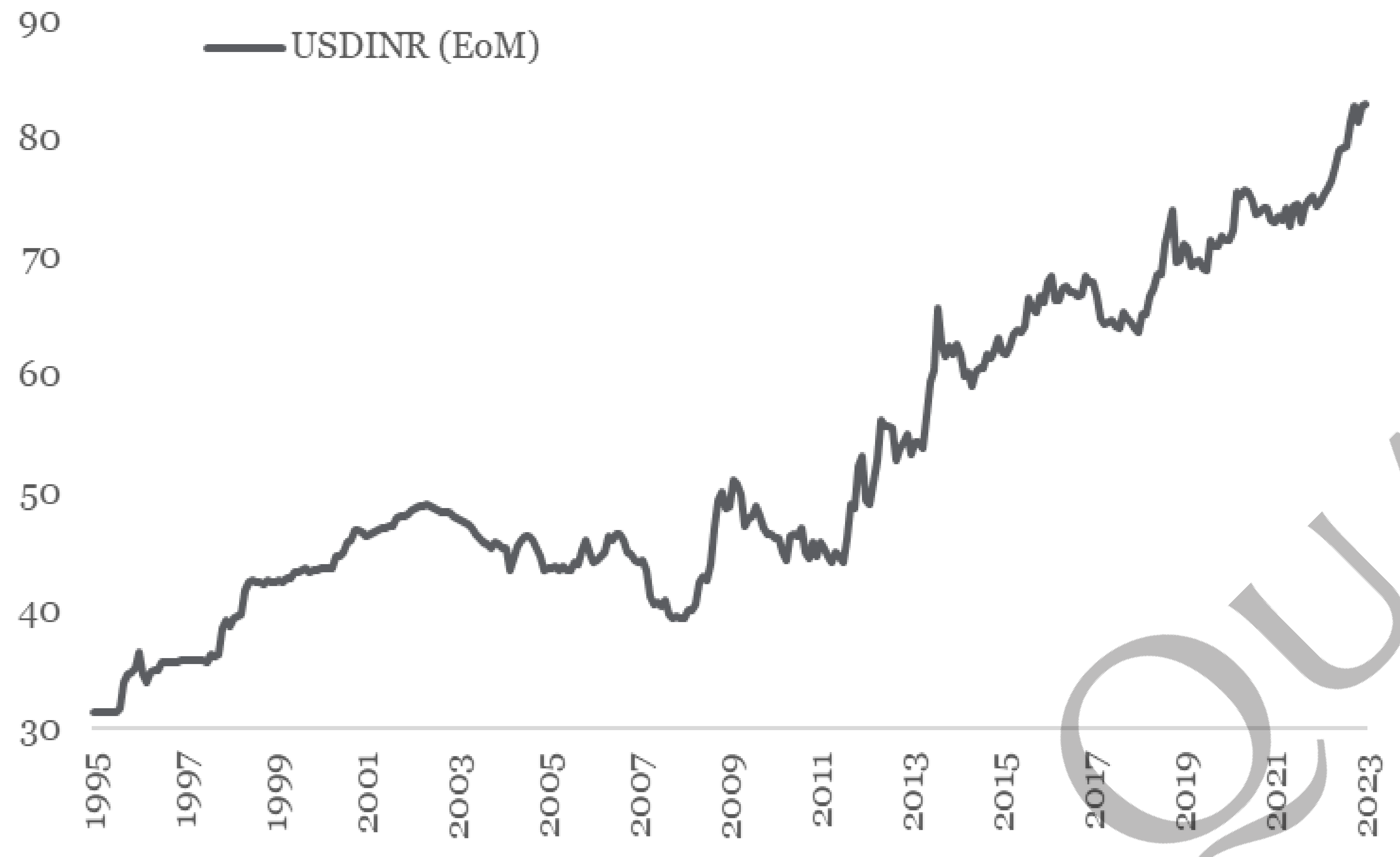
Rates outlook: Liquidity and global backdrop

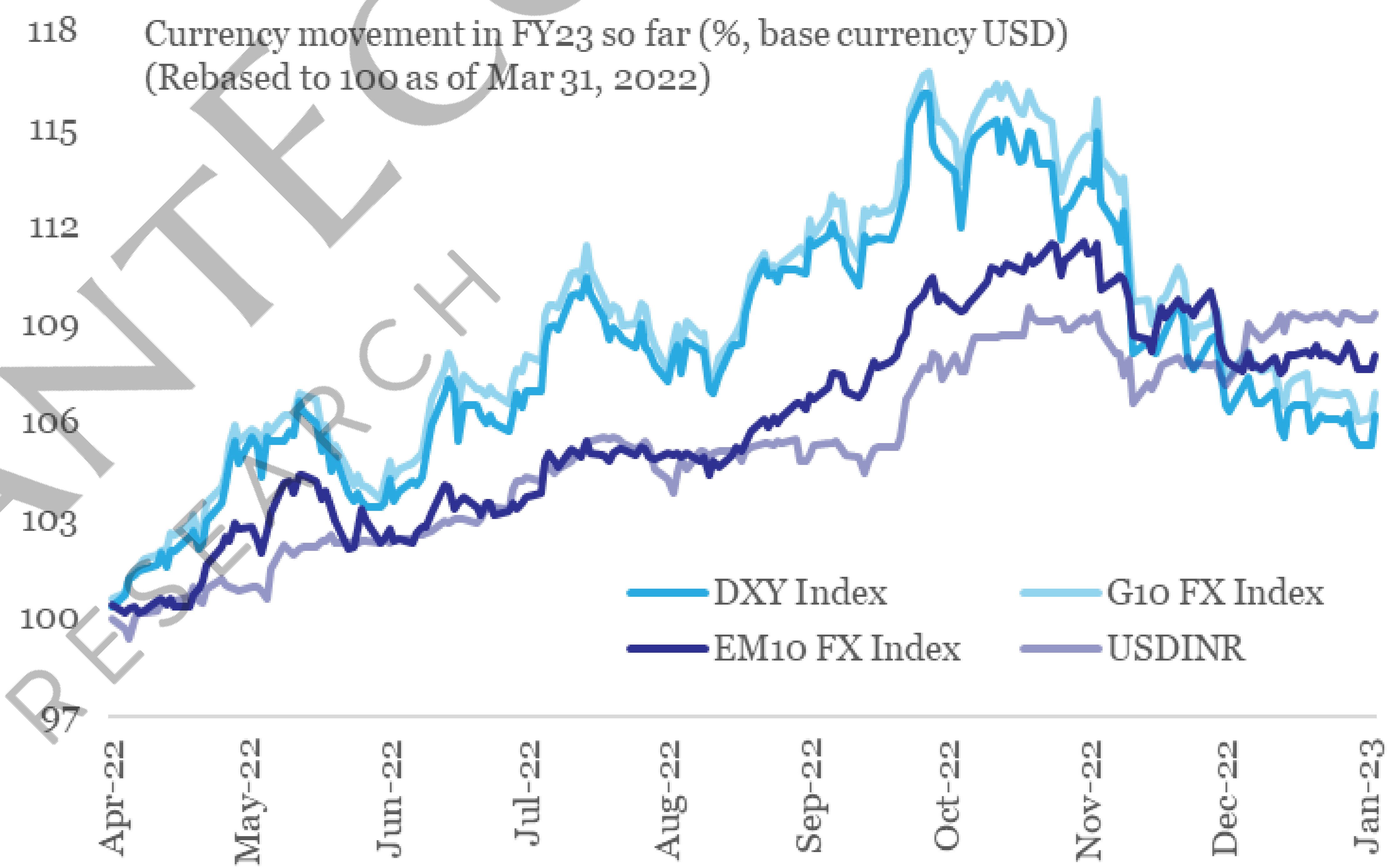




- We expect core liquidity surplus to fall below 1.5% of NDTL in Q4 FY23 from 1.7% in Q3, on the back of seasonal outflows and minor BoP deficit. Going forward, core liquidity is expected to turn into deficit by Q3 FY24. While this would put pressure on short dated yields, it would also provide an opportunity for the RBI to conduct strategic OMO purchases.
- Close to record high levels of real yield spread with UST is likely to be supportive of local yields
- We expect 10Y g-sec yield to trade close to 7.40% levels by end of FY23 and glide lower towards 6.75% by end of FY24.

Rupee weakness persists despite moderation in US dollar

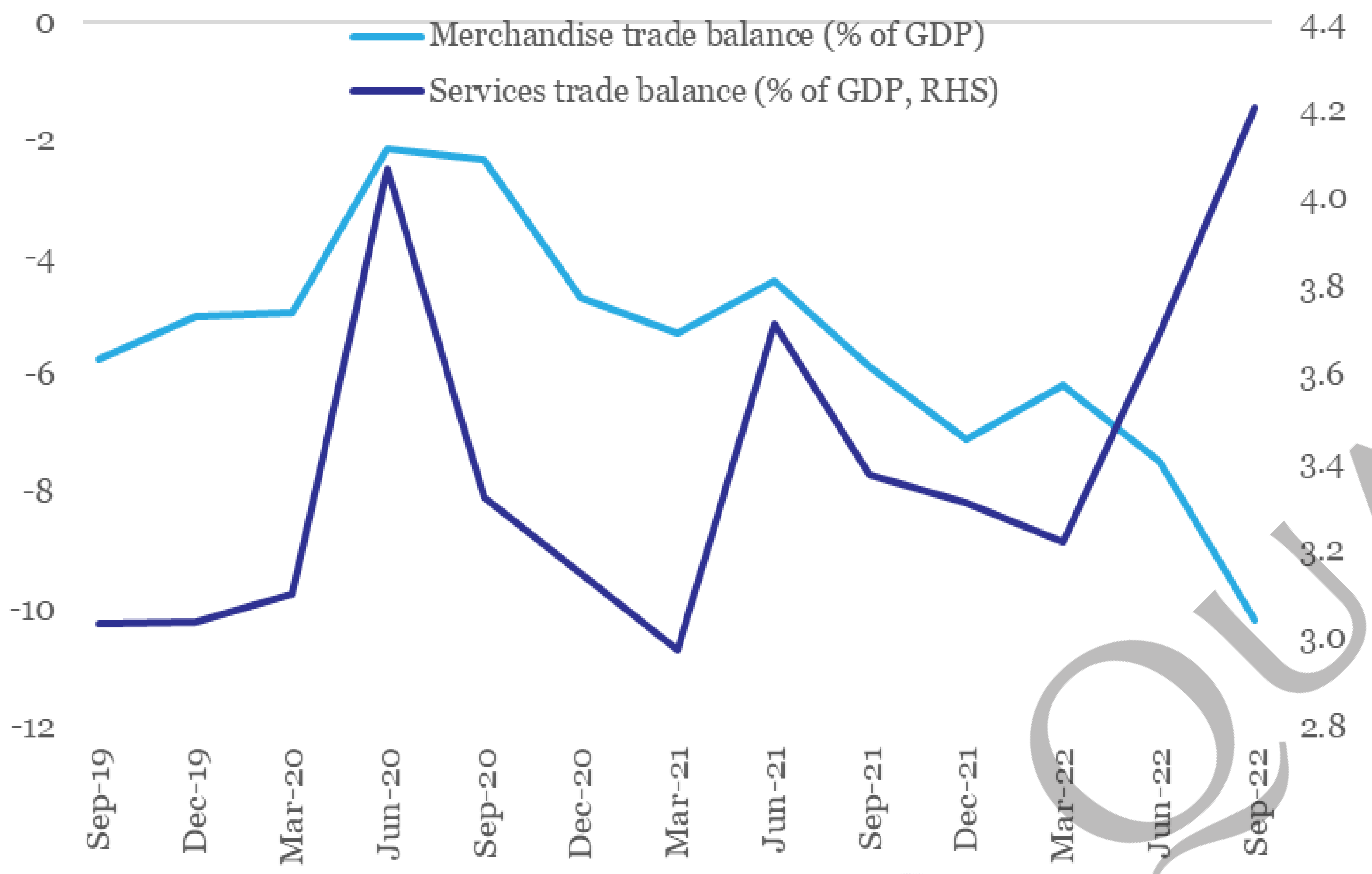


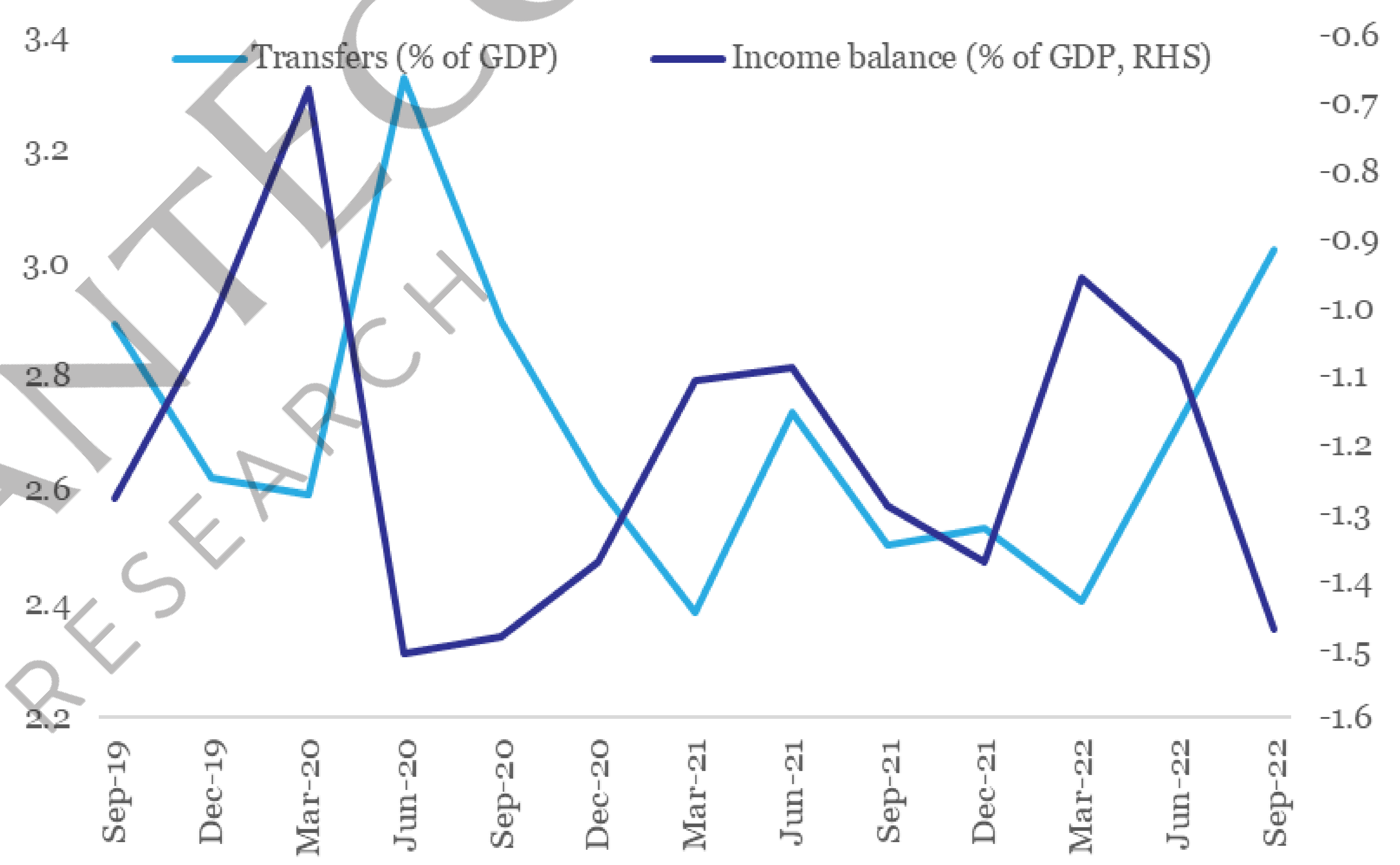


- INR has depreciated by 9.4% in FY23 so far – its worst performance since FY14, the year of *Taper Tantrum*
- While INR depreciated when USD was strengthening until Sep-Oct 2022, weakness thereafter has surprisingly coincided with a weaker USD – this can attributed to BoP pressures, or reserve accumulation by the RBI
  - While INR was outperforming EMFX trend until Nov-22, by not participating in the USD sell off trend, the currency has underperformed thereafter

QuantEco Research

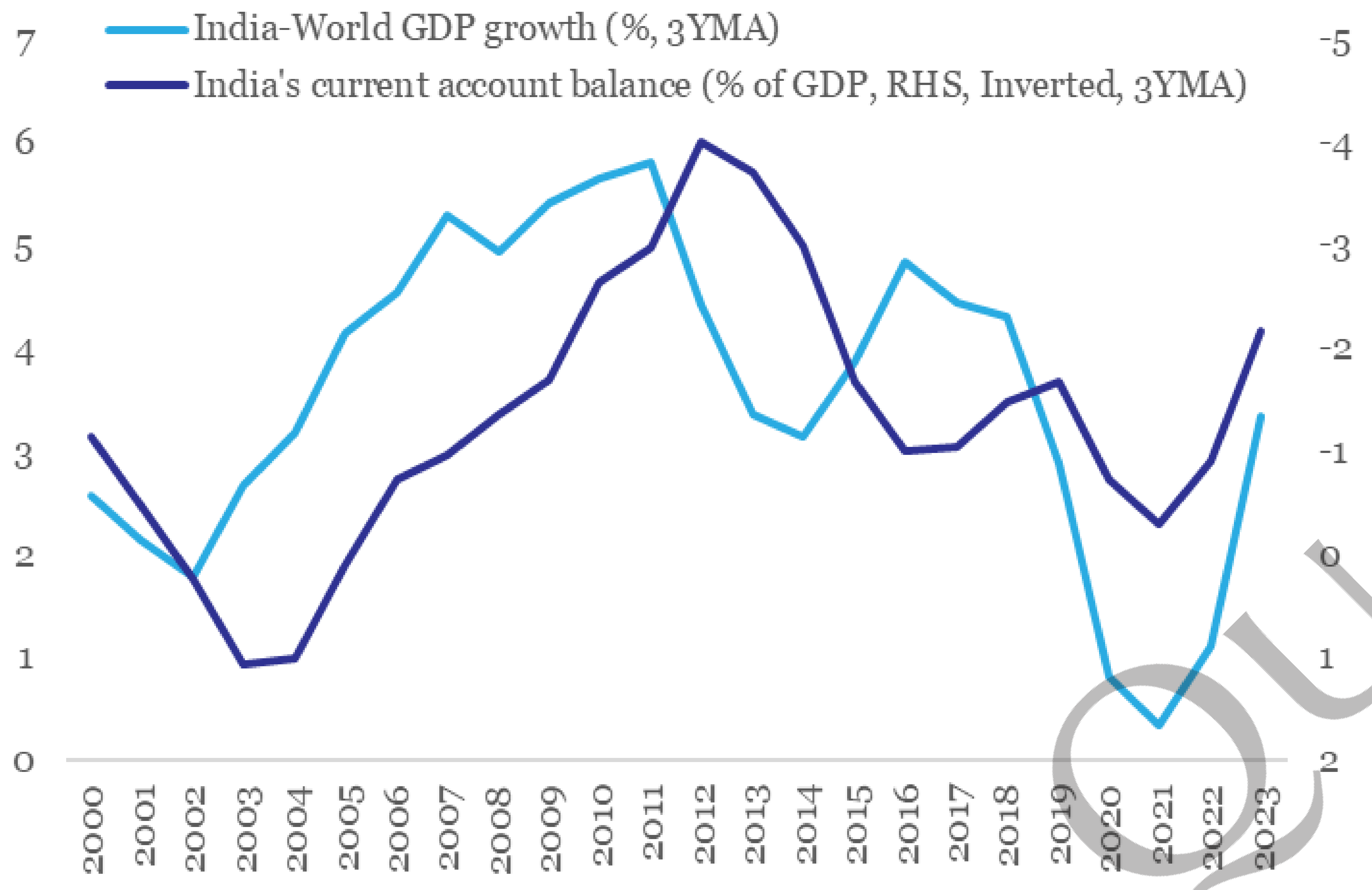
Current account: Win some, lose some

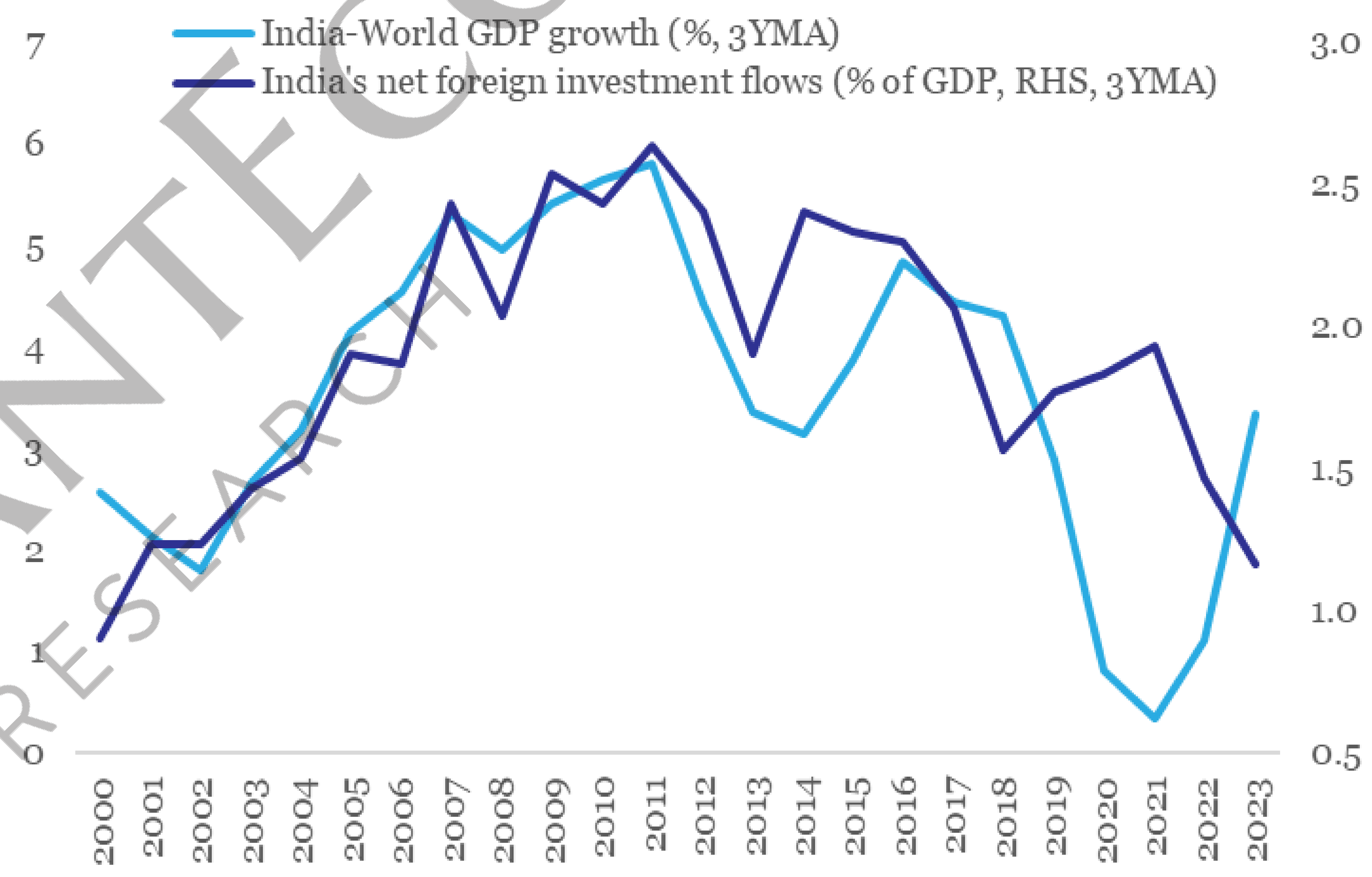




- COVID related disruption on India's external account appears to have completely normalized. Few trends emerge, which could persist in FY24:
  - While merchandise trade deficit has widened to 10-year high levels (on high commodity prices and relatively faster recovery in Indian economy vis-à-vis rest of the world), the services trade surplus has also expanded to its 14-year high levels (thrust on digitization and cost optimization) in FY23
  - Transfer payments have picked up (on global recovery post COVID) while income balance has once again started to exert pressure

Fastest growing economy* and its implications for BoP

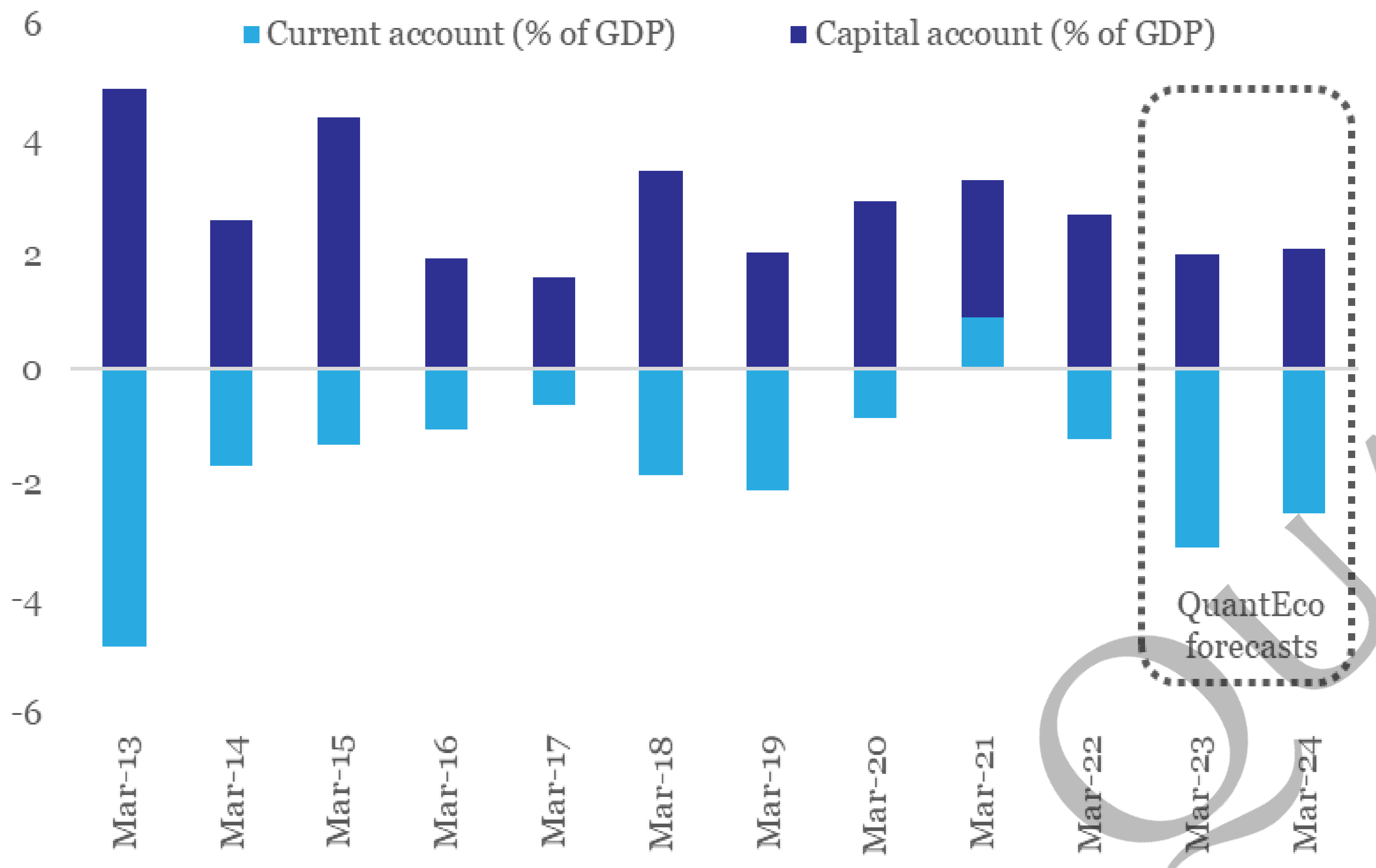


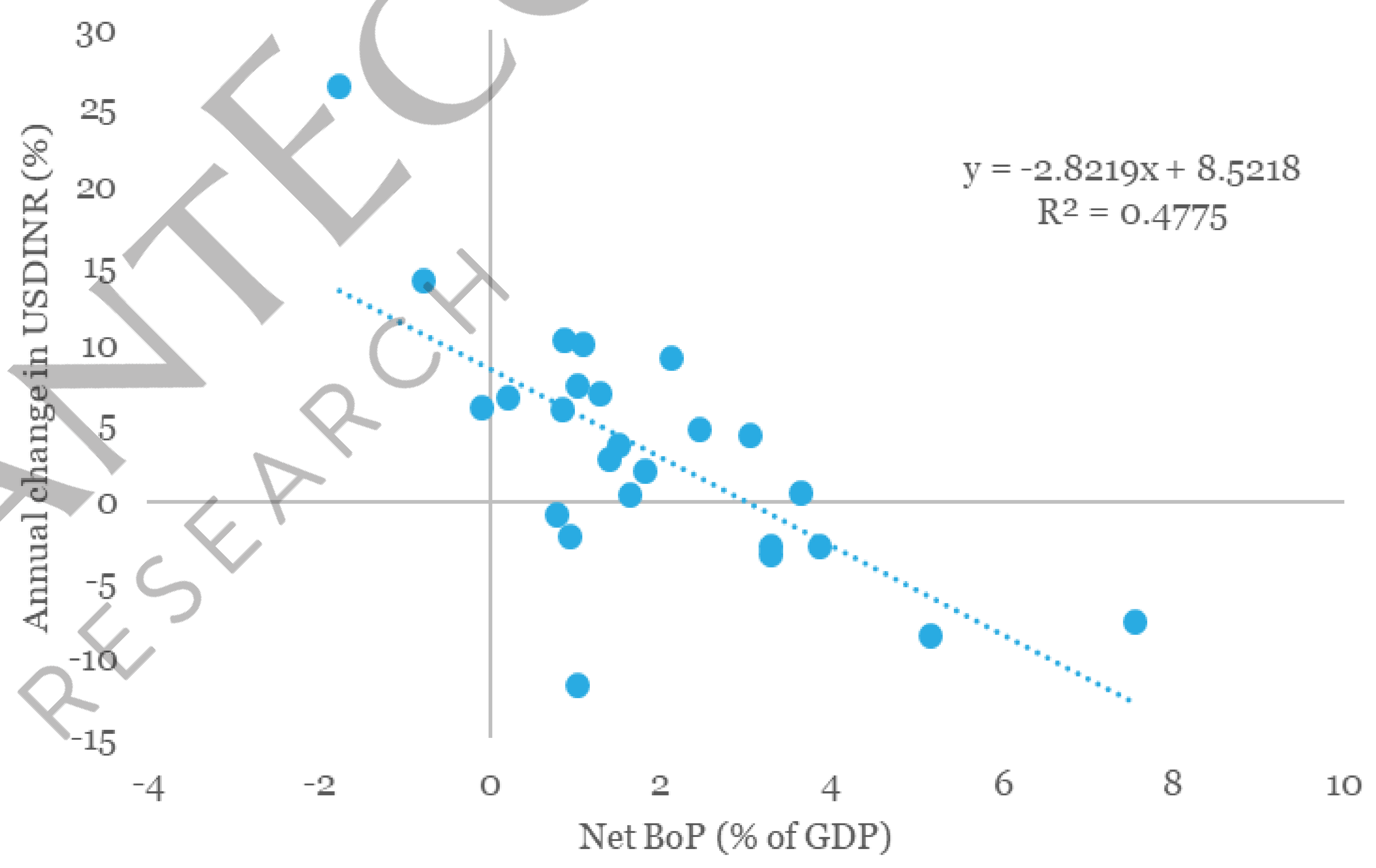


- From a BoP perspective, India's relative growth differential vis-à-vis rest of the world has two key implications:
  - We expect India to exceed World GDP growth by 3.0-3.5% in 2023. Since this would be marginally lower than the estimated growth spread of 4.2% in 2022 (and the long term average trend of 3.7%), we expect the current account deficit pressure to moderate in FY24.
  - Stable growth differential also acts as an anchor for foreign investment flows. While we expect foreign inflows to double to 1.6% of GDP in FY24, they are likely to remain lower vs. the long term trend of 2.0% on tight global financial conditions.

* As per the IMF, India will be one of the fastest growing key economy in 2023

BoP deficit to persist in FY23 and FY24





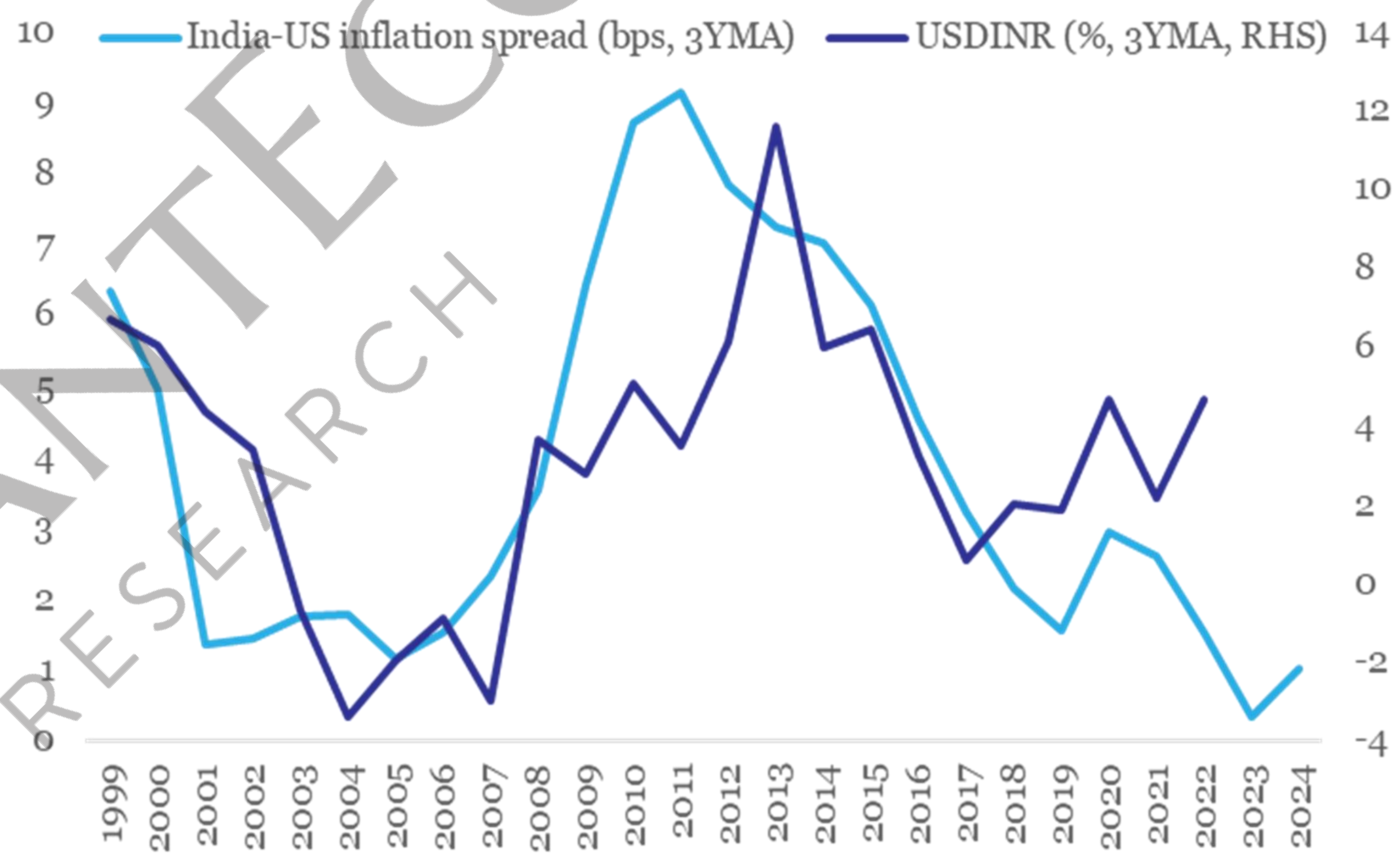
- Overall, we expect India's current account deficit to moderate towards 2.5% of GDP (USD 90 bn) in FY24 from an estimated level of 3.1% in FY23 (USD 106 bn).
- We expect BoP to remain in deficit in FY23 (USD 38 bn) and FY24 (USD 14 bn)
  - Although BoP deficit is expected to moderate in FY24, we note that i) this could be the first instance of two successive BoP deficits for India, and ii) a weaker currency has always coincided with BoP deficit

QuantEco RESEARCH

Growth, inflation, and rupee

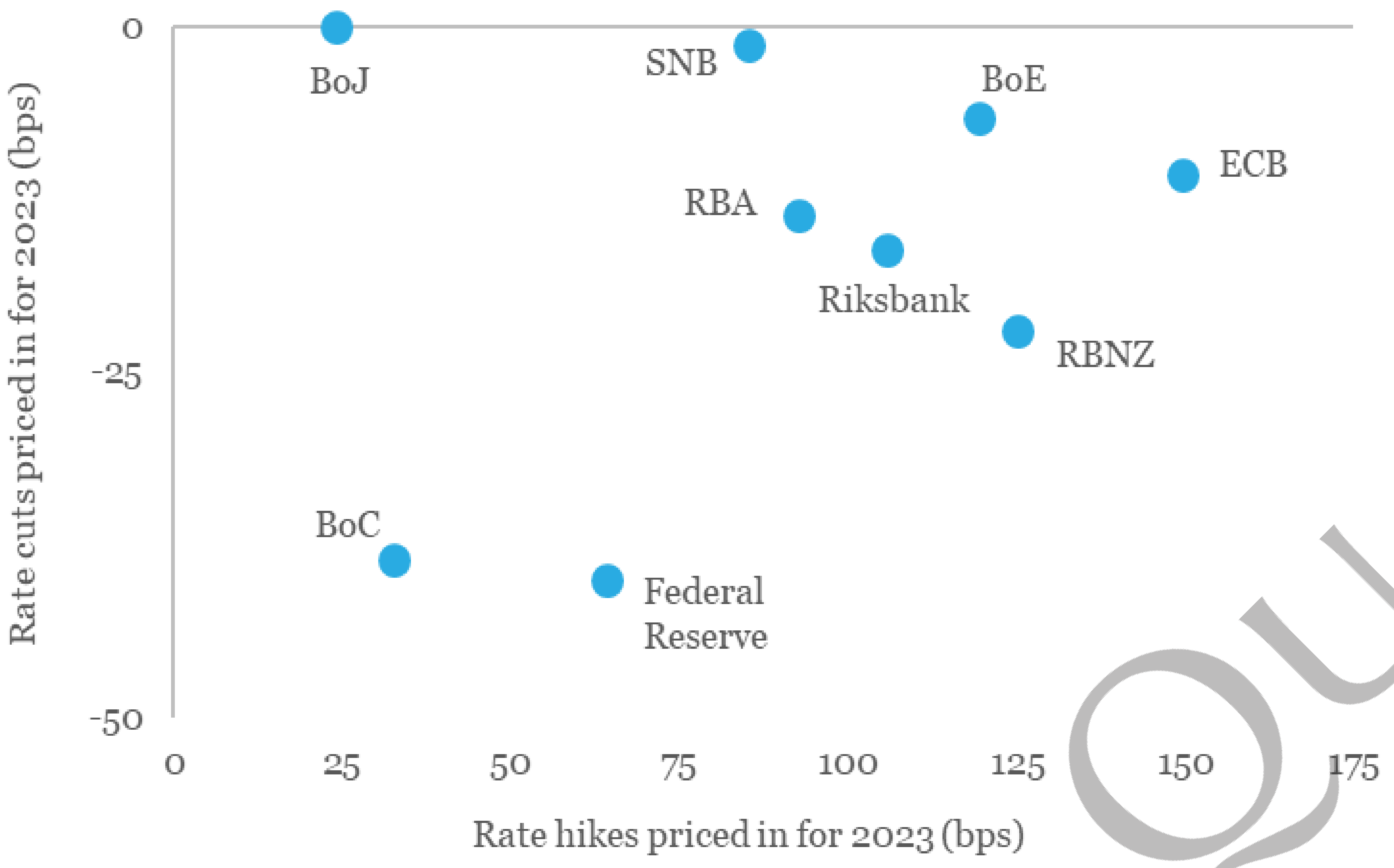
Annual change in USDINR under different growth-inflation regimes (%)			
	Low Inflation	Moderate Inflation	High Inflation
Low Growth	6.9	3.7	11.5
Moderate Growth	3.3	4.3	8.9
High Growth	-1.7	2.4	-1.5

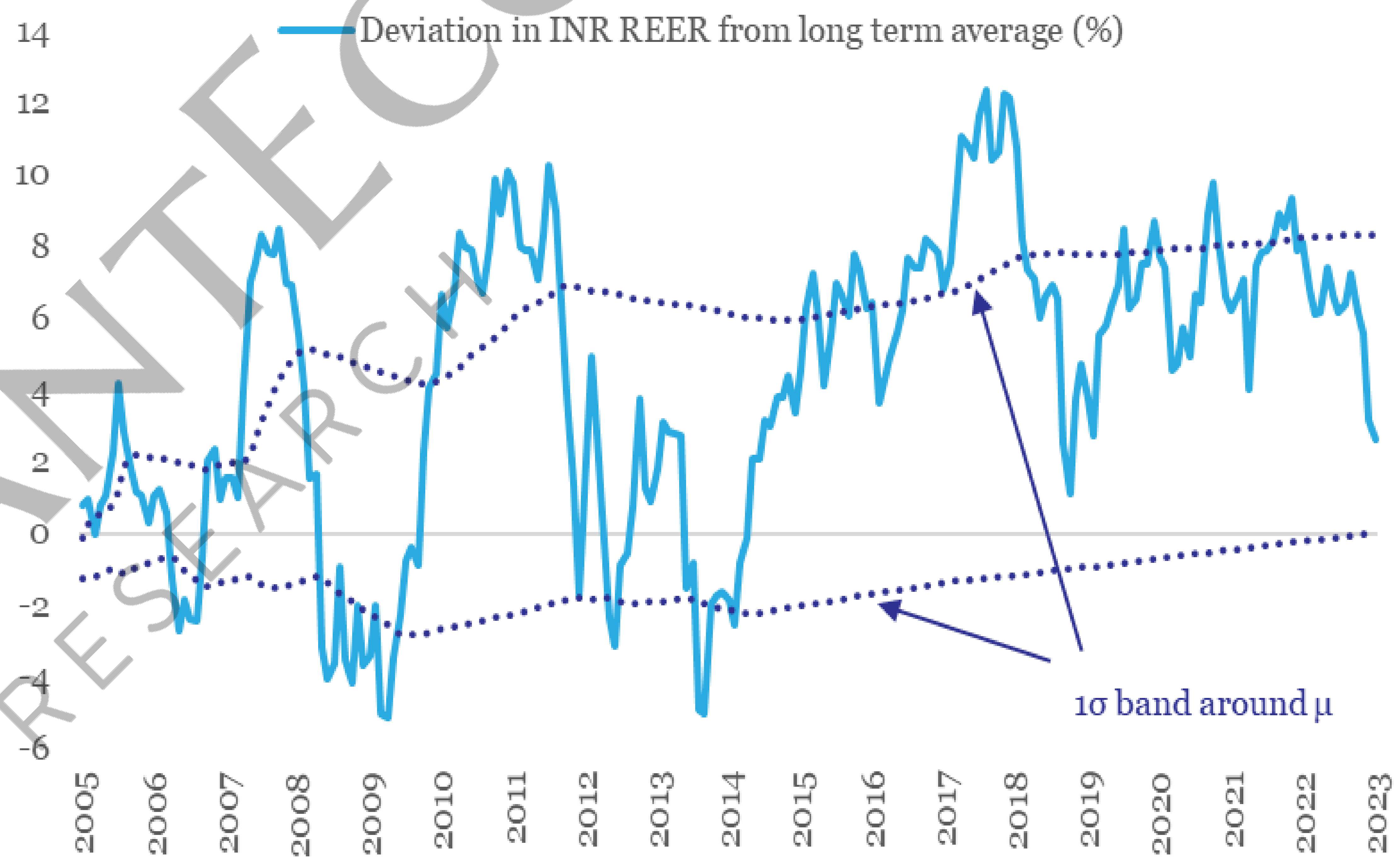
Note:
1. Low Growth = GDP growth <6%, Moderate Growth = 6% < GDP Growth < 7.5%, High Growth = GDP Growth > 7.5%
2. Low Inflation = CPI Inflation <4%, Moderate Inflation = 4% < CPI Inflation < 6%, High Inflation = CPI Inflation > 6%



- FY24 is likely to be characterized by a moderate growth/ moderate inflation regime, a switch from moderate growth/ high inflation period that characterized FY23
  - On an average, INR tends to weaken by ~4.3% in a moderate growth/ moderate inflation period
- CY 2023 is likely to see one of the lowest inflation differential (under 1%) between Indian and US. This is extremely conducive for INR as it portends a period of stability with a bias for mild appreciation.

INR outlook





- Markets expect US Fed to lead in cutting rates in 2023 (40 bps rate cut is currently priced in)
  - This would put pressure on the USD, especially in the second half of FY24
- Post recent underperformance by the INR, the extent of overvaluation has corrected sharply – this implies a stable situation from REER perspective
- Overall, we expect USDINR to trade close to 83.5 levels by end of FY23, and weaken towards 85.5 levels by end of FY24

Key forecasts at a glance

	FY23	FY24
GDP Growth (%)	6.8	6.0
CPI Inflation (%)	6.7	5.3
Central Fiscal Deficit (% of GDP)	6.4	5.8-5.9
Current Account Deficit (% of GDP)	3.1	2.5
BoP (USD bn)	-38	-14
Repo Rate (%, EoP)	6.50	6.50
10Y G-sec Yield (%, EoP)	7.40	6.75
USDINR (EoP)	83.5	85.5

Note: Data for this report has been sourced from IMF, World Bank, RBI, CCIL, PIB, Union Budget Documents, CEIC, Refinitiv, and QuantEco Research

Thank You!

About QuantEco Research

QuantEco is an independent & unbiased research house providing business economics and financial markets intelligence to corporates and investors. Powered by decades of rich industry experience, Dr. Shubhada Rao is leading the research team at QuantEco, which blends cutting edge analytics with qualitative analysis to assess emerging trends in the Indian economy.

QuantEco Research Team

Yuvika Singhal
Economist
yuvika.singhal@quanteco.in

Vivek Kumar
Economist
vk@quanteco.in

Shubhada Rao
Founder
shubhada.rao@quanteco.in

Disclaimer

This document has been prepared for your information and does not constitute any offer or commitment to transact with QuantEco Research. For material used in this document, QuantEco Research has relied upon external sources as well as in-house developed information. Reasonable care has been taken to prepare this document. However, QuantEco Research does not accept any legal liability for accuracy, completeness, and/or usefulness of any information in this document. All opinion expressed in this document by QuantEco Research constitutes its judgement in relation to the matters that are subject of such material as at the date of publication, all of which are subject to change without notice. QuantEco Research is not obliged to update this document in any form.

The opinion or expression made by QuantEco Research in this document, should not in any manner, be construed as a solicitation or endorsement of any offer for purchase or sale of any financial transaction, commodities, products of any financial instrument referred therein.

This material is strictly confidential and privileged to the recipient. No part of this material may be duplicated or copied in whole or in part in any form and or redistributed without the prior written consent of QuantEco Research. Use of the material or information contained in the document is restricted to the recipient only. If you are not the intended recipient or if this document has been sent to you in error, please email us or return this document to the sender. The contents of this document may be subject to change without any prior notice or intimation to the recipient.