Monthly Economic Review

June 2022

Economic Division

आर्थिक कार्य विभाग
DEPARTMENT OF
ECONOMIC AFFAIRS

सत्यमेव जयते

Evolution of Monthly Economic Review

The Monthly Economic Review (MER) is the flagship document of the Economic Division, Department of Economic Affairs, Ministry of Finance giving a snapshot of the latest economic developments in India as well as abroad in a simple analytical framework, with a view to easing understanding of complex economic issues by the general public. The MER has undergone several iterations since its inception driven by the ambition to make the document a world class report widely read across professions and geographies. Given the evolving geopolitical situation in the world an attempt has been made to focus on a narrower set of issues as opposed to a more comprehensive coverage of the economy. Thus, MER for May 2022 focused mostly on the macroeconomic challenges of growth, inflation and stabilization policies as both the US Fed and the RBI raised their policy rates to curb rampant inflation. Likewise, the MER for June thought it fit to tell the readers about some strong and vulnerable areas of the Indian economy as it braces itself to counter the global trends of stagflation. Going forward the focus of future MERs will be still more on emerging and dynamic issues as they arise from geopolitics or other global developments having implications for India. At the same time the coverage will continue to be still somewhat broadbased but not as much as earlier editions, so that it benefits all classes of readers.

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Abstract

Almost five months into the Russian-Ukraine conflict, economic activity in India continues to show resilience despite having to deal with the twin challenges of elevated inflation and widening trade deficit. Agriculture is picking up momentum with the revival in monsoon and Kharif sowing. As of 11th July 2022, the South-west monsoon has covered the entire country with actual rainfall 7 per cent higher than normal level. The geographical distribution of the rainfall too has improved considerably. It is far less skewed. Elevated international agricultural prices have enhanced the real purchasing power in the rural areas with terms of trade for agricultural commodities remaining positive since March 2022. This has triggered a recovery in rural demand, although some indicators are yet to recover to pre-pandemic levels.

The corporate sector has begun to show signs of revival with robust growth in net sales in the quarter ending March 2022, assisted by a general recovery in demand. A rise in operating profit margin has contributed to an increase in interest coverage ratio, indicative of improvement in credit health of most of the industries. Improved credit health is expected to facilitate the absorption of higher credit costs arising from a tighter monetary policy. Momentum in the manufacturing and services is sustained in Q1 of 2022-23, as evident in the expansion of the PMI manufacturing and services indices. Indices of core industries production, Industrial production and freight traffic have also shown sequential and year-on-year improvement in Q1 of 2022-23.

The Indian banking sector embarked upon a consolidation phase during H2 of 2021-22 as the gross non-performing assets (GNPA) ratio declined to its lowest level in six years, bolstering its lending capacity. Support measures provided by the RBI during the COVID-19 pandemic aided in arresting the rise in GNPA ratios, although even with the winding down of regulatory reliefs, the newly acquired financial strength has not weakened as capital and liquidity buffers have been built well above regulatory requirements. However, as the RBI's financial stability report cautions, if the macroeconomic environment worsens to a medium or severe stress scenario, the GNPA ratio may rise above its pre-pandemic level. For the present, Scheduled Commercial Banks (SCBs) are seeing a modest return to profitability, a development that has contributed to the double-digit growth of bank credit in recent months amid an increase in working capital requirements triggered by high inflation and shift to bank borrowings on account of rising bond yields.

Improved fundamentals of the corporate sector and a well-capitalized financial system have instilled confidence in investors. Private equity and Venture capital investments in the first two months of Q1 of 2022-23 have risen above their levels in the corresponding period of the previous year. Pending and completed mergers and acquisitions deals have reached their highest aggregated value ever in the first quarter of 2022-23. Rising Capex in the public sector may have also begun to crowd-in private investment as seen in preliminary data collated for Q1 of 2022-23. In this quarter, the share of the Indian private sector in total investment proposals reached a record high of 85 per cent, rising from an average of 63 per cent in the preceding four quarters.

The Government's sustained focus on expanding capital expenditure has resulted in its year-on-year growth of 70.1 per cent in May of 2022. To further facilitate Capex, Government has also announced rules for disbursing Rs. 1 trillion in interest-free Capex loans to States. Sustained focus on Capex may appear to pose a challenge to maintaining the budgeted fiscal deficit to GDP ratio, particularly when union excise collections during April-May 2022 have declined, following a cut in excise duty on petrol and diesel to curb rising inflation. However, robust GST collection, increase in customs duties, and imposition of windfall tax are expected to boost government revenues and assist in keeping the fiscal deficit to GDP ratio unchanged from its budgeted level.

Global headwinds, however, continue to pose a downside risk to growth as crude oil and edible oils, which have driven inflation in India, remain the major imported components in the consumption basket. For the present, their global prices have softened, as fears of recession have dampened prices somewhat. This would weaken inflationary pressures in India and rein in inflation. In addition, various measures taken by the government to temper inflationary pressures may also contribute to capping inflation. However, as long as retail inflation in India continues to be higher than RBI's tolerance level of 6 per cent, as it still is at 7 per cent in June 2022, stabilization policy measures will need to continue walking the tightrope of balancing inflation and growth concerns.

Softening of global commodity prices may put a leash on inflation, but their elevated levels also need to decline quickly to reduce India's current account deficit (CAD). Primarily driven by an increase in the trade deficit, the CAD stood at 1.2 per cent of GDP in 2021-22. Also, a sudden and sharp surge in gold imports amid wedding season (as many weddings were postponed to 2022 from 2021 due to pandemic-induced restrictions) is also exerting pressure *on CAD. In order to alleviate the impact, the government has hiked the customs duty from present 10.75 per cent to 15.0 per cent. If recession concerns do not lead to a sustained and meaningful reduction in the prices of food and energy commodities, then India's CAD will deteriorate in 2022-23 on account of costlier imports and tepid exports on the merchandise account. The deterioration of CAD could, however, moderate with an increase in service exports in which India is more globally competitive as compared to merchandise exports.*

The widening of CAD has depreciated the Indian rupee against the US dollar by 6 per cent since January of 2022. Rupee has performed well in 2022 compared to other major economies unlike in 2013, where it depreciated against other major economies, thus, reflecting strong fundamentals of the Indian economy. The depreciation, in addition to elevated global commodity prices, has also made price-inelastic imports costlier, thereby making it further difficult to reduce the CAD. To meet the financing needs of a widening CAD and rising FPI outflows, forex reserves, in the six months since January 2022, have declined by USD 34 billion. In order to further diversify and expand the sources of forex funding so as to mitigate volatility and dampen global spill overs, measures have been taken by RBI to enhance forex inflows while ensuring overall macroeconomic and financial stability. These measures include exemption from Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) on Incremental Foreign Currency Non-Resident (Bank) FCNR(B) and Non-Resident (External) Rupee (NRE) Term Deposits, lifting interest rate cap on these deposits, easing norms for FPI in debt market, increasing the external commercial borrowings limit under the automatic route.

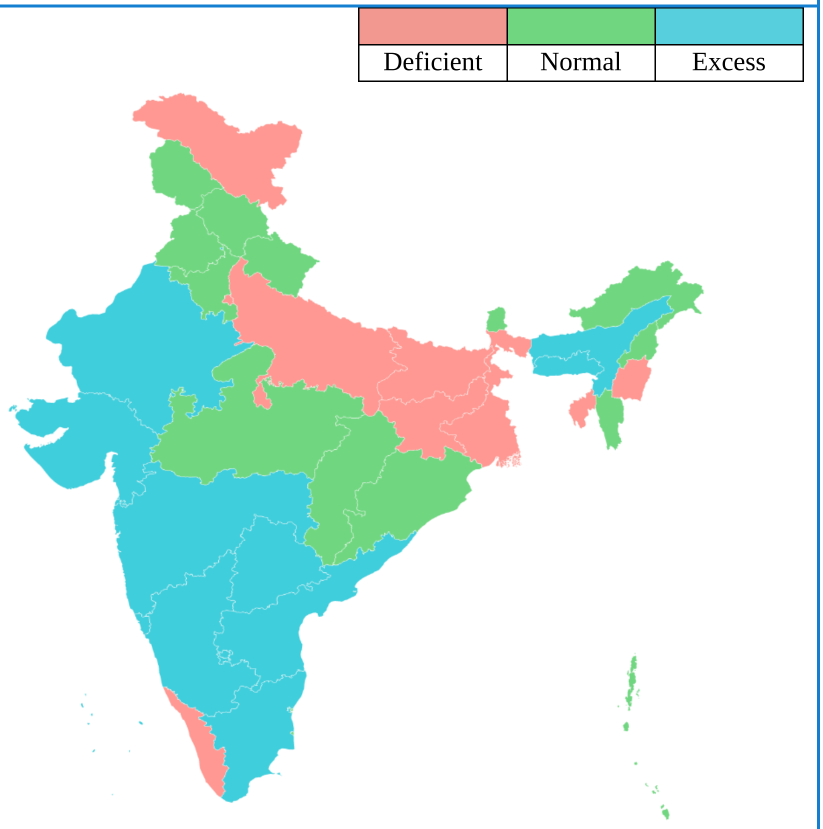
In the last six weeks, at the margin, thanks to several measures taken by the Government, by the Reserve Bank of India including rate hikes and due to global recession fears that have caused the oil price to decline, India's macro risks have receded. Prices of industrial metals are at their lowest in sixteen months and prices of some food commodities too have come off their peaks. The momentum in the economy is holding up better than expected, despite commodity price shocks in the last four months. After a sluggish start, the seasonal rainfall has picked up and it is geographically well dispersed. That is good news too.

All that being said, these are still early days in the financial year and there are still many challenges to overcome. The Federal Reserve continues to tighten. Global liquidity conditions will tighten and asset market declines can dampen sentiment and curb spending. Geopolitical risks, near and afar, are rife. For now, we will take the good news, at the margin, while remaining on guard and ready to tackle anticipated and present risks.

Agriculture sector picking up momentum

1. Indian Meteorological Department (IMD) has predicted normal rainfall across the country during the southwest monsoon for this year with rainfall during July 2022 expected to be at 94-106 per cent of the long-period average (LPA). As of 11th July 2022, the South-west monsoon has covered the entire country with actual rainfall being 7 per cent higher than the normal level with lesser skewed distribution. 27 States/UTs have experienced above normal level rainfall with the remaining 9 experiencing a deficit. Ensuring water adequacy for irrigation during the year, the storage availability in 143 reservoirs as of 7th July 2022 is 95 per cent of the live storage for the corresponding period of the last year and 121 per cent of storage on average for the last ten years.

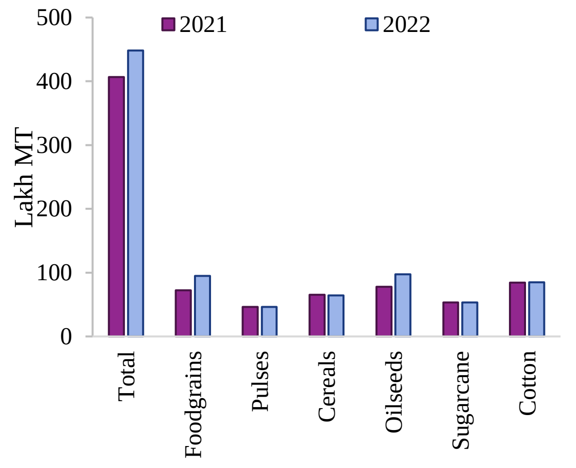
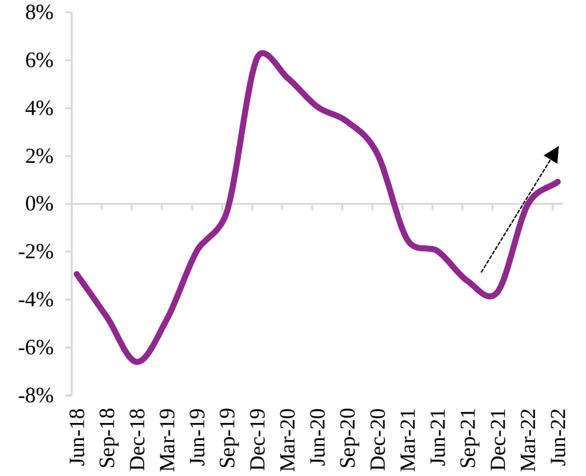
State-wise distribution of South-West Monsoon across India-2022



Source: Compiled from data available on IMD as of 11th July 2022

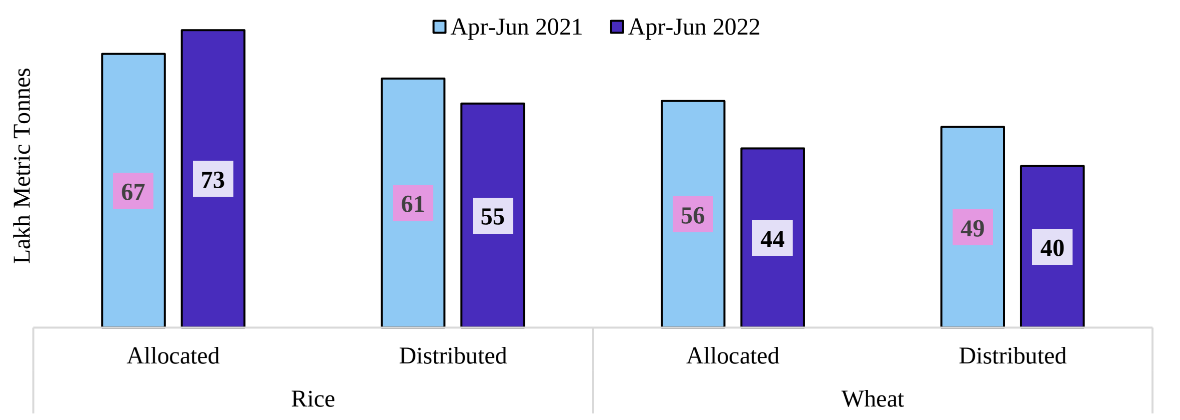
2. As of 8th July 2022, the actual area sown under Kharif crops was 9.3 per cent less than the corresponding period of the last year. Area sown under food grains, oilseeds, sugarcane, and cotton has moderated; however, sowing under pulses and coarse cereals registered YoY growth of 0.98 per cent and 1.5 per cent respectively. Fertilizer and domestic tractor sales during May 2022 rose by 4.9 per cent and 47.3 per cent respectively. It augurs well for enhanced agricultural production in 2022-23. Gains from enhanced agricultural production may likely percolate to the workers as average rural wages have risen more than 4 per cent in

April 2022 as compared to the previous year. In addition, the real purchasing power in the rural sector is set to rise as terms of trade (ToT) for agricultural commodities have turned positive since quarter ending in March 2022.

Progress in sowing of Kharif crops	Terms of Trade for the Agricultural Sector
	
Source: Department of Agriculture Note: Data as of 8th July 2022	Source: Compiled using MOSPI data

3. FCI currently has adequate availability of stocks of food grains with 1.5 times the mandatory requirement. Food grain offtake by States during April-May, 2022 was 20.3 per cent of the allocated quantity, indicating excess availability of food grains. Over time the gap between the two will narrow as government schemes that involve food distribution will increase their coverage of needy beneficiaries. From April-June 2022, out of the total food grains allocated to fair price shops (FPS), 81.3 per cent was successfully distributed to National Food Security Act (NFSA) beneficiaries through automated e-POS devices compared to 89.7 per cent during the corresponding period of the previous year, indicating improvement in income levels and therefore, lesser reliance on Government support.

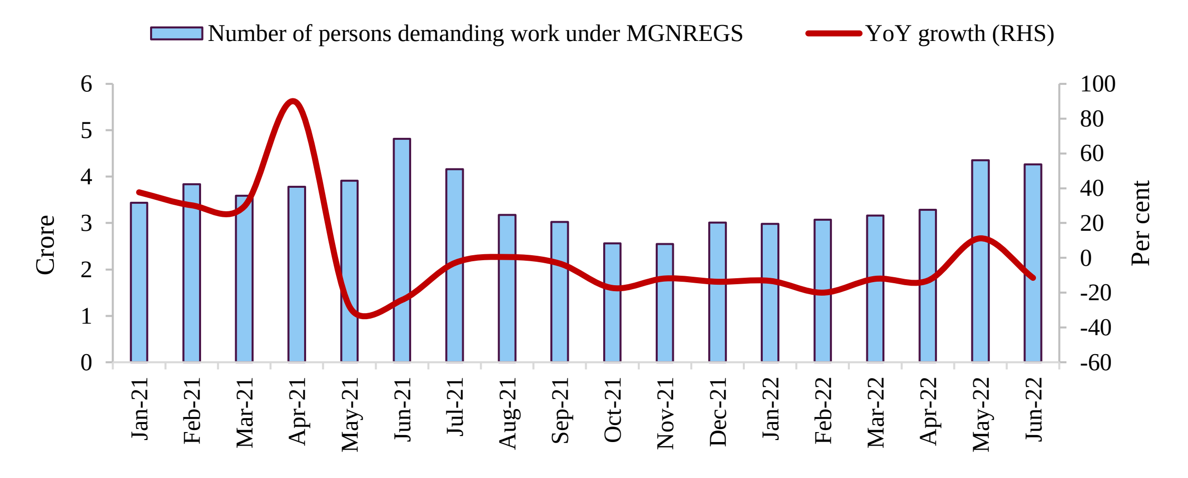
Food grain allocation and distribution during April-June 2022



Source: Annavitran Portal
Note: Data as on 7th July, 2022

4. The decline in demand for work under the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) in June 2022, after a rise in May 2022, is another pointer to rising agriculture activity levels seeking a larger number of agricultural laborers, that in turn will ensure positive growth in agriculture production. A similar trend is visible in a 9.4 per cent fall in wages disbursed under the scheme during June 2022 compared to June 2021.

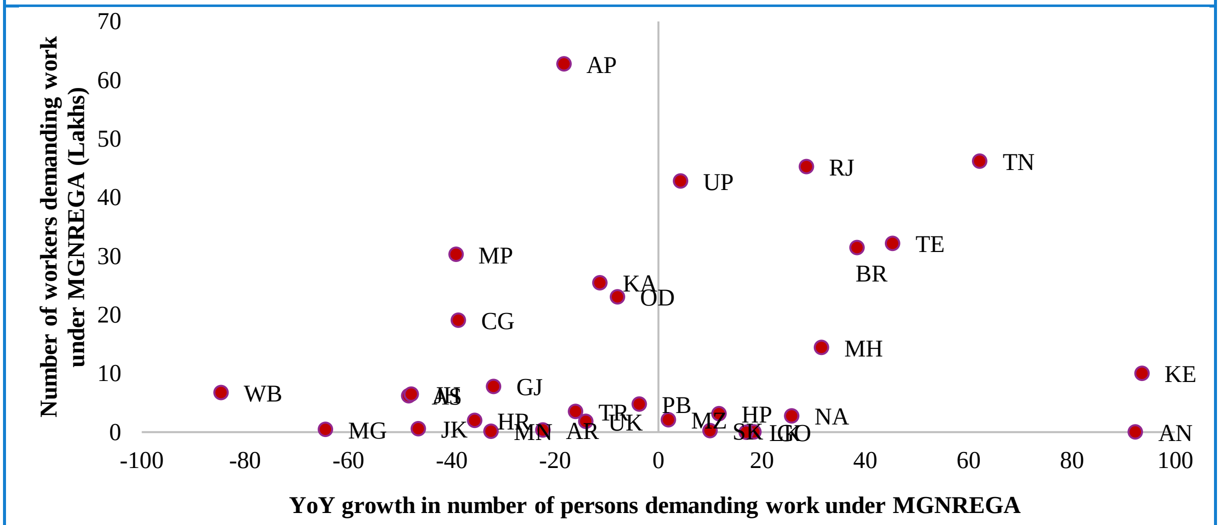
Number of persons demanding work under MGNREGS



Source: https://nrega.nic.in
Note: Data as on 7th July, 2022

5. Out of 23 major States / UTs, with more than 1 lakh persons demanding work, the dependency on MGNREGS work, during June 2022, declined in 13 States and increased in 10 States as compared to June 2021. A delay in the arrival of the South-West monsoon in 2022 may have led to low demand for agricultural labour and a consequent rise in MGNREGS demand.

State-wise growth in persons demanding work under MGNREGA during June 2022



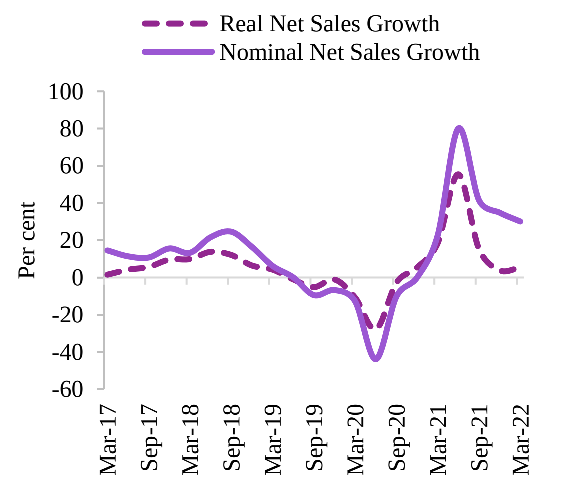
Source: https://nrega.nic.in
Note: Data as on 7th July, 2022

Corporate Sector

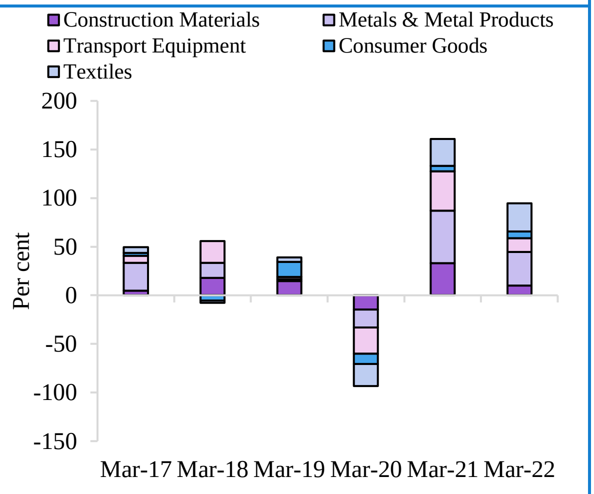
Manufacturing sector shows resilience and sustained recovery in demand conditions

6. During the quarter ending March 2022, the corporate sector experienced robust year-on-year growth in net sales, both in nominal and real terms, reflecting a sustained recovery in demand conditions. Real sales growth expanded on a sequential basis as well.

Manufacturing: YoY Real and Nominal Growth



Net Sales YoY Growth (%)



Source: Private Sources

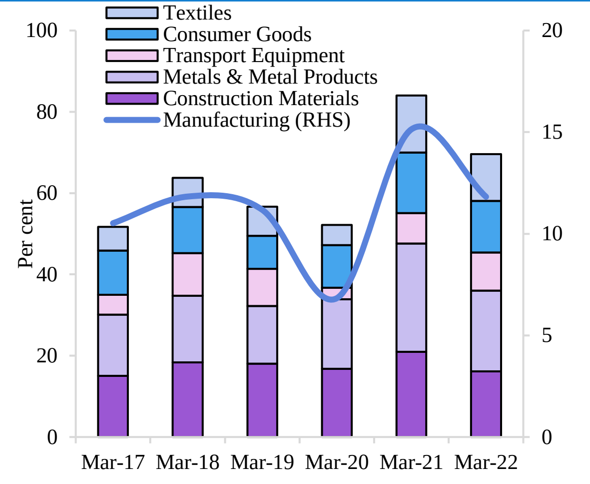
7. Within the manufacturing sector, inorganic chemicals such as fertilizers, pesticides, petroleum products, and rubber performed particularly well. This is consistent with the sustained performance of the agricultural sector during the pandemic and the export surge that drove economic recovery. Recovery was also seen becoming broadbased in the quarter ending March 2022 with metals & metal products (both ferrous and non-ferrous), electrical machinery, textiles, vegetable oils & products, commercial vehicles, and paper/ newsprint/ paper products also earning healthy revenues.

8. The ability to pass through prices is reflective of pricing power, which is most evident in the edible oil industry. The drought and frost in South American countries and the choked shipments in the Black Sea region owing to the Russia-Ukraine conflict raised input costs for edible oils. The enhanced input costs could be passed through as a spike in demand for palm oil lent pricing power to the edible oil industry. This led to a rise in prices of edible/vegetable oils such as soyabean, sunflower, and palm oil. Growth in sales revenues of the edible oil industry in the quarter ending March 2022 quarter was largely due to pass-through.

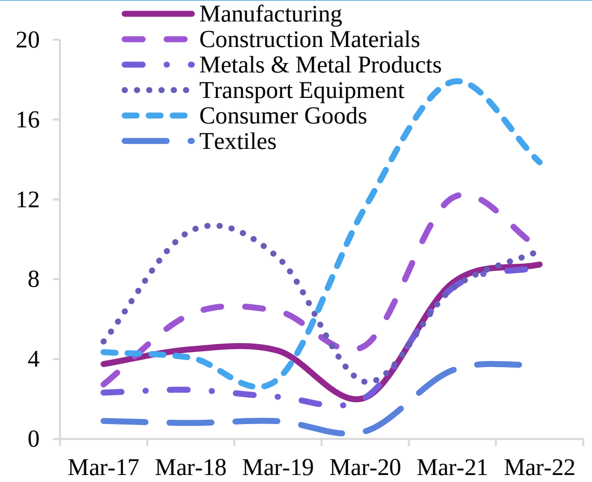
9. In the quarter ending March 2022, the sales growth in textile industry did not suffer despite the pass-through of input prices due to pent-up demand. Average prices in the textiles

industries were up 12-22 per cent, year-on-year. The pass-through helped the petroleum products as well as the metals product industry with the latter showing real growth in sales following the elevation of metal prices triggered by the Russia-Ukraine conflict. Higher subsidies on the other hand helped the fertilizer sector earn higher sales revenues. The pesticides sector witnessed volume growth from both the domestic as well as from export front. The sales revenue of commercial vehicles industry increased in both, volumes and realisations. Robust demand from the real estate, infrastructure and e-commerce sectors facilitated the demand for commercial vehicles.

Operating Margin YoY Growth (%)



Interest Coverage Ratio



Source: Private Sources

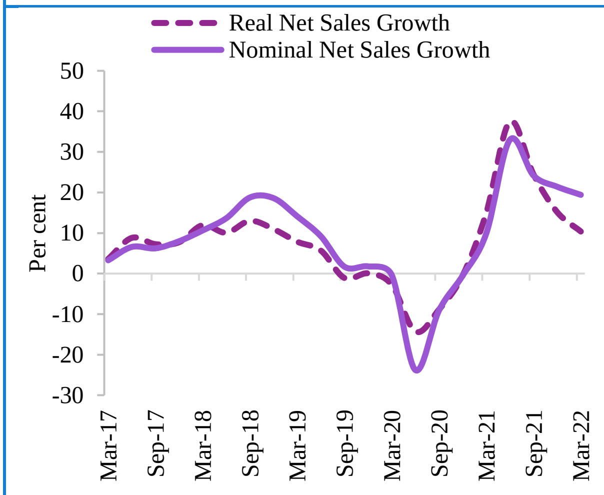
10. Improved operating profit margin has contributed to the post-pandemic increase in interest coverage ratio, indicative of improvement in credit health of most of the industries. Industries such as consumer goods, construction materials, transport equipment, and metal & metal products were in a position to meet their interest obligations at least eight times over in the quarter ending March 2022. Going forward, improved credit health implies that the manufacturing sector will be resilient against tighter monetary policies as governments across the world strive to rein in surging inflation.

11. Continuing the momentum of robust performance of the sector during Q4 2021-22, the manufacturing PMI continued to be in the expansionary zone clocking 53.9 in June, slightly lower than 54.6 in May. The slight dip may be attributed to the moderation in new export orders with the weakening in the growth of world output. Supply-side disruptions may no longer be held out as the reason for the weakening of trade and growth as a sub-index tracking delivery times of goods stood above the 50-mark for the first time since February 2021 and at its highest in nearly three years. Data on eight core industries' production in May also showed resilience. All industries registered positive growth on a year-on-year and sequential basis. The sequential momentum of steel and fertilizer production remained strong. Coal and electricity production also remained almost 14 per cent above pre-pandemic levels of 2019.

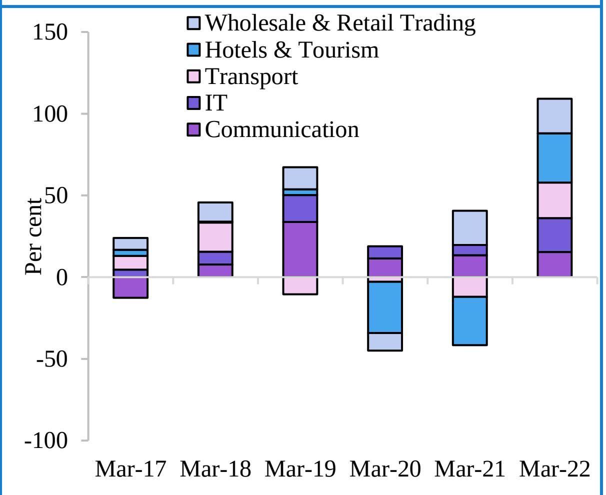
Services sector on the path of recovery

12. During the Jan-March 2022 quarter, the service sector witnessed a broadbased recovery in sales revenues in nominal and real terms. Information technology (IT) companies maintained strong growth while non-IT service companies continued to recover from the slump caused by the lockdown. Hotels & tourism, trading, shipping transport services, information technology or software and films exhibition all witnessed a growth of over 20 per cent. Road, railway, shipping transport, and media content experienced negative growth in real terms. IT and non-IT service sector companies were also able to maintain their operating profit margins.

Services: YoY Real and Nominal Growth



Net Sales YoY Growth (%)

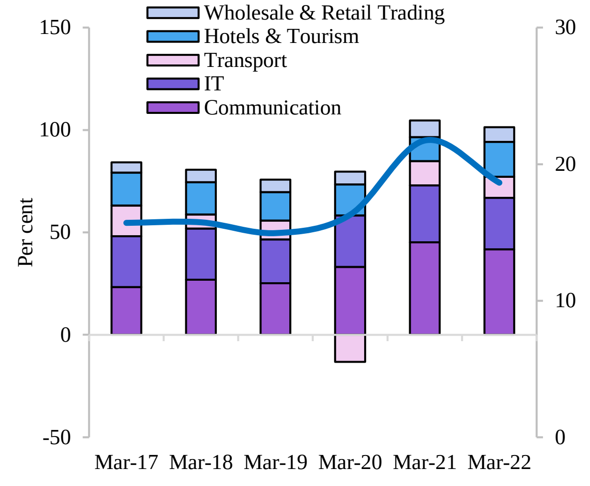


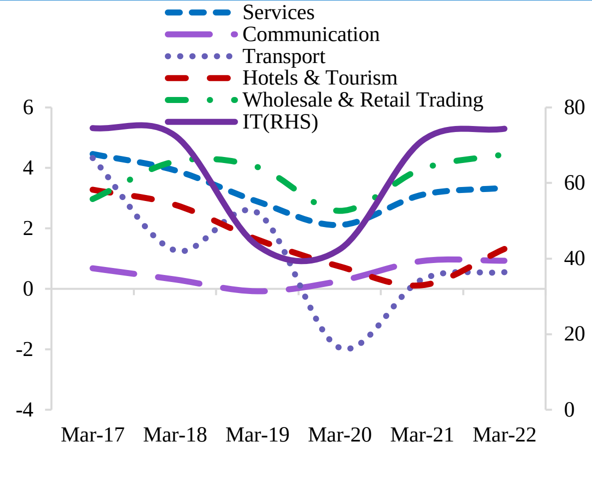
Source: Private Sources

13. Interest coverage ratio in the services sector was weakening pre-pandemic, though it is now on its path to recovery. However, hotel & tourism and transport services continue to show a weak interest coverage ratio as compared to the pre-pandemic levels. The interest coverage ratio is nonetheless high for the IT sector and wholesale and retail trading services.

14. Broadbased recovery in service activity continued in the first quarter of 2022-23, with PMI services rising further to 59.2 in June from 58.9 in May. The expansion can be attributed to improvements in demand following the retreat of pandemic restrictions, capacity expansion, and a favourable economic environment. Freight data also signalled resilience, with railway freight continuing to expand in double-digit by 11.3 per cent on a year-on-year basis in June 2022.

Operating Margin YoY Growth (%)	Interest Coverage Ratio





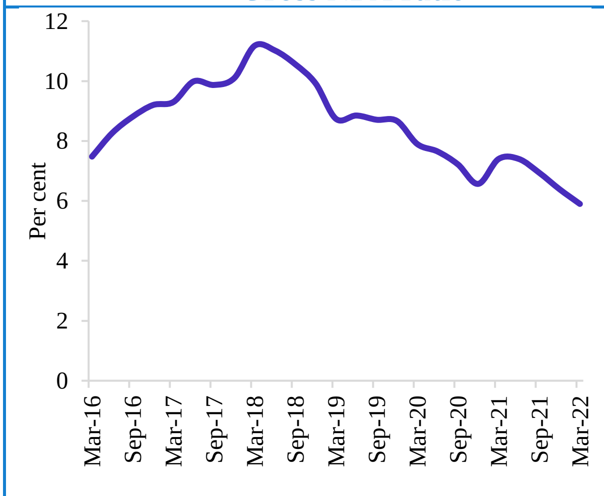
Source: Private Sources

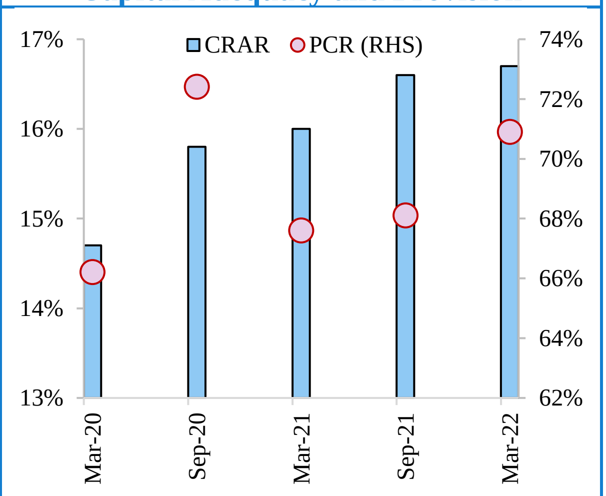
Financial Sector Stability

The financial system is adequately capitalized to absorb macro-economic shocks

15. Indian banking system has strengthened its risk absorption capacity over the years driven by policy support, including regulatory dispensations. Asset quality of Scheduled Commercial Banks (SCBs) is improving steadily over the years across all major sectors. Gross non-performing assets (GNPA) ratio has decreased from 7.4 per cent in March 2021 to a six-year low of 5.9 per cent in March 2022. There was a broadbased improvement in the GNPA ratio in respect of the industrial sector, though it remained elevated for gems and jewellery and construction sub-sectors. The provisioning coverage ratio (PCR) improved to 70.9 per cent in March 2022 from 67.6 per cent a year ago.

Gross NPA ratio	Capital Adequacy and Provision





Source: RBI

16. Capital raising and earnings retention by banks supported capital augmentation. The Credit to risk-weighted average ratio (CRAR) has been on the rise since March 2020, improving further to 16.7 per cent in March 2022. The CRAR of PVBs and Foreign Banks remained above 18 per cent. The return on assets (RoA) and return on equity (RoE) ratios improved during H2:2021- 22. PVBs, which have been maintaining higher profitability than PSBs, further improved their profile in H2 as compared to H1 of 2021-22.

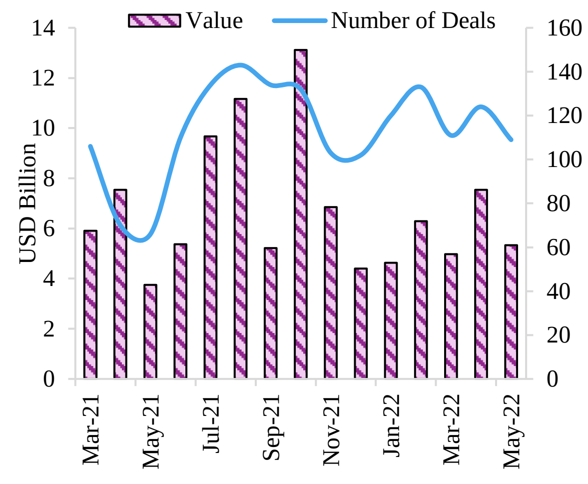
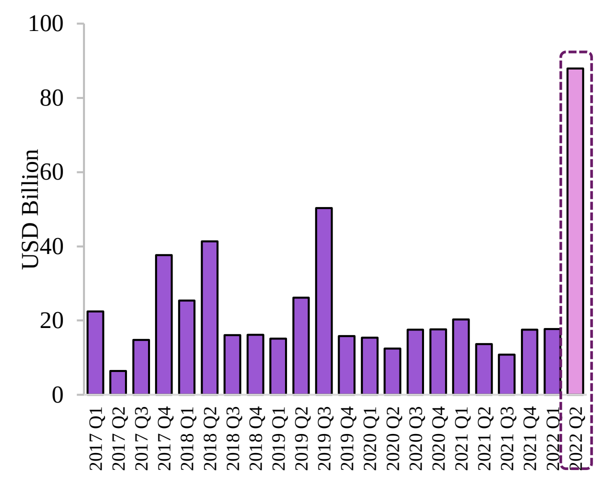
17. The macro stress test undertaken by RBI revealed that SCBs were well capitalized and capable of absorbing macroeconomic shocks even in the absence of any further capital infusion by stakeholders. Support measures provided by the regulator during the COVID-19 pandemic aided in arresting GNPA ratios of SCBs even with the winding down of regulatory reliefs. Under the assumption of no further regulatory reliefs and without taking the potential impact of stressed asset purchases by National Assets Reconstruction Company Limited (NARCL) into account, stress tests indicate that the GNPA ratio of all SCBs may improve from 5.9 per cent in March 2022 to 5.3 per cent by March 2023. If the macroeconomic environment worsens to a medium or severe stress scenario, the GNPA ratio may rise to 6.2 per cent and 8.3 per cent, respectively.

Investment

Sustained momentum in investment activity driven by private sector

18. A well-capitalized financial system and improved fundamentals of the corporate sector have instilled confidence in the investors. Resilience in economic activity during Q1 2022-23 reflects strong macroeconomic fundamentals of the economy, suggesting a positive growth outlook in the coming quarters. The ratio of real GFCF to GDP surged to 32.0 per cent in 2021-22 from 30.5 per cent in 2020-21, reflecting a revival of investment sentiments. Improvement in investment sentiment can be attributed to the policy actions taken by the Government over several years. Factors such as progress in ease of doing business, easy exit for businesses, maturing digital infrastructure, and easy & cheap data access have sustained investment activity.

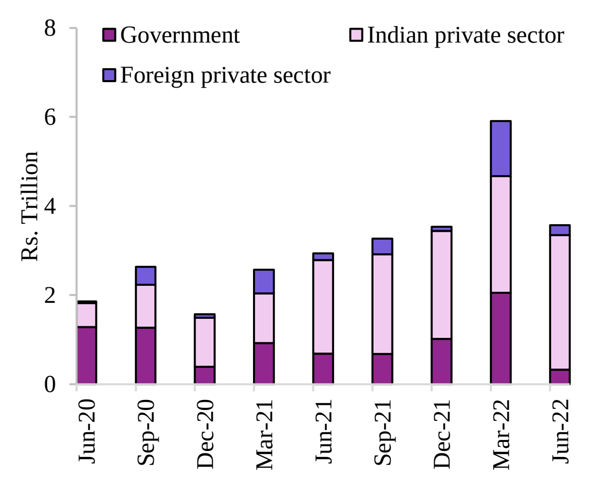
19. Private equity (PE) and Venture capital (VC) investments reached record high levels in 2021. Sustaining the investing momentum, PE/VC investments in the first two months of Q1 2022-23 stood at USD 12.9 billion, 14 per cent higher than the value recorded in the corresponding period of the last year. The number of deals, which stood at 233, was 71 per cent higher than last year. By deal type, growth deals received maximum PE/ VC investments followed by start-up investments. From a sectoral point of view, real estate was the top sector followed by the infrastructure sector.

Total PE/ VC investments	M&A Deals
	
Source: VCCEdge	Source: Bloomberg

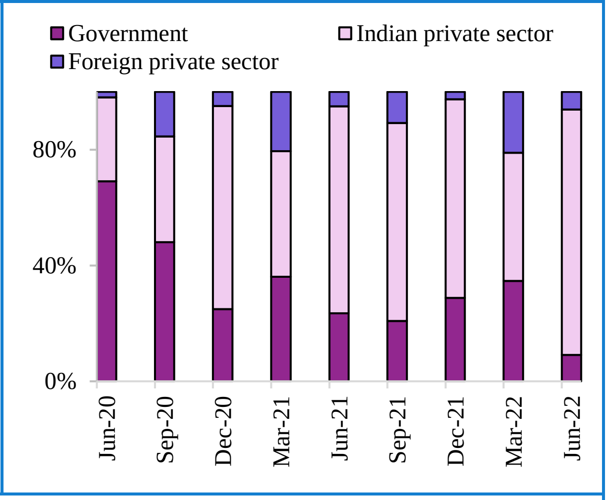
20. Pending and completed mergers and acquisitions (M&A) deals reached the highest amount, valued at over $87 billion in the first quarter of 2022-23. It has been more than twice as much as the previous record of $38.1 billion in the second quarter of 2019-20. The surge in M&A deals in India was dominated by HDFC Bank's purchase of Housing Development Finance Corporation in a $60 billion all-stock deal in April, combining India's one of the most valuable banks and largest mortgage lender. The biggest dealmakers in the quarter also included companies in India that are leading the shift to renewable energy.

21. An uptick in investment momentum is also witnessed in preliminary data collated by CMIE for April-June 2022 quarter. A geopolitical crisis, monetary tightening, rising uncertainty and increased cost of raw materials have exerted pressure on overall business sentiments. But despite that, new investment projects announced by the Indian private sector improved sequentially (17.7 per cent) as well as annually (46.7 per cent) to Rs. 3.1 lakh crore in June 2022. The share of the Indian private sector in total investment proposals shot up to 85 per cent in Q1 of 2022-23, compared to the average of 63 per cent in the preceding four quarters. Further, domestic institutional investors remained net buyers in capital markets for consecutive 16 months, underscoring the confidence in the domestic economic outlook. On the other hand, new project announcements by the foreign private sector declined in June 2022 quarter as compared to the previous quarter as circumspection prevailed owing to the ongoing geopolitical tensions.

New Project Announcements

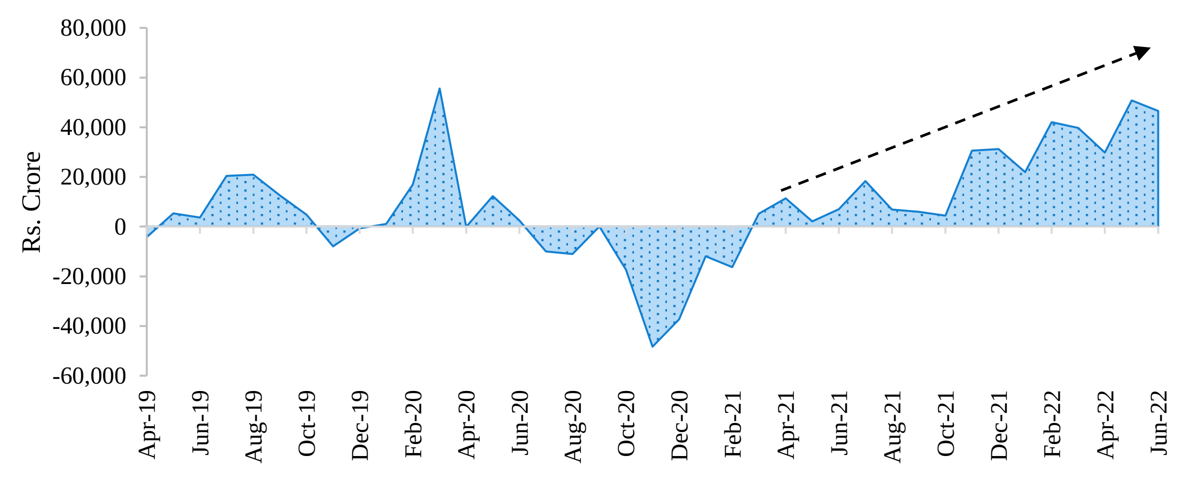


Share in new projects announcement



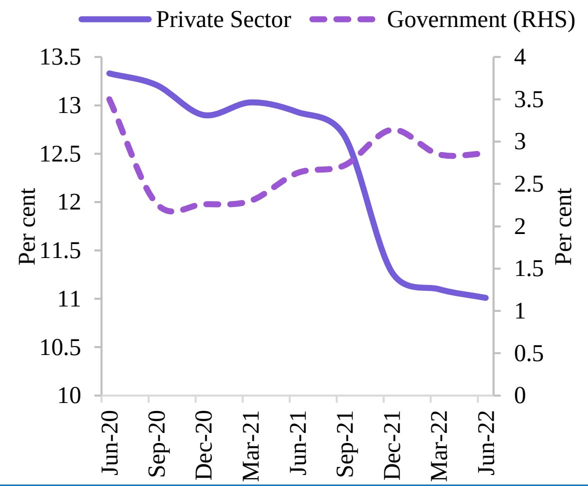
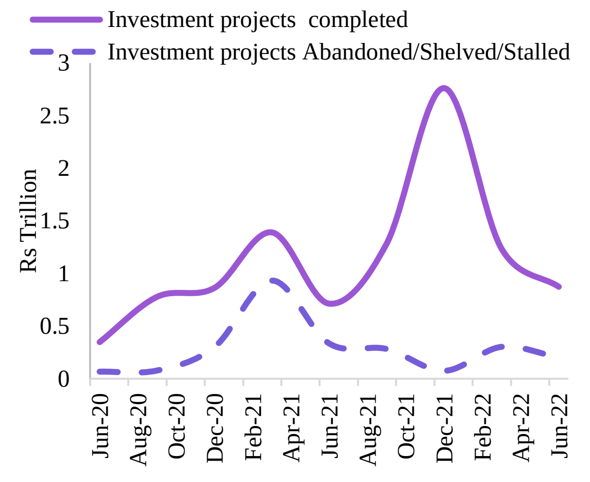
Source: Private Sources

Domestic Institutional Investors

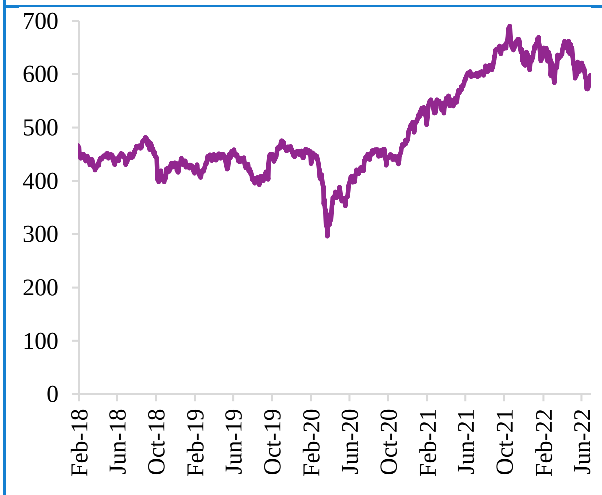
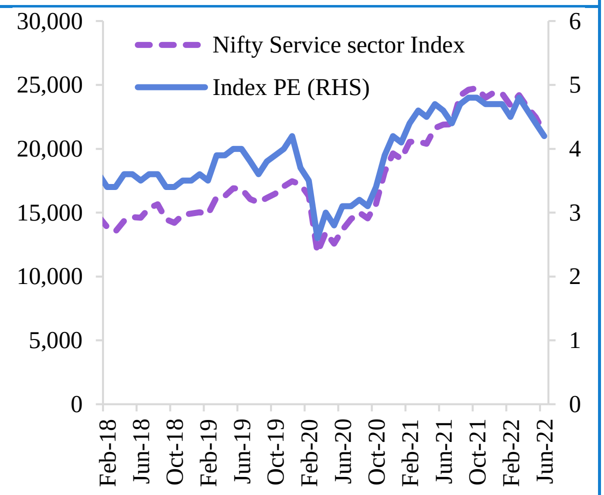


Source: NSE

22. The transport and hotel & tourism services sector led to the rising new project announcements by the domestic private sector. Other sectors experiencing an inflow of investment include electricity (mostly comprising renewable energy), textiles, chemicals, and chemical products. Infrastructure investment-related sectors also witnessed improved trends. The cement and Steel index in the Eight Industries Core Index saw double-digit YoY growth in May 2022. Further, the value of completed projects witnessed a 37 per cent increase in June 2022 quarter, as compared to the corresponding quarter last year. On the other hand, the stalling rate has also reduced in the quarter ending June 2022 as compared to the corresponding quarter last year, with a significant contraction witnessed in the domestic private sector.

Stalling rate	Value of Projects Completed and stalled
	
Source: Private Sources	

23. Investor sentiments in the secondary market remained buoyant in 2021; however, global uncertainty has dented the sentiments in the first half of 2022. Looking at sectoral returns, S&P BSE Manufacturing Index fell by 8.3 per cent, while the Nifty Service sector erased gains by 12.7 per cent during H1 2022. However, looking at a longer time horizon from an investment point of view, S&P BSE Manufacturing Index grew at a compound annual rate of return of 9 per cent during 2017-22 (till June). On the other hand, the Nifty Service sector registered a double-digit growth of 12 per cent annually during 2017-22. The value of both manufacturing and services indices in June was 1.3 times higher than June 2019 levels. The price to equity (PE) ratio of the service sector index was 20.3 in June compared to the ten-year average of 23.0 times.

S&P BSE India Manufacturing Index	Nifty Service Sector Performance
	
Source: Asia Index Private Limited	Source: NSE

24. Going forward, private sector investment is expected to gain further traction on account of recovery in capacity utilization, bigger appetite for undertaking fresh investments, and crowding-in driven by a huge increase in public investment. Indian manufacturing companies

as per RBI's Industrial Outlook Survey of the Manufacturing Sector, expect sequential improvements in demand conditions, capacity utilization and overall business situation in Q2 and Q3:2022-23. Further, the PLI scheme is also expected to give a significant push to private investment.

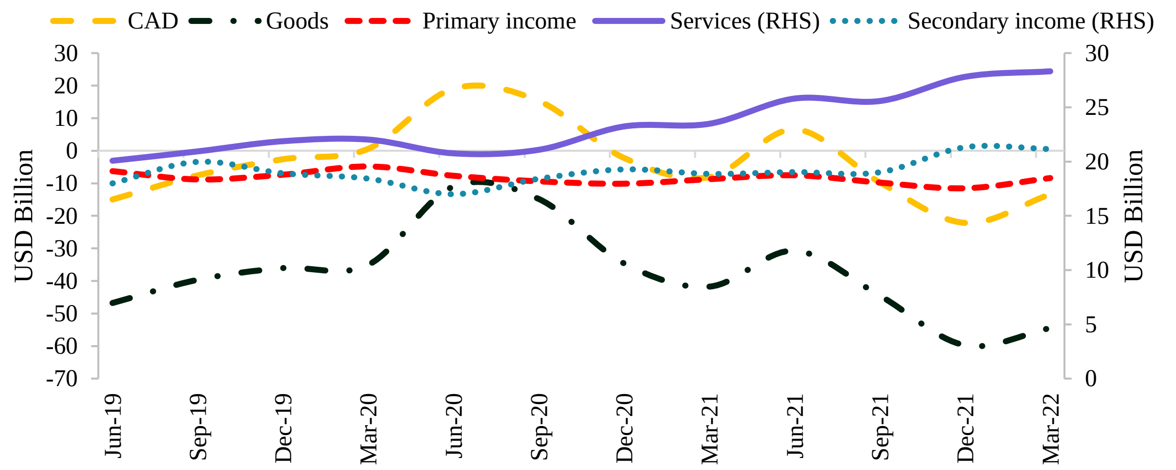
External Sector

CAD declined sequentially in Q4 2021-22, set to widen in 2022-23

25. The current account balance recorded a deficit of 1.2 per cent of GDP in 2021-22 as against a surplus of 0.9 per cent in 2020-21 largely driven by the widening of the trade deficit. The trade deficit would have been larger but for the surplus on services trade which increased by 21 per cent in 2021-22 over the previous year.

26. The current account deficit (CAD) in 2021-22 would have been also larger but for a sequential moderation from 22.2 billion (2.6 per cent of GDP) in Q3:2021-22 to USD 13.4 billion (1.5 per cent of GDP) in Q4:2021-22. The sequential moderation in CAD was not only driven by improvement in net services receipts and lower net outgo on primary income such as interest and dividends payment, but also due to the narrowing of the merchandise trade deficit enabled by robust growth in exports. The rise in India's merchandise exports is largely attributed to the subsiding of pandemic restrictions and the resulting demand growth in advanced economies.

Current Account Deficit Snapshot



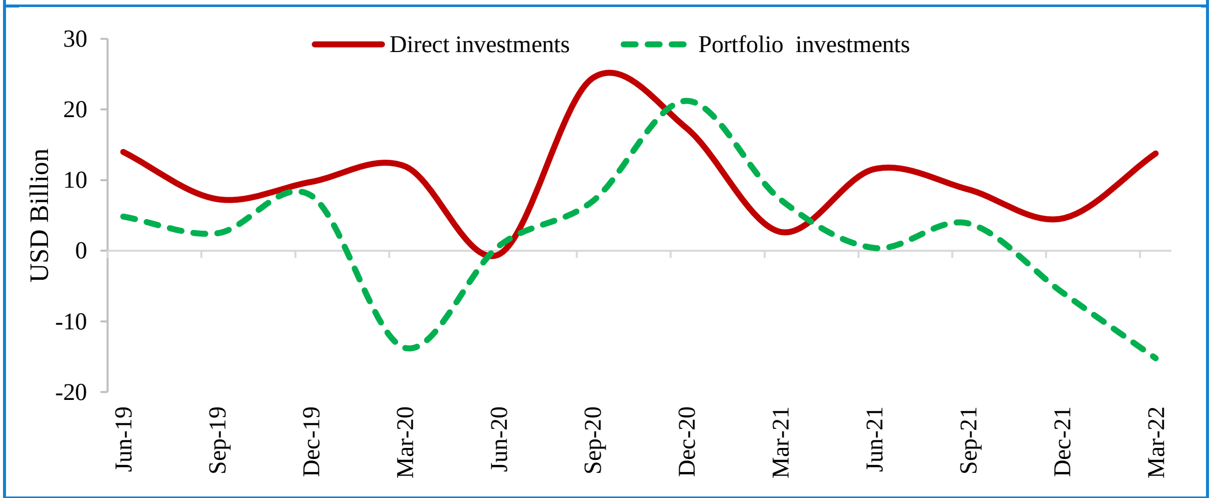
Source: RBI

27. The relaxation of pandemic restrictions was however not the reason for the improvement in net services receipts from Q3 to Q4 of 2021-22 as, despite fewer mobility restrictions the world over, travel and transport services continued to lag the digitally based service exports comprising net earnings from insurance and pension services, financial services

and telecommunication, and information and computer services. Among travel services all major components - education, business, and health experienced a decline in net inflows.

28. The CAD in March ending quarter was adequately cushioned by robust capital flows despite net foreign portfolio investment (FPI) recording an outflow of USD 15.2 billion caused, in part, by monetary tightening in advanced economies and the conflict in Ukraine, inducing risk aversion on the part of global investors. An increase in foreign direct investment (FDI) over the corresponding quarter of the previous year compensated for the increase in net FPI outflows as medium to long-term foreign investors continued to back the growth potential of India's economy.

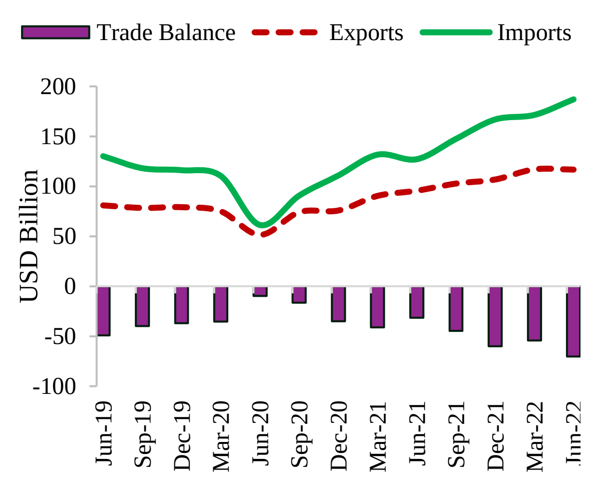
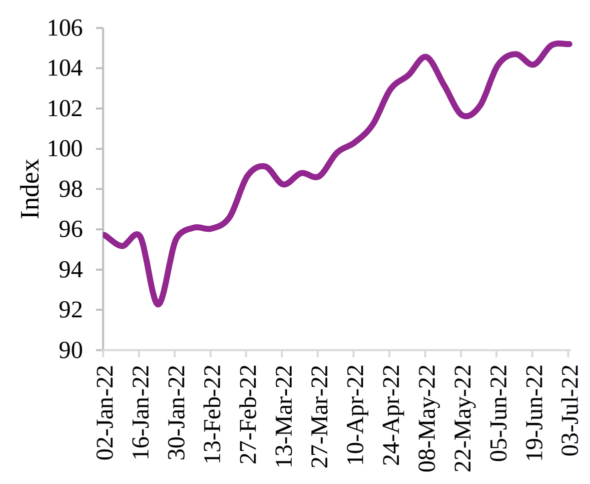
Balance of Payment- Financial Account



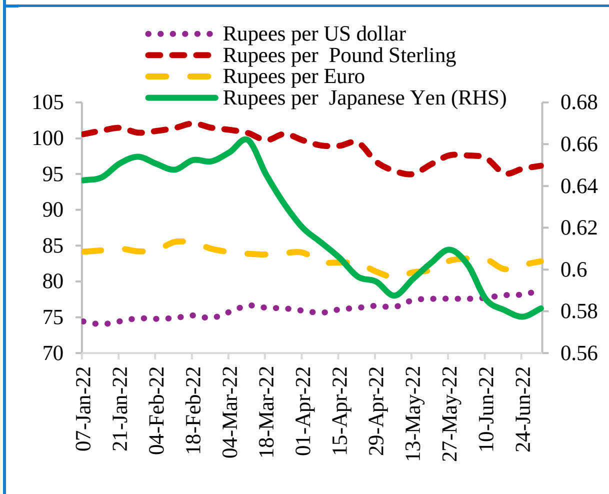
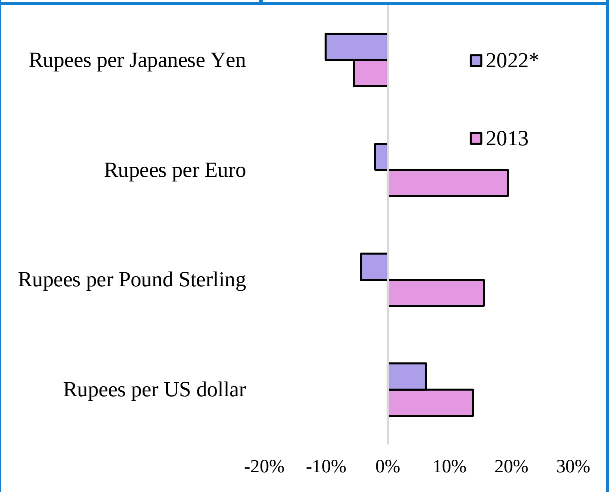
Source: RBI

29. Global trade slowed in Q1 2022-23 as compared to Q4 2021-22 largely affected by disruption in supply chains, broadbased inflationary pressures, increased uncertainty and the resulting slowdown in global growth, leading to a moderation in India's exports in the current quarter (Q1 2022-23) compared to the previous quarter (Q4 2021-22). Moreover, with China reaffirming its commitment to zero COVID-19 policy, shortages of manufacturing inputs are expected to continue further impacting India's exports.

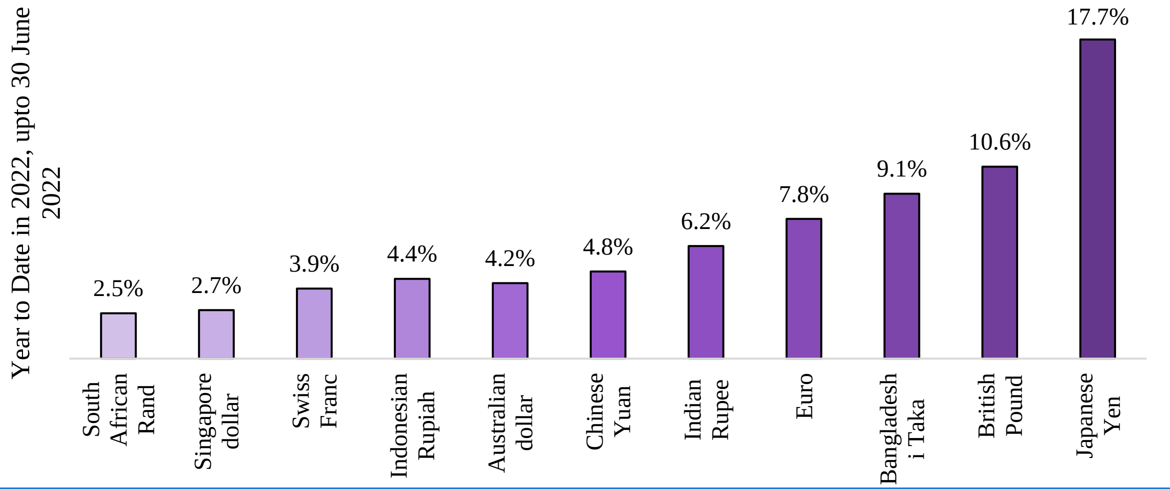
30. At the same time, shortages, unprecedented commodity price rises and rising US dollar induced by monetary tightening have meant a rising import bill for net import-dependent countries like India. Consequently, on account of a faster rise in imports than exports, the trade deficit widened in Q1 2022-23 from the previous quarter. An increase in the merchandise trade deficit could lead to a widening of CAD in Q1 2022-23, although an increase in net service receipts, driven by sustained growth in non-tourism services could moderate the deterioration in CAD. The government has also hiked the import duty on gold to rein in CAD.

Trade balance widens	Dollar Index Strengthens
	
Source: Ministry of Commerce	Source: Bloomberg

31. The widening trade deficit has exerted pressure on the rupee with its value having depreciated 6 per cent against the USD since January of 2022. However, India's experience is not isolated as all major net commodity importing countries have seen a weakening of their currency. Rupee has performed well in 2022 compared to other major economies unlike in 2013, where it depreciated against other major economies, thus, reflecting strong fundamentals of the Indian economy. The Indian rupee has, in fact, strengthened against the Pound sterling, the Euro and the Japanese Yen, reflecting that all these currencies have depreciated more against the US dollar. In terms of the 40-currency real effective exchange rate (REER) rupee has appreciated in the month of May due to higher depreciation of currencies of India’s major trading partners against the US dollar and relative price effect. It would seem at this stage that monetary tightening by the Fed has been more responsible for triggering the depreciation of the Indian rupee rather than any reappraisal of India’s macroeconomic strength by the foreign exchange market.

Exchange rate	Rupee performance in 2013 vs 2022* (-)value rupee appreciation/(+)value rupee depreciation
	
Source: FBIL. Note:* data till 30th June 2022.	

Year to date change in USD value compared to other currencies



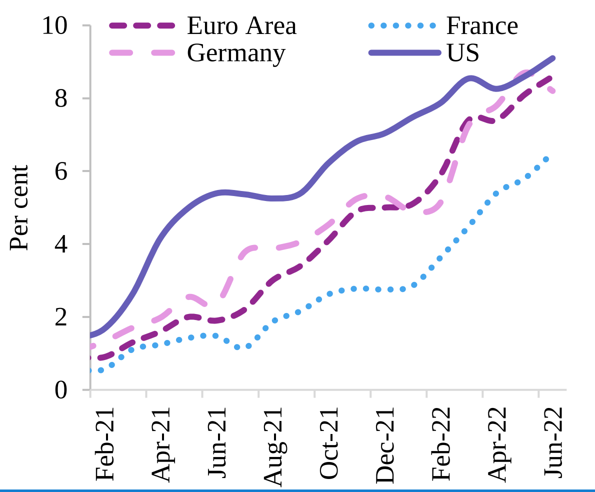
Source: Bloomberg

Inflation

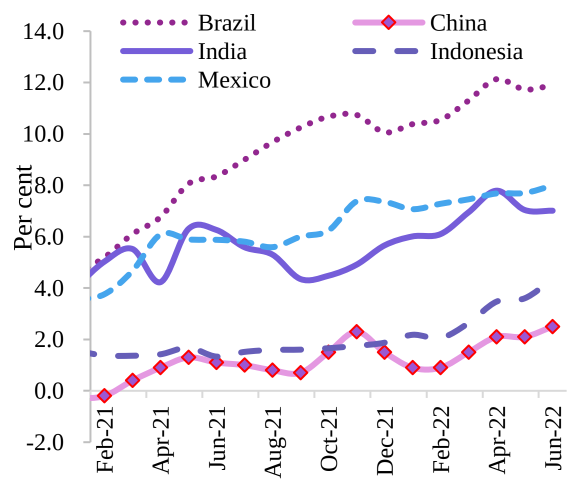
Domestic inflation has moderated driven by relief measures and the downward trending of international commodity prices.

32. Inflation continued to remain elevated in June 2022 around the world. Earlier, the upward pressure on prices had set in as the global economy, beginning to recover after the easing of pandemic-related restrictions, encountered unrepaired supply chains. Inflationary pressures were aggravated considerably by the liquidity glut arising from unprecedented levels of monetary and fiscal expansion. A sharp surge in prices of commodities following the Russia-Ukraine conflict further contributed to a broad-basing of inflation. As central banks around the world began to tighten their monetary policies in response to inflation rates being the highest in decades, the effects of these measures will show up with a lag. Global inflation is thus expected to stay high in the coming months and then begin declining gradually.

Inflation in Advanced Economies



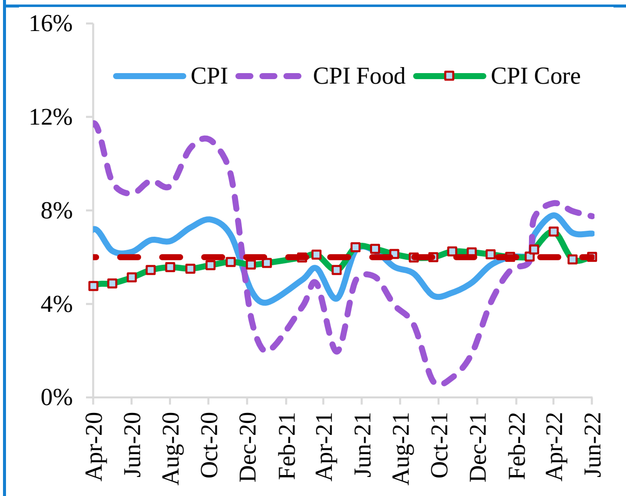
Inflation in Developing Economies



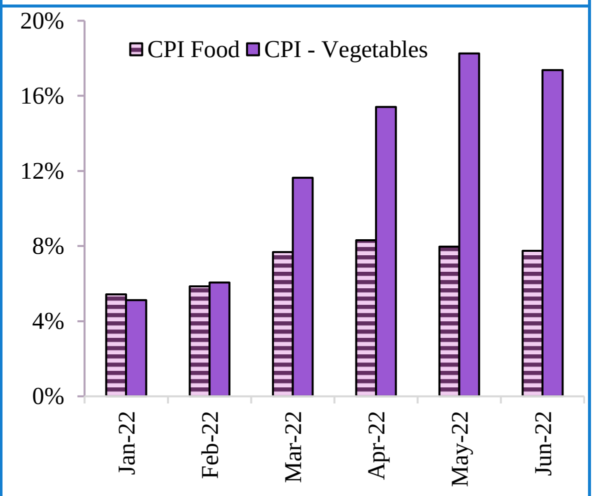
Source: OECD, MoSPI

33. Retail inflation in India marginally eased from 7.04 per cent in May 2022 to 7.01 per cent in June 2022, causing the average retail inflation in Q1 FY 2022-23 to reach 7.3 per cent. This is the sixth successive month in which retail inflation has been above the RBI's tolerance level of 6 per cent. Retail inflation remained elevated on account of inflation in the subcategories of 'fuel and light', 'clothing and footwear', and 'food and beverages' which grew by 10.4 per cent, 9.5 per cent, and 7.6 per cent respectively. Food inflation declined slightly from 8 per cent in May to 7.8 per cent in June on the back of slowing inflation in 'oils and fats', and vegetables. Crude oil and edible oils remained the imported components in the consumer basket that drove retail inflation.

CPI and Components



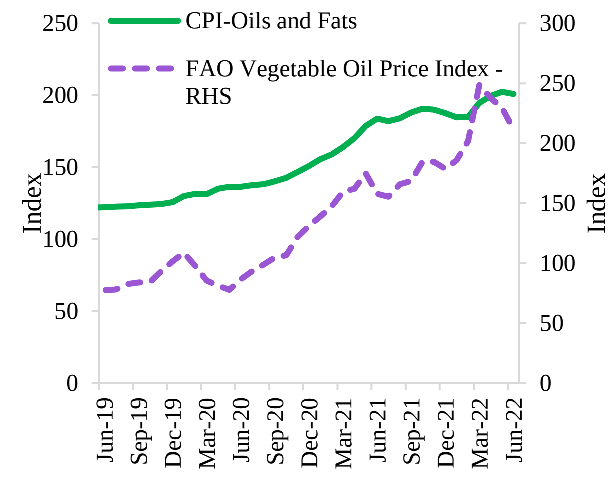
High inflation in CPI – Vegetables



Source: MOSPI

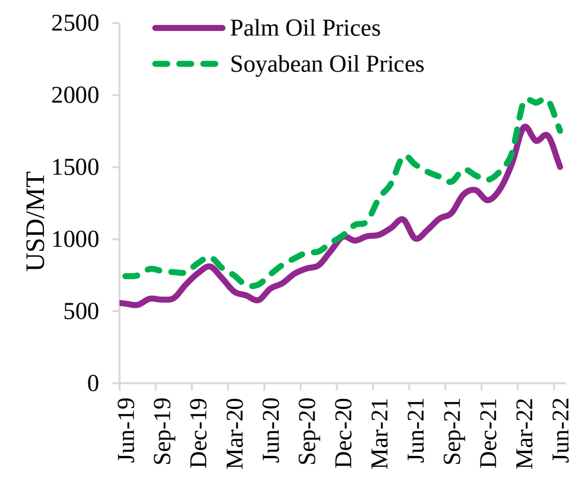
34. However, towards the beginning of July 2022, the global prices of edible oils, particularly that of palm oil, dropped significantly. As per the World Bank, the price of palm oil in June 2022 averaged USD 1,501/metric tonne, a sequential decline of 12.6 per cent from the average price in May and a decline of 15.6 per cent from the historic high recorded in March 2022. The price decrease is a continuation of the trend that was observed in May and is expected to contribute to moderating retail food inflation and overall inflation as well. The tempering of prices is due to the ramping up of palm oil exports by Indonesia following an easing of its export ban, along with a rise in commodity inventories in Malaysia as production enters the peak of the seasonal cycle. The prices of soybean oil fell by 11 per cent as well from a record high of USD 1,963/metric tonne in May 2022 to USD 1,752/metric tonne as tepid demand from India and China, global recessionary fears and reports of lower biofuel mandates in the EU have also contributed to the moderation in global edible oil prices.

Edible Oil Inflation



Source: MOSPI, FAO

Global Edible Oil Prices



Source: World Bank Pink Sheet

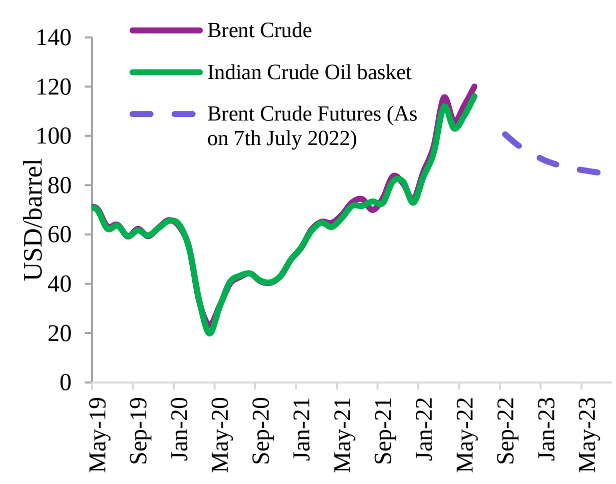
35. Before the decline in edible oil prices, the benefit from the cut in import duty by the government had been passed on to consumers in the form of a Rs. 10-15 decrease in the retail prices of edible oils. As of 6th July 2022, the government has asked producers to implement a further reduction in retail prices and ensure price uniformity across geographies amidst the decline in global prices. These measures are expected to temper inflationary pressures in the economy in the coming months.

36. International prices of crude oil, the second significant imported component of India's consumption basket, increased in June 2022 and continue to remain volatile. The average price of Brent crude increased from USD 112.3 /barrel in May to USD 120.1/barrel in June. Accordingly, the price of Indian basket of crude has increased from USD 108.2/barrel in May to USD/116.1/barrel in June but is expected to trend downward if recessionary sentiments weigh heavy on global crude oil prices. Recessionary sentiments may have already come into play as in the beginning of July as crude oil futures started to trade closer to the USD 100/barrel mark. Another significant development in India's crude oil sector is the increased reliance on Russian crude oil. In the absence of European customers, Russian crude oil producers have provided India with significantly discounted crude oil since the beginning of the Russia-Ukraine conflict. The impressive diversification of India's crude imports is evident as vessel tracking data by Bloomberg shows that Russian producers are estimated to export about 988,000 barrels per day to India in June 2022, making Russia the second-largest source of crude oil imports.

37. Apart from edible oils and crude oil, the global prices of multiple other commodities such as rice, wheat, fertilizers, iron ore, and of metals such as copper, lead, tin, and zinc have all softened in June 2022 on the back of revised growth outlooks feeding the fears of recession. In fact, an index of prices of industrial metals is a third lower from its peak in March this year.

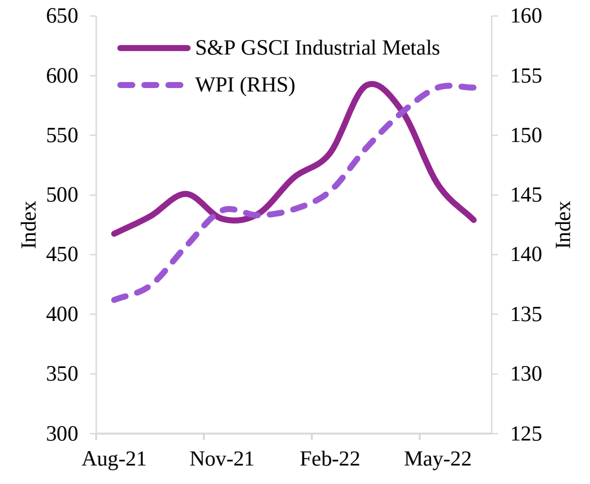
Since metal prices feed into WPI inflation, the decline in global prices of industrial metals will help to lower India’s wholesale price inflation rate too in the coming months.

Prices of Brent Crude, Indian Basket of Crude, and Brent Crude Futures



Source: World Bank, PPAC, CME

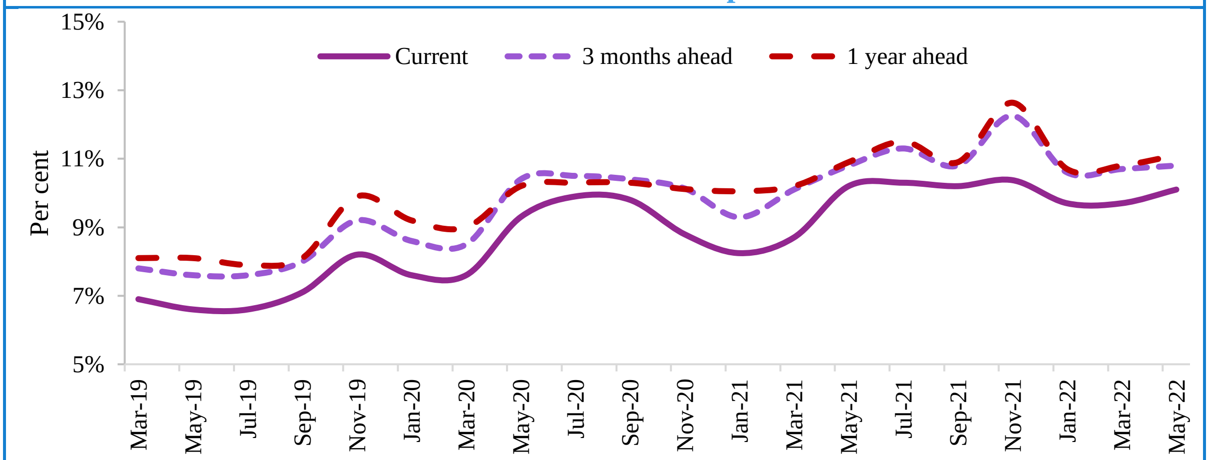
S&P-GSCI Industrial Metals Index &WPI Index



Source: S&P Dow Jones Indices, O/o EA, DPIIT

38. The decline in key commodity prices has helped shape both household and business inflation expectations downward. The RBI in its May 2022 round of inflation expectations surveys estimated that households' median inflation perception for the current period increased by 40 basis points (bps) when compared to the March 2022 round of the survey. However, when the RBI conducted an extension round of the survey after the cut in excise duty on petrol and diesel which covered around half of the households who had responded in the regular survey round, the inflation expectations for three months and one year ahead declined by 190 bps and 90 bps, respectively. It is expected that inflation expectations will trend further downward as global and local prices of key commodities moderate. The Bank for International Settlements observed in its Annual Economic Report published in June 2022 that households in the developed world have tended to overpredict inflation rates.

RBI Household Inflation Expectations



Source: RBI

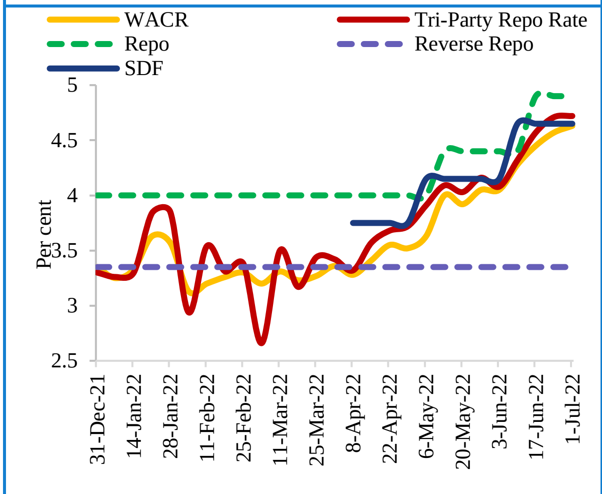
39. The May 2022 round of the IIM Ahmedabad's Business Inflation Expectations Survey which covers approximately 5000 panelists representing businesses from various sectors like manufacturing, wholesale and retail trade, suppliers, transport, construction, etc., also indicates early signs of a tapering of inflation expectations as the 1-year ahead business inflation expectations in May 2022 have declined sharply by 44 bps to 5.58 per cent from 6.02 per cent reported in April 2022. Even as inflation expectations decline, observed inflation is likely to remain elevated in the near term as the pass-through of lower input prices to the retail inflation basket may happen with a lag. This is likely to keep the core inflation sticky.

Policy Implications

40. To rein in inflation, RBI in its June Monetary Policy Committee meeting hiked the repo rate by another 50 basis points in June on top of the earlier hike of 40 basis points in May 2022. Liquidity tightening measures undertaken by RBI to control financial uncertainty are leading to the withdrawal of accommodation and absorption of surplus liquidity from the system.

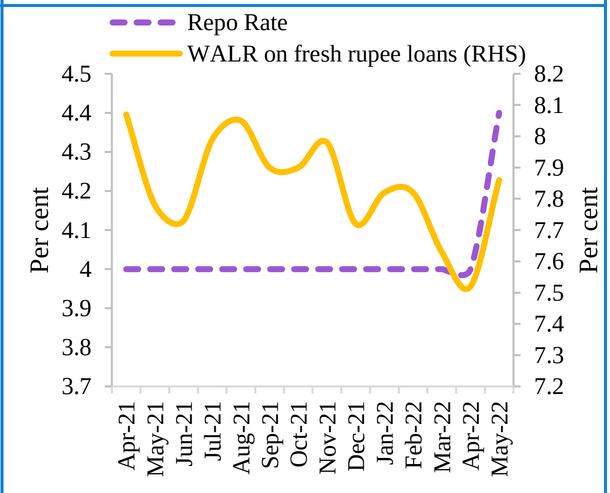
41. Pass through of hike in repo rate is visible in the rising marginal cost of fund-based lending rates (MCLR) and Weighted Average Lending Rate (WALR). Median MCLR for Public Sector Banks increased by 15 basis points in June 2022. Similarly, the Weighted Average Lending Rate (WALR) on fresh rupee loans increased by 35 basis points in May 2022 on a month-on-month basis. The rise in MCLR and WALR is likely to lower liquidity demand by individuals and businesses which may lower inflation. Rates in the overnight money market i.e.; Weighted Average Call Rate (WACR) and Tri-Party Repo Rate trended in the upward direction, with their spreads from Standing Deposit Facility (SDF) rate (upper limit of LAF corridor) declining noticeably indicating a continued normalization of liquidity conditions.

LAF Corridor



Source: RBI

Movement in WALR on fresh rupee loans



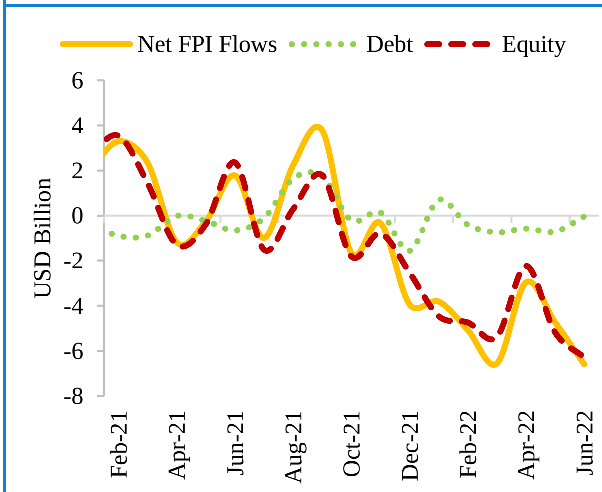
Source: RBI

42. The higher domestic short-term interest rates and the prospect of a further increase in interest rates by the US Federal Reserve have led to an increase in the yield of G-sec bonds in India from 6.78 per cent in February to 7.49 per cent in June 2022. The yield on AAA-rated corporate bonds has also similarly increased from 7.09 per cent in February to 7.89 per cent in June 2022. The increase in policy rates in India is expected to lower FPI outflow from India and arrest the excessive volatility of the rupee. Additionally, the RBI is selling dollars in foreign exchange markets to address volatility, which is resulting in a reduction in foreign exchange reserves. The reserves stand at USD 593.3 billion as of 24th June 2022, which, equivalent to financing 10 months of projected imports, is presently a sufficient buffer against external shocks.

43. RBI has recently announced a series of measures to increase forex inflows and expand sources of forex funding. The measures include exempting banks from maintaining the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) for incremental Non-Residential External (NRE) and Foreign Currency non-resident bank (FCNR (B)) deposits, allowing banks to raise fresh FCNR (B) and NRE deposits without reference to regulations on the interest rate, relaxing FPI norms in Government bonds and residual maturity for FPI investments in Government & corporate debt, increasing the limit under automatic route in case of External Commercial Borrowings (ECBs).

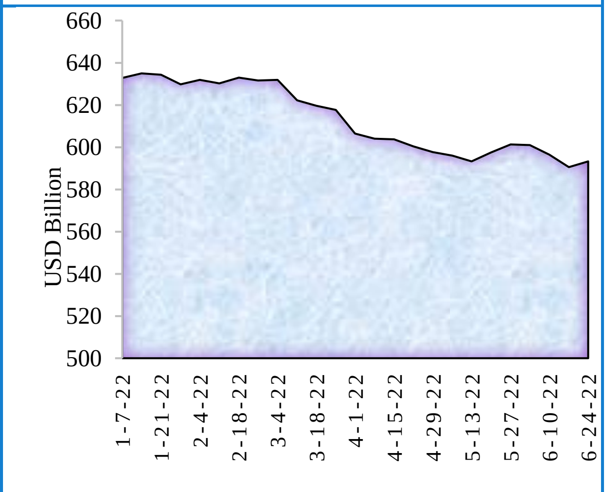
44. In the meantime, the steady depreciation of the Indian Rupee and a sharp increase in interest rates in the global economy have resulted in a decline in External Commercial Borrowings (ECB). For the same reasons, a contribution made by domestic investors abroad, either to capital or through the purchase of existing shares, witnessed a downfall with overseas Direct Investment (ODI) declining to USD 803.3 million in May 2022.

FPI Flows



Source: NSDL

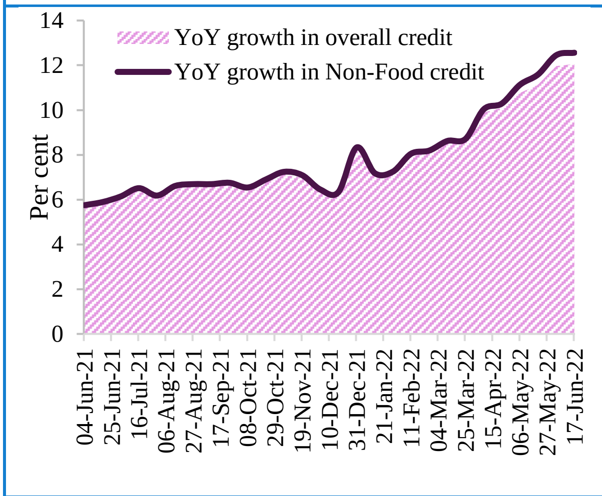
Foreign Exchange Reserves



Source: RBI

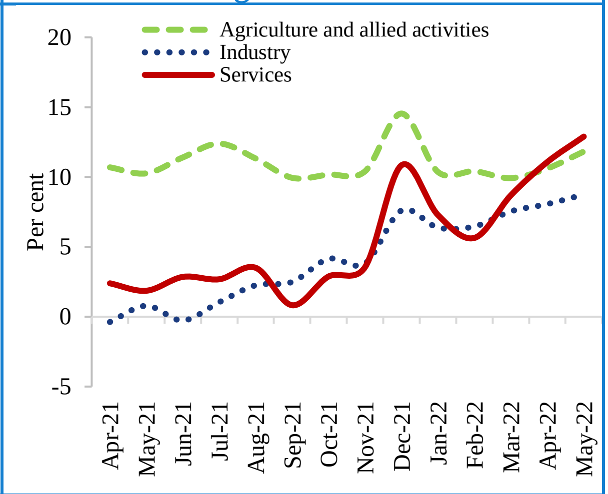
45. Overall bank credit registered double-digit growth in the second week of June 2022 giving indications of sustained growth in activity levels. Credit growth was driven by an increase in working capital necessitated owing to higher inflation and a shift to bank borrowings on account of rising bond yields, both in local and overseas markets. On the sectoral front, credit offtake by agriculture and allied activities increased in May 2022 on account of the Government's continuous support to the interest subvention scheme. Credit support to the industry witnessed positive growth due to the effective implementation of the Emergency Credit Line Guarantee scheme (ECLGS) and improved pace of digitization which led to faster loan approval by banks. Credit support to the services sector increased mainly due to a surge in credit growth to hotels & restaurants and shipping.

Growth in Overall Bank Credit



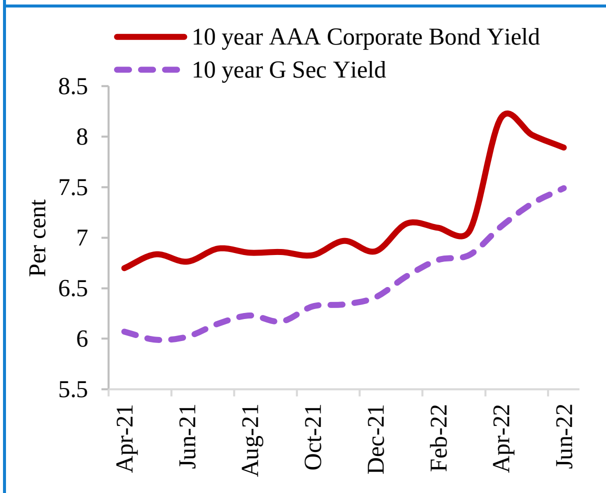
Source: RBI

Sector-wise growth in Bank credit



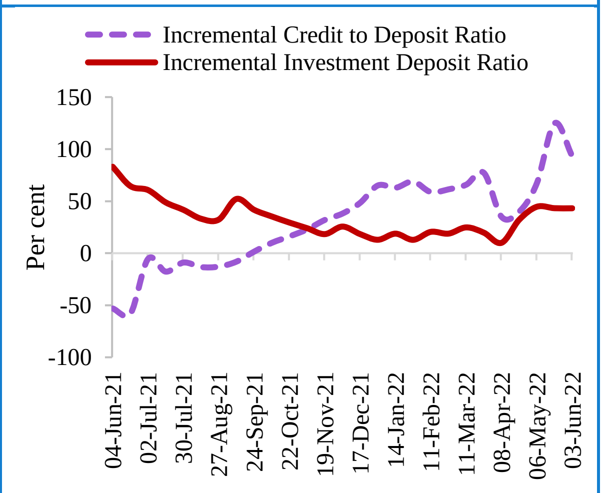
Source: RBI

Bond Yields



Source: CCIL, RBI

Incremental Credit to Deposit Ratio and Incremental Investment Deposit Ratio



Source: DPIIT

46. The incremental credit-deposit ratio and incremental investment-deposit ratio increased significantly during the second week of June 2022 compared to the corresponding period of

the previous year reflecting the banking system's growing willingness to lend, encouraged by economic recovery and projection of a 7 per cent plus growth for India's economy in the current year. The rise in the ratios despite a hike in repo rate by RBI signals individuals' and corporates' optimism about the economic future.

47. On the fiscal front, GST collections in Q1: 2022-23 registered a growth of 36.4 per cent compared to the corresponding period of the previous year indicating a stronger revenue position of the Government. A recent revision in GST rates is expected to boost Government's revenue collections. Cut in excise duty on petrol and diesel to curb rising inflation led to a fall in union excise collections in April-May 2022. However, the Government's recent initiatives such as an increase in customs duty on gold imports, imposition of a windfall tax, and special excise duty/cess on the export of petrol, diesel and aviation turbine fuel are likely to have a positive impact on Government's tax collections. Expenditure on subsidies declined on account of a fall in expenditure on fertilizer subsidies. However, the focus on capital expenditure continues as it registered YoY growth of 70.1 per cent in April-May 2022. In a move to facilitate Capex by States, the Government has recently announced rules for disbursing Rs. 1 trillion interest-free Capex loans to States. The loans will be released under seven heads with conditions such as facilitating Gati Shakti, funding the PM Gram Sadak Yojana, incentivizing digitization, laying the optical fibre cable network, urban reforms, disinvestment, and monetization. Rs 20,000 crore is to be earmarked for infrastructure connectivity projects such as laying of optical fibre cables for last-mile connectivity under BharatNet in rural areas and road projects under the GatiShakti master plan.

Outlook

48. Economic activity is holding up better than expected despite the ongoing geopolitical tensions; rise in interest rates in America and in India and the elevated price of crude oil and few other commodities. The services sector recovery is continuing and manufacturing strength is steady. There is an apparent keenness to invest on the part of the private sector. Banks are willing to lend and their financial health, as the central bank's stress tests reveal, is quite strong. Brisk GST receipts monthly confirm the momentum in the economic activity.

49. Recent moderation in the international prices of food items, industrial metals and even crude oil are welcome developments for India's inflation control. Recent revenue generation measures announced by the government will not only help to rein in the rise in the current account deficit but also ensure that fiscal slippage, if any, is well contained.

50. In sum, at the margin, June and the first ten days of July were better for Indian macro than the first two months of the current financial year. That is some cause for relief and even cautious optimism in these times.

With an aim to track the progress of the Indian economy since the outbreak of the Russia-Ukraine conflict, the HFI table has been rebased to January 2022.

36.7 100 256.2

Performance of High Frequency Indicators
Base Month Jan 2022= 100

Indicator	Feb-22	Mar-22	Apr-22	May-22	Jun-22
Agriculture					
Tractor sales	98.5	138.1	169.0	155.3	179.0
Fertilisers sales	71.6	60.9	36.7	88.3	
Industry					
8-Core Industries	94.8	109.3	99.7	102.3	
IIP-Consumer Durable goods	95.5	108.4	95.0	95.0	
IIP-Consumer Non-Durable goods	90.8	73.3	91.0	89.4	
IIP- Capital	99.6	117.4	94.3	100.4	
Domestic Auto sales (Excluding Commercial vehicles)	94.4	106.3	101.0	108.8	
Domestic Passenger vehicles sales	103.4	109.9	98.9	98.3	
PMI Manufacturing	101.7	100.0	101.3	101.1	99.8
Power consumption	97.1	115.6	118.0	120.7	119.0
Natural gas production	91.0	100.9	98.8	101.8	
Cement production	95.8	112.7	96.9	93.8	
Steel consumption	89.0	95.6	89.2	91.2	90.6
Services					
Average daily ETC Collection	111.5	113.5	120.4	120.9	123.3
Domestic air passenger traffic	119.7	165.5	163.2	178.3	
Port cargo traffic	93.7	111.2	103.9	105.4	

Indicator	Feb-22	Mar-22	Apr-22	May-22	Jun-22
Rail freight traffic	100.6	104.1	112.4	114.4	115.0
PMI Services	97.3	109.9	100.8	101.2	103.4
Fuel consumption	99.4	115.5	116.6	125.0	121.9
UPI (Value)	98.1	117.1	116.8	128.8	127.0
UPI (Volume)	100.6	104.1	112.4	114.4	115.0
Inflation					
WPI	101.7	104.2	106.3	107.8	107.8
CPI	100.2	101.2	102.7	103.6	104.2
CPI - food	99.8	101.2	102.8	104.4	105.4
Crude price (Average of Brent, Dubai, WTI)	111.4	134.0	123.2	131.2	139.2
Crude oil Indian basket	110.8	135.0	122.2	129.8	136.9
External Sector					
Merch Exports	105.5	126.2	113.0	110.8	107.6
Non-oil-exports	98.7	113.4	104.2	99.6	98.4
Non-oil & non-gold imports	94.7	109.8	103.7	101.9	
Capital goods Imports	89.6	94.9	90.1	89.2	
Baltic Dry Index	104.2	139.9	126.1	167.1	135.7
Exchange Rate	100.7	102.4	102.3	103.9	104.9
NEER	99.2	98.1	98.7	98.7	
Net FDI	72.6	47.1	86.5		
FPI	133.0	172.0	77.6	124.0	172.8

Indicator	Feb-22	Mar-22	Apr-22	May-22	Jun-22
Fiscal					
Gross tax revenue (Central Govt)	104.4	256.2	137.3	101.2	
Capital Expenditure	86.9	215.1	157.7	214.0	
GST	94.4	100.7	119.2	100.0	102.1
E-way Bill Volume	101.7	115.0	110.3	108.8	108.8
Monetary and Financial Markets					
M3	101.2	102.7	103.8	103.7	103.6
Non-food-credit	101.7	103.9	104.6	106.2	108.4
Sensex	97.0	101.0	98.4	95.8	91.4
Nifty	96.9	100.7	98.6	95.6	91.0

Note: Scale is reverse for inflation indicators.