

## Economic Round-up: July 2024

Markit global manufacturing PMI noted downturn in global activity as the index slipped to 49.7 in Jul'24 from 50.8 in Jun'24. Of the 32 countries surveyed, only 15 noted expansion in activity. The biggest drag was on account of slip in new orders, with steepest decline in investment goods. Country-wise, activity weakened significantly in Germany, China and the US (ISM index). Both China and the US are now showing signs of slowdown at the start of Q3. In the US, apart from the manufacturing sector, single family home starts and retail sales have also moderated. Labour market is seen cooling down. As a result, Fed in its latest statement sounded more dovish than expected and hinted at a rate cut in Sep'24. In China, weakness in manufacturing sector growth has spread from larger companies to smaller and mid-size companies as well, which are more export oriented. Real estate sector continues to reel under pressure and government post its third plenum of CPC also did not announce any major initiatives to revive growth, which worrying for global growth. On the domestic front, growth is expected to hold ground as monsoon has fared well so far. It is currently (as of 2 Aug 2024) 4% above LPA, which in turn has supported Kharif sowing (+2.9% so far).

**Global Central Banks:** In Jul'24, In line with market expectations, both US Fed and ECB kept their policy rates unchanged. However both are expected to announce rate cuts in the Sep'24 meeting. In the Eurozone, while the decision is expected to be driven by weaknesses economic growth, in the US, cooling labour market and inflation scenario will help make FOMC the decision to cut rates. Analysts expect 3 rate cuts by Fed this year and 2 cuts by ECB. BoE in its not so unanimous decision (5-4 vote), lowered its policy rate by 25bps for the first time in 4 years, but cautioned that it does not expect to cuts too soon, as inflation pressures persist. BoJ delivered a hawkish rate hike, as it increased its policy rate to 0.25%, up by 15bps versus est.: 10bps increase. It also announced to trim its bond buying program by 2026. This decision comes, as wage negotiations have led to highest gains in three decades, which in turn may add to inflationary pressures in Japan. RBI in its policy meeting this week, is expected to hold rates unchanged. We expect first rate cut not before Dec'24.

**Key macro data releases: Union Budget for FY25** showed that the government is committed to sticking to the path of fiscal consolidation. As a result, fiscal deficit (as % of GDP) is estimated to be lower at 4.9% in FY25BE. **Rainfall** is currently 4% above the LPA till 2 Aug 2024. Pickup was noted in the last fortnight. There is also an improvement noted in the **sown area** (+2.9% YoY), with higher acreage of pulses, paddy, oilseeds, sugarcane and coarse cereals compared with last year. **Net sales** for a sample of 933 companies shows a pickup on a YoY basis (1.9% in Q1FY24 to 7.4% in Q1FY25). However, there has been a sharp **deceleration in profit growth**. Excluding the BFSI sector, the decline in profit is even more striking. INR depreciated by 0.4% in Jul'24 to currently trade at 83.73/\$, close to its lifetime low of 83.74/\$. This was despite weakening US\$. **We expect INR to trade in the range of 83.70-83.85/\$.** India's 10Y yield eased in Jul'24. Going forward, the **10Y yield is expected to trade in the range of 6.85%-6.95% in Aug'24**, with risk evenly balanced. **CPI** for June came at 5.1% as against our forecast of 4.9%. Inflation was up mainly due to food inflation which was 9.4%. Major contribution from vegetable, fruits, pulses and cereals. Our headline **estimate of CPI stands at 3.8-4% in Jul'24**, with risks tilted to the upside.

## Global developments

### Global growth: Impending slowdown

Preliminary estimates for US GDP growth in Q2CY24 show that GDP rose by 2.8% from 1.4% in Q1, driven by acceleration in gross private domestic investment, government consumption and investment, and private consumption. Within private consumption, while expenditure on goods increased, that on services moderated in Q2. On the investment side, non-residential fixed investment gained momentum, while resident fixed declined. Federal government consumption and investment rebounded in Q2, but that of state and local governments eased. This broadly signals that consumers are beginning to face pressures due to prevailing elevated rates. As a result, they have curtailed their spending on services and investments have also been impacted. This is also reflected in retail sales and housing starts data. Retail sales came in flat (0% MoM) in Jun'24, slowing from 0.3% increase in May'24. This was on account of decline in sales of motor vehicles & parts and gasoline, and moderation in sales of clothing, furniture, sporting goods and restaurants. Labour market is also beginning to show signs of cooling down with continuing claims for the week ending 27 Jul 2024 rising to 1.87mn (highest since Nov'21) from 1.84mn in the previous week. In addition, JOLTS report also shows that job openings fell to 8.18mn in Jun'24 from 8.23mn in May'24, implying that there were 1.20 per unemployment person in Jun'24 versus 1.24 jobs in the previous month. Manufacturing activity in Jul'24 further weakened with ISM index slipping to 46.8 from 48.5 in Jun'24. The drag came from dip in production, new orders, and employment. Worryingly, input price sub-index inched up, suggesting pressure on margins.

Eurozone's GDP in Q2CY24 rose by 0.3% (QoQ basis), unchanged from the previous quarter (0.3%), as Germany's growth surprised negatively (-0.1% versus 0.2%), while the French economy held ground (0.3%) and Italy's GDP (0.2% versus 0.3%) recorded marginal slowdown. At the start of Q3 as well, conditions remain bleak. The manufacturing PMI index remained unchanged in Jul'24 (45.8) from the previous month. The two largest economies, Germany and France, recorded poor performance. France's PMI fell to 6-month low of 44.0 in Jul'24 from 45.4 in Jun'24, led by sharp decline in new orders, in particular export orders. Production levels also decreased, led by capital goods. On the supply side, renewed pressures were visible in case of delivery times and increased input costs. In Germany's case, the headline index slipped to 43.2 from 43.5 in Jul'24, due to reduction in output. New orders also fell. Survey participants also reported increase in freight rates, which could eventually feed into higher output prices. Germany's Ifo business climate index also signals downbeat economic environment with headline index slipping to 87 in Jul'24 from 88.6 in Jun'24. This was due to drop in both current situation index (87.1 versus 88.3) and expectations index (86.9 versus 88.8). Industry wise, manufacturing and trade noted significant declines. This trend is worrisome for overall Eurozone GDP growth.

China's GDP growth also slowed in Q2 (4.7%; est.: 5.1%) compared with Q1 (5.3%). H1CY24 growth is at 5%, in line with government's target. This was mainly on account on weak domestic consumption. In Jun'24 alone, retail sales rose by only 2% versus est.: 3.3%. Decline in discretionary spending appears to be impacting sales. In case of industrial production, output rose by 5.3% versus est.: 5% increase. It was supported by 8.8% increase in high-tech manufacturing production. However in Q3, the economy seems to be losing even more momentum with overall manufacturing sector growth now beginning to contract (PMI indices for both small & mid-size companies, and larger companies settling below the 50 mark in Jul'24). The official manufacturing PMI, which surveys the bigger companies, recorded the index for Jul '24 at 49.4 from 49.5 in Jun'24. The Caixin/S&P manufacturing PMI (focusing on small & mid-size companies) fell to 49.8 from 51.8 in Jun'24. The

smaller companies are also more export oriented and reported drop in new orders on account of intermediate and investment goods. However orders for consumer goods still remain strong.

## RBI

The Reserve Bank of India's Monetary Policy Committee (MPC) is likely to hold repo rate steady for the 8<sup>th</sup> consecutive meeting in Jul'24. The stance of the monetary policy is also expected to be retained at withdrawal of accommodation. Incidentally, the stance of the monetary policy was last changed in Jun'22. This is because RBI is unlikely to be comfortable with the elevated levels of food inflation in the recent months. On the other hand, domestic growth impulse has been strong giving RBI the room to keep rates at current levels until it has sufficient confidence that inflationary pressures have subsided on a durable basis. Liquidity conditions have eased significantly with the average system liquidity in surplus in Jul'24. RBI is likely to manage the evolving liquidity situation through its fine-tuning operations including scaling up its VRRR auctions. At the current juncture, the inflation trajectory faces risks from skewed distribution of rainfall, geo-political tensions in the Middle East and a depreciating currency. Taking this into cognizance, the earliest possibility of rate cut is pushed back to Dec'24.

## Global central bank decisions

**US Fed** kept its policy rates unchanged at 5.25-5.5% for the 8<sup>th</sup> consecutive time in Jul'24 meeting. However, the Fed Chair acknowledged that recent macro prints are pointing towards a soft landing. These include trends in labour market, real estate, and manufacturing sector. In addition, inflation moving in line with Fed's trajectory is also seen as a big positive, allowing the FOMC to indicate that there might be rate cuts soon. Based on this narrative, as per CME FedWatchTool, majority of the investors are now expecting 3 rate cuts this year (25bps each), starting Sep'24.

**Bank of England (BoE)** in Jul'24 announced its first rate cut in more than four years. The decision was a close call as it was voted by 5-4 in favour of 25bps rate cut. The policy rate now stands at 5%. This was considered to be a more hawkish rate cut, as the Governor clarified in his statement that the Central Bank will not cut rates too soon, and its decision will be data dependent. Investors have now reduced the possibility of 2 more rate cuts this year. This in line with BoE's expectation of CPI averaging 2.3% in Q3, before rising again to 2.7% in Q4.

In line with expectations, **ECB** held rates unchanged in its Jul'24 meeting at 3.75%. The ECB President highlighted that inflation still remains elevated and pressure persists in case of services inflation. The Central Bank also stated it will require more macro evidence before cutting any more rates. There is now a high probability that rates will be cut in the Sep'24 meeting, as GDP growth in Eurozone's largest economy (Germany) continues to falter, and manufacturing sector remains in deep downturn.

**BoJ** surprised the markets with a hawkish rate decision announced its Jul'24 meeting. It raised its interest rates to 0.25%, thus hiking the rate by 15bps versus est. 10bps increase. This comes in the wake of rising inflationary pressures (due to wage negotiations recording highest gains in three decades). Core CPI was at 2.6%, higher than BoJ's 2% target for the 27<sup>th</sup> consecutive month now. It has projected CPI to average 2.1% till Mar'26 versus 1.9% estimated earlier. It also announced to trim its monthly bond buying program from ¥6tn to ¥3tn by mid-2026.

## Special studies

### Price picture: “Top”pling inflation

**Price picture using BoB Essential Commodity Index:** On MoM basis, BoB ECI rose by 2.1% in Jul'24 compared to 1.7% in Jun'24. Sequentially, TOP (Tomato, Onion and Potato) topped the chart of inflation. It has risen by 57.3%, 21.4% and 16.2%, respectively in Jul'24. Apart from this, there was some degree of loss of momentum in prices of major essential commodities such as rice, all categories of pulses (Moong, Gram and urad witnessing maximum decline), and edible oils (especially mustard and sunflower oil). On a seasonally adjusted basis, the increase in BoB ECI is lesser at 1.5% in Jul'24. Thus, part of the increase is attributable to seasonal phenomenon. On YoY basis, BoB ECI inched up by 5% in Jul'24, albeit an elevated base. Price build-up for Potato and onion were considerable.

**So where is CPI print headed?:** High frequency price data showed that inflation is not threatening in a holistic manner. It is concentrated in a few vegetable items such as Tomato, Onion, Potato and Garlic. The volatile items of CPI with a weight of 5.48%, e contributed to a 1.3% increase in the headline index in Jun'24. In Jul'24, it has risen by 37.7%, thus it has the potential of pushing up CPI by another 2.1%, barring the normal adjustments.

Further, these perishable items have the potential to be impacted thoroughly on account of weather-related vagaries. For Tomato, both the May-Jul transplanting and Jul harvest have been affected either due to excess rainfall or heatwaves. Thus, prices would possibly be higher in the coming months, as well. For Onion, the Jul sowing might be impacted as major Onion producing States such as Maharashtra, Karnataka have been reeling under pressure of excess rainfall (cumulative as of 2nd Aug 2024) (Table 2). For Potato, fresh harvest comes generally during Sep'24, thus there might be a Cobb Web effect on prices.

For controlling prices, direct price intervention by the government, export duty or stock limits may prove to be efficient in the short run. However, in the long run, coherent policies such as large-scale clusters for vegetable production closer to major consumption centers, as announced in the Budget, are more welcoming to check volatility.

Thus, balancing and counterbalancing all these factors, **our headline estimate of CPI stands at 3.8-4% in Jul'24, with risks tilted to the upside.**

### Economic Survey 2023-24

**GDP growth:** Economic Survey expects the Indian economy to do better with steady growth as it has recovered swiftly from the pandemic with real GDP in FY24, remaining 20% above the pre-pandemic levels. The country is currently in the midst of private capex upcycle and this has been supported by government capital expenditure. The economy is pegged to grow by 6.5-7% in FY25 with risks evenly balanced. BoB forecast is at 7.3-7.4%. The prospects of agriculture sector will improve on the back of normal monsoon as has been projected by IMD and will thus support the revival of rural demand. Additionally, merchandise exports are expected to pick up given the growth prospects in advance economies, service exports are also expected to register improvement. The focus areas in the short to medium term include the following generating productive employment, addressing skill gap

challenge, tapping the full potential of agriculture sector, easing compliance requirement and financing bottlenecks confronting MSMEs, manging green energy transition amongst others.

**Inflation:** CPI inflation in India was impacted by twin shocks of the pandemic and geopolitical conflict. This was exacerbated by weather induced volatility in prices of key food items. Efficient monetary policy management along with the government's supply side interventions helped keep inflationary pressures in India relatively subdued. The report also notes that since weight of food items in the rural basket is higher, inflation in rural regions was higher than urban areas. With expected moderation in global prices and prospects of a normal monsoon, the inflation in India is expected to moderate further. To manage inflationary pressures, the report suggests increasing production of oilseeds and pulses along with improving storage facilities for seasonal vegetables.

**Agriculture and Food management:** Agriculture and allied sector growth has been buoyant through the years on the back of the measures adopted by government. In the last 5-years, this sector has grown at an average pace of 4.18%. Additionally, the allied sectors are also turning out to be capable growth centres and new sources of improving farm incomes. Important and challenging issues such as credit accessibility, agri-infrastructure needs to be addressed in order to manage and promote crop diversification for pulses, oilseeds, along with horticulture. To manage better price discovery and improve market infrastructure, E-NAM, FPOs and cooperatives should be allowed to participate in agri-marketing. To improve farm income and manage sustainable agriculture practise, there is a need to promote the usage of digital technologies along with improving quality of seeds and promoting natural and organic farming.

**Employment and skill development:** There has been sustained pace of rise in employment and upscaling of factories. Higher youth and women participation in the labour force has opened an opportunity in tapping the demographic and gender dividend. The employment level in the organised sector has gained momentum and is expected to rise above the pre-pandemic level. Agro processing and care economy are two of the new promising sectors that will help in generating and sustaining quality employment. Currently only 4.4% of the workforce is formally skilled and hence there is a need to address the skilling gap. Rapid expansion of artificial intelligence across economic activity has formed a case of adopting and embracing the new technology even in the job market front with collective welfare remaining a key objective.

**SMEs:** The report notes the progress made in government schemes targeting MSMEs. There has been an increase in number of unincorporated sector enterprises in India, with signs of increased labour productivity. Furthermore, the number of MSMEs registered on the Udyam portal has increased to 4.69 crore. The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) with an outlay of Rs. 9,000 crore in FY24, has also shown a significant pickup in guarantees. Even so, the MSMEs continue to face significant challenges including access to credit, market access, formalisation, digitalisation and upskilling. The survey recommends measures including facilitation of labour intensive MSMEs, single window clearance, providing grassroots-level facilitation to ensure market access and skill development through joint efforts by government industry and academia.

**Financial sector:** India's banking sector performance in FY24 was marked by double-digit growth in credit even as asset quality noted a significant improvement. The report also makes note of the progress made in financial inclusion, which is imperative for inclusive and sustainable growth. This has been complemented by a steady

growth in other capital markets as well. However, taking note of the increased retail participation in the equity markets particularly in the “speculative” derivatives segment, the report cautions against “over financialization”, suggesting that the growth in financial sector should broadly correspond with the economic growth rate. To achieve the government’s goal of Vikasit Bharat, India needs to tap into its flourishing fintech space with a data driven and customer centric approach. This will need to be supplemented by lowering lending costs, greater access to credit, and lower financial intermediation costs along with further opening of the domestic capital markets.

**External sector:** The Economic Survey makes note of India’s strong external position led by positive momentum in services exports and uptick in merchandise exports in H2FY24. India’s share in global goods and services exports has increased, primarily driven by an increase in its share in services exports to 4.3% in FY24 from an average of 3.3% in FY16-FY20. Outlook for FY25 is largely positive. For services, India’s improving integration in global value chains (GVCs) as well as a thriving Global Capability Centre (GCCs) landscape has led to a steady improvement in India’s services exports.

Schemes like Atmanirbhar Bharat and PLI are likely to benefit India’s merchandise exports. Apart from this, focusing on increasing its manufacturing competitiveness in areas such as agricultural commodities, along with improvement in logistics infrastructure will be key in improving India’s export potential. Headwinds remain from volatility in global commodity prices, increased trade and lower demand from key trade partners as well as increased protectionism in global markets.

**Climate change and Energy transition:** India’s annual per capita carbon emission is only one third of the global average, despite being one of the fastest growing economies globally. India has envisioned the goal of achieving the net zero carbon emission by 2070, which is a considerably challenging task. The reason being the access to stable energy at reasonable cost to complete ambitious targets and remaining on low-carbon pathway is a tightrope, especially when it is financed through the domestic resources. The country needs to diversify energy resources given the evolving ambitious NDC targets along with the objective of ensuring energy security. The diversification will enable them to minimize risk and they can continue to focus on national commitments, while managing low-emission pathways. To achieve these objectives, there is a need of integration of renewables, exploring nuclear energy as well as biofuels. Furthermore, with the objective to support large scale usage of renewables, thermal power plant is also expected to play a significant role.

## Global Fiscal Analysis

In this study we focused purely on IMF data to make global comparison of fiscal indicators. This data set uses figures for general government, which includes: federal/central government, state governments, and local bodies. For the purpose of our study, we have focused the discussion on 4 key indicators: overall fiscal balance (% of GDP), revenue (% of GDP), expenditure (% of GDP), and gross debt (% of GDP). In our sample, we have analysed 6 major advanced economies (AEs) and 6 major emerging economies (EMs).

**Overall fiscal balance:** Starting with overall balance of general government, we note that amongst the AEs, the US and UK pushed the fiscal deficit envelope the most during the Covid-19 pandemic period. US still has significantly high deficit level (8.8% in 2023 and est.: 6.5% in 2024) and has not yet returned to the pre-pandemic

levels (5.8% in 2019). Same is the case with UK. In contrast, Japan government's overall fiscal balance came down only in 2021 and 2022, but since then has seen inching up again. Following a deficit of 5.8% in 2023.

Amongst the EMs, India has had consistently high fiscal deficit in the recent years, with China/Brazil coming close second. This was due to significant fiscal measures announced during the Covid-19 period to protect the poor and vulnerable (expansion of food subsidy scheme, measures for MSMEs, street vendors, health insurance). In case of other EMs, only Indonesia is expected to reach pre-pandemic level (2.1%) in 2024 (2.2%). South Africa, Brazil, and China still remain 130-140bps above their pre-pandemic levels. Thailand, which was running a surplus in 2019 (0.4%), is expected to see a deficit of 3.7% in 2024, higher than 3.2% in 2023, owing corporate tax reform measures.

**General government revenues:** Interestingly, amongst the AEs, US has the lowest revenue to GDP ratio, estimated at 30.5% in 2024, compared with 30% in 2019. Apart from this, economies like Australia (35.2% in 2024) and Japan (35.8%) also have revenue-GDP ratio on the lower side. On the other hand, France has the highest (within our sample size) revenue to GDP ratio (52% in 2024).

Amongst the EMs, while major countries have revenue to GDP ratio lower than 30%, Brazil is an outlier. Brazil's revenue as % of GDP is gradually inching back to pre-pandemic level of 41.8% (2019), with ratio settling at 40% in 2023 and 40.9% in 2024. On the other hand, Indonesia has the lowest revenue-GDP ratio, averaging ~14%. Other weak performers include, India and Thailand. India's revenue-GDP ratio has averaged 19.6% between 2019 and 2024, while that of Thailand has averaged 20.3% during the same period. In recent years, post Covid-19 period, India has registered improvement in its revenue to GDP ratio, from 19.8% in 2022-23 to 20.1% expected in 2024-25.

**General government spending:** France, apart from having the highest revenue to GDP ratio, also has the highest expenditure to GDP ratio amongst the major advanced economies. In the pre-pandemic period it was around 55%, which then jumped to 61% in 2020, but has since then come down to 57.3% in 2023 and is estimated at 56.9% in 2024. Germany and UK also remain high spending states. Further, similar to trends observed on the revenue side, on the spending side as well, the US and Australia have the lowest ratios amongst the major AEs. In the US, historically expenditure-GDP ratio averaged ~35% (between 2015 and 2019), but it jumped to 44.6% in 2020 due to Covid-19 pandemic. Since then, the ratio is following a downward trajectory and is expected at 37% in 2024, down from 38% in 2023.

Amongst the EMs, in proportion to Brazil's higher revenue to GDP ratio, its expenditure to GDP ratio is also much higher than other EMs. Before Covid-19 pandemic (between 2015 and 2019), Brazil noted average expenditure to GDP ratio at ~48%. Apart from Brazil, China and South Africa are the other major spenders. In case of China, the pre-pandemic (2015-19) average was ~33%, post the pandemic (2020-24), the average is expected at ~34%. Even India, has seen pick up in spending as government have given significant impetus to capital spending to improve the quality of overall spending. The ratio has picked up from an average of 26.7% (2015-16 to 2019-20) to 29.2% (2020-21 to 2024-25). The lowest expenditure-GDP ratio is reported by Indonesia, traditionally hovering ~17%. It is expected to remain at similar levels in 2024 as well (est.: 17.4%).

**General government debt:** Gross debt-GDP ratio tells us, how much of fiscal deficit financing is done through borrowing. The higher the ratio, the higher is the interest repayment burden on countries, which then leaves little

room for making quality expenditures. Another aspect of this is also that some countries (like Japan and US) borrow heavily at cheaper interest rates and then invest in riskier assets to earn higher returns. In such a scenario, comparing net debt levels are of more use. However, as net debt-GDP ratio is not available for a lot of emerging markets, we stick to analysing gross-debt ratio.

Amongst the advanced economies, as it is well known, Japan and the US are the two major countries with significantly high gross debt-GDP levels. Interest rates in Japan have hovered near 0% level for a long period of time now, which allows government to borrow at cheap rates and then invest elsewhere for higher returns. As a result, its gross debt averaged ~232% between 2015 and 2019, and jumped to ~255% in the post-pandemic period (2020-24). Comparatively, during the same period, its net debt was much lower at 149% and 157% respectively. Thus implying that on net basis, the increase in ratio was much smaller. In case of the US, its gross debt jumped from 106% (2015-19) to 125% (2020-24), and net debt rose from 82% to 97%. However, in here, equally sharp increase in US' net debt ratio is concerning. Other major countries, with high debt levels are France and UK.

Amongst the EMs, China, Brazil and India are amongst the heavily indebted countries, while Indonesia has the lowest level of gross debt-GDP ratio. In case of India as well, Covid-19 pandemic proved to be a significant financial burden on the government, as its gross debt to GDP ratio moved from ~71% (2015-16 to 2019-20) to ~84% (2020-21 to 2024-25). However, in the recent period, it has shown notable decline from 88.4% in 2020-21 to 82.5% estimated in 2024-25.

## Impact of commodities with high inflationary potential

India's inflation has witnessed considerable volatility in the last few years. From episodes of low inflation, it overshoot RBI's 4+/-2% bandwidth. However, a statistical evaluation of the entire disaggregated series of CPI shows that volatility is concentrated in few food items. At times, fuel products have also exhibited high annualized average monthly volatility which was mainly due to changes in retail prices at certain points of time. The distribution of inflation also witnessed positive skewness in the past two years and higher kurtosis (>3), which indicates that due to certain specific items, inflation is ruling higher.

The analysis here looks at commodities in the CPI basket which have witnessed high inflation and volatility in the last few years relative to the headline numbers and examines their price movements as represented by a combined index called 'CPI-volatile Index'. The CPI-volatile series indicates that most of the overshooting of CPI beyond its 6% level is attributable to higher inflation in these few items. In May'24, these volatile items pushed up CPI by 1.5%. Historically as well, in most of the periods, these volatile items have been responsible for higher inflation.

**Background:** Inflation trajectory has evolved interestingly since FY19. We witnessed episodes of low inflation just prior to the pandemic period (FY18 and FY19), supported by benign food inflation. The pandemic witnessed a slack in demand conditions and core inflation softened. However, with resumption of economic activity, inflation numbers witnessed an upturn with normalization in core inflation and food prices spiraling on account of a variety of factors. This can be attributed to both domestic factors (crop failures) as well as global factors (disruptions due to wars)

**Volatility:** Headline CPI has exhibited annualized average monthly volatility of 3.3%. Within the disaggregated items some components of food showed maximum volatility. What comes as a comfort is that the number of these



items is limited and most of the increases are also not a persistent phenomenon. 56.5% of the items in the CPI with weight of 64% had volatility of less than 10. Only 12 items had volatility of over 100 while 21 had in the range of 50-100%.

Next, we analysed how different items fall in different inflation bands. We note two different things. 1) Most of the food products have an inflation range within MPC's bandwidth. 2) However, the tail becomes heavier towards higher end of inflation spectrum due to concentration of few food products. These items are causing CPI to diverge its projected path. In the 6-8% average inflation band as well, food has more than 40% share and majority of the rest are miscellaneous items (components of core inflation).

**CPI volatile items and BOB ECI:** In the next exercise, we examined the volatile items of CPI based on certain criteria such as items having higher annualized average monthly volatility and items whose average inflation far outweighed headline CPI consistently since pre pandemic (FY19). Certain items which bear the impact of Russia Ukraine war especially fuel and transport and communication components have been kept out as these are transient phenomenon. However, the number and share of those items in the overall CPI basket is limited. The CPI volatile items have an overall weight of 5.48% and include potato, tomato, onion, tur, garlic, jeera, chicken and dry chillies. Notably, the CPI volatile items have been rebased to Mar-17, for the purpose of parity in our analysis, as this study mostly focuses on pre- pandemic (since FY19). The CPI-volatile series has an annualized average monthly volatility of 45.9%, which is far higher than headline equivalent number of 3.3%. However, with small weight, the quantum of their increase has been higher and current run rate is above 20%. Thus, we believe because of this volatility index, CPI was 1.5% higher in May'24. Notably, in previous episodes, it was seen that whenever CPI-volatile index has posted a higher inflation rate of above 20%, CPI had the tendency of posting an above 6.5% number (Jul-Nov'20).

In 27 of 62 episodes monitored by us, the overshooting of CPI above 6% upper bandwidth has happened due to the CPI volatile items. Notably, the CPI-volatile series has a fair degree of positive correlation with BoB ECI at 0.54. Our BoB ECI, on YoY basis for Jun'24 and Jul'24 is at 7.8% and 3.3% respectively.

**Conclusion:** Repeated worrisome prints of CPI are posted due to significantly higher inflation skewed in certain commodities. Thus, inflation is not broad based. Even discounting seasonal variation only 8 commodities out of the 299 disaggregated list have been charted out as per higher deviation from average inflation and having significant annualized average monthly volatility. The correction of their trajectory is contingent on concrete supply management policies of the government which has been seen in the past as well.

## India's imports from Russia

Ever since the Russia-Ukraine war commenced there were distortions in global commodity prices with various punitive measures being invoked by the western powers on Russia. More importantly, there were embargos on trading with Russia. However, fuel products were exempted from these bans. India did leverage this opportunity to lock in imports from Russia at a much lower rate than what was prevailing in the market. This helped to save on costs. Besides, some part of the trade was reckoned in rupees as the concept of 'rupee trade' caught on with the RBI and Government working on internationalizing the currency. This analysis assesses the potential theoretical gains that were made on importing two products from Russia – crude oil and coal.

Russia became an important import partner for India from FY23 onwards. In FY24, out of total imports of \$ 675.5bn, Russia had been sourced for \$ 61.4bn. The share in total was hence 9.1%. This can be contrasted with 6.5% in FY23 and 1.6% in FY22. In FY24, Russia was the second largest source of imports coming after China which accounted for \$ 101.2bn. The other countries in the pecking order were UAE with \$ 48bn, USA with \$ 40.7bn and Saudi Arabia and Iraq with \$ 30-31bn each. China hence tops today with share of 15.1% in total imports.

The major gain made by India in the last two years is on import of crude oil. The share of Russia has risen to account for a third of total imports of crude oil highlighting hence the importance of this source for India. In quantitative terms India imported 232mn tonnes of crude oil in FY24. Russia accounted for 83mn tonnes which is about 35.7% of the total.

The average world price on the basis of tonnage is compared with the average cost at which we imported from Russia in the last three years. The same is applied to the oil imported from Russia to arrive at the implicit gain for India. As can be seen in the table the gain has been around \$ 3.5bn in both the years.

An alternative scenario is also presented where the cost from Russia is compared with the next lowest price which is from Iraq. Here the gains would be lower and would be \$ 2.4bn and \$ 1.7bn respectively in the last two years. The assumption here is that the quantity imported from Russia is procured from the lowest cost country during the year which is Iraq.

Interestingly in the first two months of FY25, Russia accounted for 35% of total imports of crude oil to India followed by Iraq with 23%. But the cost from Iraq was lower at \$ 606/tonne against \$ 615/tonnes from Russia.

In case of coal, Russia accounted for 8.6% (23.3mn tonnes of the total of 269mn tonnes) of imports in FY24 compared with 3.9% in FY22. The cost per tonne amounted to \$ 161.3/tonne from Russia, while that from Australia (which accounted for 28% of imports of 269mn tonnes) was \$ 242.7/tonnes (there would be variations in quality which is not captured here). The difference of around \$ 80/tonne would tantamount to a maximum potential of around \$ 1.8bn assuming no quality differences.

There have hence been some perceptible gains by importing minerals like crude oil and coal from Russia. The gains tend to be higher when the global prices are moving in the upward direction. As price come down, the potential gains would also tend to reduce.

## **Corporate Investment in Q1-FY25**

Investment announcements for the first quarter of the year were at the 20-year low level at Rs 44,300 core. The previous lowest level was in June 2005. Given the fact that the economy has been growing at a steady pace, the only reason that can be attributed to the sluggish intentions can be the Elections. Industry has been probably in a wait and watch mode before taking any investment decision. This however, has not been the trend in the past when Elections were held. For Q1-FY15, investments were for Rs 2.9 lakh crore and Rs 2.1 lakh crore for Q1-FY20. Hence, while June does tend to have lower investment announcements as they normally peak in March which is the yearend, it has been exceptionally low this year. The exhaustion of plans in the preceding March quarter where

a high of Rs 12.35 lakh crore was announced, which was lower to only that of March 2023 when it was 16.20 lakh crore could be another reason for this slowdown.

Manufacturing has been the dominant sector in the total intentions listed here with share of 46.4%, followed almost evenly by electricity and services. Interestingly, over the period June 2023 and June 2024, the fall in value of investment announcements was Rs 7.4 lakh crore. Of this, the major dip was accounted for by the transport services sector at 61%. This decline of Rs 4.61 lakh crore was due to the airlines industry as in the past they had announced intentions to buy new aircrafts. It may be inferred that this pattern would be observed in the coming quarters too as these plans are unlikely to be restored until the earlier orders are executed fully. Another 20% of the decline of the order of around Rs 1.5 lakh crore was in the electricity sector. In the past most of the additions have been in the renewable space and here too a slowdown may be expected.

**What does activity in the financial sector show?:** CMIE data on corporate bond issuances for the first quarter of the year show that a similar trend is witnessed. Overall issuances had increased from Rs 1.43 lakh crore in Q1-FY23 to Rs 2.86 lakh crore in Q1-FY24, but came down sharply to Rs 1.73 lakh crore in Q1-FY25.

During the first quarter of the year, 76% has been accounted for by the financial services sector with power, mining and diversified companies having shares each of between 4-5%. On the banking front, there is information available up to 14th June 2024. Between March end and June 2014, incremental credit was Rs 2.78 lakh crore as against Rs 3.78 lakh crore last year. In terms of growth rate on YTD basis it was 1.7% against 2.5% last year.

Therefore, it can be concluded that there has been a slowdown in investment in the first quarter of the year. It would need to be seen whether there is any major pick-up in the second quarter considering that the budget will be announced only towards the end of July. A good monsoon and steady demand during the festival season which starts from end-August and lasts till December would be the time when investment could increase at a faster pace

### **Do Stamp duty collections reflect health of real estate sector?**

India's real estate industry is expected to contribute more than 15% to India's GDP by 2047<sup>1</sup>, from 7% share currently. There has also been a steady rise in the sales of upscale property signalling rising income, premiumization and pent up demand. This has been supplemented by the push given by the government to affordable housing through subsidies which has stabilized demand at the lower end of the price scale.

There are various factors that determine the demand of the sector, such as migration, prices, location, interest rates, rentals etc. Higher revenue receipts by state government through the stamp duty collection has been one of the high frequency indicators that sheds some light on how the housing market is faring. However, there are some caveats that needs to be taken in to account when looking at this variable.

- Stamp duty is paid for both primary, secondary purchases as also for rental/lease agreements. Also it is not possible to distinguish between residential and commercial transactions.
- In addition, these rates have changed over the years across states and vary on the value of the property.
- Higher collections by states would also be due to higher value of the houses/property being transacted.

Hence, while interpreting the results based on stamp duty collections, caution needs to be exercised as all these factors have been at play in varying degrees. Stamp duty collections from property registrations have grown at a steady pace over the years. The total stamp duty collection across the sample of 23 states considered here for the last 10-years stand at Rs 13.7tn. The top 5-states that have contributed the most to this collection, includes Maharashtra with a share of 23.4%, followed by Uttar Pradesh at 13%, Tamil Nadu (9.2%), Karnataka (8.4%) and Gujarat (6.7%).

In this study, dataset for last 10-year has been taken and divided equally in 2-parts ranging between the years FY15 to FY19 and between FY20 to FY24 across all the states. All India (aggregate) has recorded a sharp increase in CAGR growth from 10.4% in the first quinquennium to 12.5% in the last 5-years, signalling much higher demand during this period. It has been noted, out of the 23-states, 16 of them have registered a higher CAGR growth in the last 5-years compared with the previous period.

States like Maharashtra have clocked double digit growth with a CAGR of 12.2% for the period between FY20 to FY24 compared with a CAGR growth of 8.9% during the period FY15 to FY19. Cities like Mumbai have played a pivotal role in contributing towards the same, as has been noted by real estate consultants like Knight Frank. For the last year itself, there has been significant advancement in property registrations, with residential units contributing the most.

Notably the stamp duty rate in the last 10-years has changed substantially for the state, including a reduction in rate announced during the Covid-19 period back in Dec'20. This propelled the demand for housing sector in the state and drove up the registrations during the said timeline. However, later with the normalization, the reduction in stamp duty rate was withdrawn. Currently, the rise in stamp duty collection due to higher property registration has been attributed to pick up in income level and growing interest towards the homeownership. Furthermore, property with higher value continue to grow at a steady pace.

In the last 5-years, CAGR growth of these 5-states namely Telangana, Bihar, West Bengal, Haryana, Odisha and Meghalaya have witnessed gradual moderation in their stamp duty collections reflecting possibly a slowdown in the demand of real estate in these states.

The CAGR growth in terms of stamp duty has come down to 2.9% for West Bengal, raising some concern over the demand for realty sector. However, given the recent rebate on stamp duty that has been further extended, it is expected to boost the demand for the sector.

**Stamp Duty Rates:** In the context of stamp duty collections by the states, an important factor to analyze is the stamp duty structure in these regions. The absolute level of rates as well as changes over time would provide some insights on how the policy rates have impacted stamp duty collections.

These rates vary with transactional value, area and gender as different criteria are used by states. The purpose of presenting the average stamp duty rate is only to show how they vary across states. Data have been collected from different sources and hence the definitions would differ. Therefore, they are at best indicative of rates prevalent in the states.

There is considerable variation across states with the rate varying from 4% to 8% (if Meghalaya is excluded). Also while some states have lowered the rates over this period, other have raised them.

- A significant reduction can be seen for Uttar Pradesh and Chhattisgarh. It also came down for Mizoram, Odisha, West Bengal and MP.
- Kerala and Assam have increased the rate by 200 bps. Other states where rates have gone up are Punjab, Maharashtra, Haryana, Telangana, Andhra Pradesh, Gujarat and Sikkim.
- States where the rates remained unchanged are Jharkhand, Uttarakhand, Tripura, Bihar, Tamil Nadu and Meghalaya.

Hence these actions would also contribute to the quantum of increase in stamp duty collections.

**Conclusion:** Stamp duty collections of the government is a good indicator of the health of the real estate sector in India. Stamp duty rates have changed over time but tends to be very gradual and remains unchanged for a larger part of a time period. The prices of homes have grown at differential rates and also contribute to the collections. However increase in HPI is always associated with the state of the real estate market and hence it would be reasonable to conclude that higher collections associated with rising HPI does indicate a buoyant market

## Data Releases

### Currency outlook

INR depreciated by 0.4% in Jul'24 to currently trade at 83.73/\$, close to its lifetime low of 83.74/\$. This was despite weakening US\$. The factors that impacted Rupee include: rise in average international oil prices in Jul'24 compared with Jun'24, and increased dollar demand by gold importers after the budget announcement. However, the decline was not as steep as it was in case of other currencies, mainly due to steady FPI inflows. While inflows into equity were impacted by increase/rationalisation of capital gain taxes, debt inflows held ground. As a result, INR traded in the range of 83.45-83.74/\$. In the next fortnight, we expect pressure on INR to remain, in the wake of increased dollar demand, and renewed volatility in international oil prices. However, weakness in US\$ and softer global yields may help cushion the downward bias. We expect INR to trade in the range of 83.70-83.85/\$.

### Bond Market Round-up

Global yields softened further in Jul'24. US 10Y yield declined sharply. Fed kept rates on hold and dovish commentary by Fed Chair signalled rate cut likelihood as early as Sep'24. This was supported by softer PCE price index which came in line with expectations. On the domestic front, India's 10Y yield eased. Notably, RBI has recently restricted foreign ownership access towards 10&14Y securities, with more demand shifting towards the securities leading up to 10 years. Going forward, the 10Y yield is expected to trade in the range of 6.85%-6.95% in Aug'24, with risk evenly balanced. The attention will turn towards the upcoming monetary policy meeting to provide more guidance on inflation outlook.

### Update on corporate result

Net sales for a sample of 933 companies shows a pickup on a YoY basis. From 1.9% in Q1FY24, sales have picked up to 7.4% in Q1 FY25. However, there has been a sharp deceleration in profit growth. Excluding the BFSI sector, the decline in profit is even more striking. For the Ex. BFSI segment (771 companies), the growth in profit has seen a sharp decline to 10.6% in Q1 FY25, falling from 54.2% in the preceding year. Sales growth is also muted at just 5.1%.

### Monsoon and sowing update

Rainfall is currently 4% above the LPA till 2 Aug 2024. Pickup was noted in the last fortnight when 160.7mm rainfall was received between 20 Jul and 2 Aug, versus 123.7mm between 6 and 19 Jul. Out of 36, 27 subdivisions (77% of the country) have received normal or above normal rainfall so far and 11 states are in the deficient zone. Region-wise, Southern peninsula (+27%) and Central region (+18%) continue to record excess rainfall, while North West (-12%) and East & North East (-16%) regions still report deficient rainfall. Supported by higher than normal rainfall, there is an improvement noted in the sown area, with higher acreage of pulses, paddy, oilseeds, sugarcane and coarse cereals compared with last year. Spatial distribution of rainfall will be critical this month as well, for sowing purposes.

## Union Budget 2024-25

Union Budget for FY25 outlined key areas where government will be focusing in the next five years. These included: employment, education and skilling, focus of manufacturing, agriculture sector, MSMEs, infra, innovation/R&D, energy, and social justice. Government also committed to stick to the path of fiscal consolidation. As a result, fiscal deficit (as % of GDP) is estimated to be lower at 4.9% in FY25BE. Revenue deficit (% of GDP) will also be brought down to less than 2% in FY25BE. Government is also set to lower its debt-GDP ratio to 56.8% in FY25BE from 58.1% as per FY24RE. Government also continues to expect nominal GDP to rise by 10.5% in FY25, unchanged from interim budget. However, we expect real GDP growth to average ~7.3-7.4% and inflation to average between 4-4.5%. Tax structure shows that, taking into account the changes announced in direct taxes, the direct tax-GDP ratio is expected to increase from 6.6% as per FY24RE to 6.8% in FY25BE. Indirect tax-GDP ratio on the other hand is estimated to remain broadly stable at 5% in FY25BE, unchanged from FY24RE.

Size of the budget has seen considerable increase over the past two years, with growth averaging ~8.7%. However, as a % of GDP, it has come down gradually from 15.6% in FY23 to now 14.8% in FY25BE. The increased size is also reflective of greater focus on improving the quality of spending, by increasing attention to capital spending, and support to states. We believe, government is on track to attain FD ratio of <4.5% in FY26.

## India's Foreign Trade: Q1-FY25

India's merchandise trade deficit was higher in Q1FY25 at US\$ 62.3bn versus US\$ 56.2bn in Q1FY24, as imports have risen at a sharper pace than exports. Merchandise Imports have risen to US\$ 172.2bn in Q1FY25 from US\$ 160.1bn in Q1FY24. Exports on the other hand rose to US\$ 110bn from US\$ 103.9bn. However, going forward, we expect some correction in the trade deficit as exports are expected to pick up. An easier monetary policy will lend support to global growth thereby providing momentum for exports. However, headwinds for imports emanate from a pickup in non-oil non gold imports with domestic consumption gaining ground. Overall, we expect CAD to be in the range of 1-1.5% in FY25. This along with a recovery in FDI and FPI inflows will support the rupee.

## Core sector growth

Eight core industry growth eased to 4% in Jun'24 from 6.4% in May'24. This was driven by moderation in output of petroleum and refinery products, crude oil, natural gas, steel and electricity. Output of only coal, fertilizers, and cement inched up. Drag in refinery output is reflected in drop in petroleum exports in Jun'24. Steel output noted slowdown on account of softer government spending and muted auto demand. Early onset of monsoon also helped cool temperatures and reduced electricity demand. On the positive side, start of Kharif sowing season has helped fertilizer output and government's push to increase coal production has also shown positive results in that sector. Increase in cement sector output indicates revival in construction activity. In Q1FY25, core sector output eased to 5.7% from 6% in Q1FY24. Given the latest trends in core sector growth, we expect 4-5% IIP growth in Jun'24.

## Fiscal update

Centre's fiscal deficit remained contained at Rs. 1.4 lakh crores in Q1 FY25 which is only 8.1% of the budget estimate, compared with 25.3% of the target achieved last year. This can be attributed to muted capital expenditure due to general elections, as well as buoyant receipts growth led by a sharp increase in income tax.

With the elections now over, the government's capital expenditure is expected to pick up. We expect the government to meet its revised fiscal deficit target of 4.9% of GDP in FY25, led by prudent expenditure management and supported by robust tax collections.

### **WPI inflation accelerating**

WPI inflation rose to a 16-month high of 3.4% in Jun'24 compared with an increase of 2.6% in May'24, driven by surge in both food and manufactured inflation. Our forecast was 3.7%. Led by elevated prices of cereals, vegetables and fruits, food inflation rose to 22-month high in Jun'24. Prices of potato and onion accelerated sharply. For cereal inflation both paddy and wheat continue to register an uptick. On the other hand, some moderation was registered for pulses. Fuel and power inflation moderated marginally, despite an increase in global oil prices. Manufactured product inflation inched up to 1.4% in Jun'24 given the higher global prices of aluminium and other metals. Given the major sowing occurs during the Jul and Aug period, the progress of monsoon will play a determinant role in managing food inflation.

### **CPI inflation**

CPI for June came at 5.1% as against our forecast of 4.9%. Inflation was up mainly due to food inflation which was 9.4%. Major contribution from vegetable, fruits, pulses and cereals. The heatwave impact has been seen on vegetables. Wheat production lower according to the market for FY24 which has seen prices move up. These products will continue to witness high inflation. Progress of monsoon important here as any shortfall in regions growing pulses can increase prices.

In the non-food category, inflation has been under control with fuel and light seeing negative inflation. Personal care products continue to see high inflation of 8.2% due to increase in prices of products by manufacturers. Half the states have witnessed inflation of above 5.1%. Odisha has highest of above 7%, while Uttarakhand and Delhi less than 3%.

With inflation back past 5%, there will definitely be no rate action by RBI. While RBI has projected inflation to come down in Q2 to less than 4%, the monsoon progress will determine whether this is sustainable or not. RBI expects inflation to go back to 4.5% in the following quarters. Any rate action can be considered only in October and will be heavily data dependent.

### **Growth in Industrial Production**

IIP growth for May came in at 5.9% which is close to our forecast of 6%. There has been some encouraging news on the consumer goods front with durable witnessing growth of 12.3%. This can be attributed to both base effect as well as spending post Rabi season. FMCG goods however have seen moderate increase in production. Growth pushed up by electricity with 13.7%. Higher industrial activity as well as heatwave contributed to this increase. Manufacturing growth was subdued at 4.6%. Industries doing well were beverages, apparel, pharma, base metals, computers (base effect at play), electrical equipment and auto. Non-electrical equipment was subdued which also got reflected in low capital goods growth of just 2.5%. Infra industries have done well with 6.9%. Clearly the IIP growth is on a stable path which bodes well for the economy. The post-harvest festival season will hold clue to revival of demand, especially rural.



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