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ECONOMY OBSERVER

JUNE 2022

Aggressive rate hikes by global central banks implies higher depreciation pressure on rupee and more rate hikes by the Central Bank

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> "Multi-year high input price pressures, rising borrowing cost along with the volatility in the financial markets are expected to restrain the pace of business activity in India. The depreciating rupee is also adding to the landing cost and borrowing cost of firms. Household consumption will be constrained by inflationary pressures as the labour market is yet to fully recover from the pandemic. Growth to moderate from FY22, however, the extent of slowdown remains uncertain given that the downside risks from the external sector grows stronger as global growth outlook turns bleak."
>
> **Dr. Arun Singh**
> Global Chief Economist , Dun & Bradstreet

Real Economy

Dun & Bradstreet expects industrial production during May to grow at a higher rate partially owing to the low index value last year when the spread and rise in the COVID-19 cases had forced states to impose restrictions and lockdowns impacting industrial activity. Nonetheless, industrial activity is expected to gain some momentum before moderating towards the 2nd half of 2022. Capacity utilisation (CU) in the manufacturing sector increased further to 74.5% in Q1 2022 from 72.4% in Q4 2021 and is likely to strengthen driven by government's capex push. Risk to industrial activity prevails from high input costs and rising borrowing cost, supply chain bottlenecks, geopolitical uncertainty along with slowdown in global economic activity. Dun & Bradstreet expects the Index of Industrial Production (IIP) to have grown by 6.0% -7.0% during May 2022.

Price Scenario

Ongoing supply-chain disruptions and aggravated geopolitical risks mean headline inflation is expected to remain above the RBI's upper limit threshold of 6% for most part of the year. The risks to both headline and retail inflation stems from elevated commodity prices, revisions in electricity tariffs across many states, and significant liquidity in the banking system. The deprecating rupee would also add to inflationary pressures through costlier imports. We expect the pass through of rising cost from wholesale to the retail inflation to take place faster than expected as businesses face margin pressure both from rising input costs and borrowing cost. The Central bank will be under pressure to further hike interest rates owing to heightened uncertainty to the domestic inflation outlook. Dun & Bradstreet expects Consumer Price Inflation (CPI) to be in the range of 7.2% - 7.4% and Wholesale Price Inflation (WPI) to be around 16.0% - 16.5% in June 2022.

Money & Finance

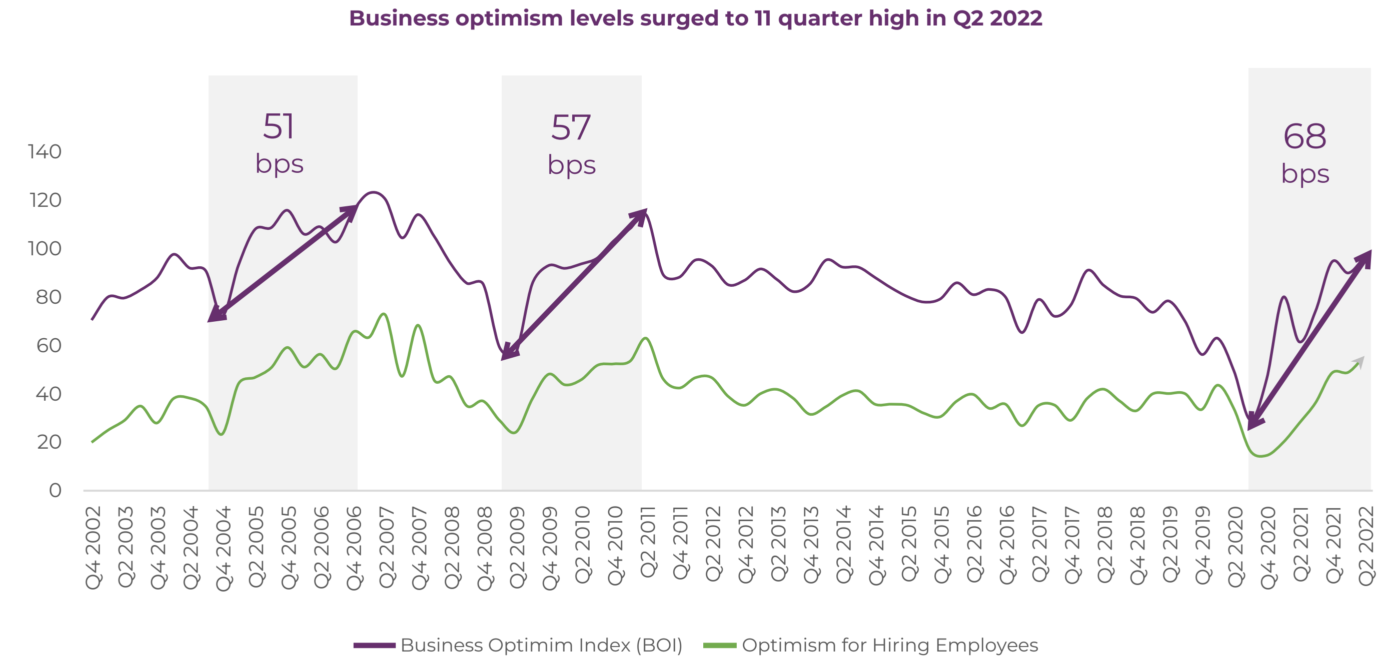
Flattening of the yield curve indicates further rate hikes and sign of worries over economic growth. The Central bank has hiked the policy interest rate by 90 bps points in two tranches (April and May) and will be under pressure to further hike interest rates owing to high inflationary pressures and aggressive tightening by global central banks. With more policy rate cut in the pipeline and outflows in the debt market, bond yields are expected to remain elevated. Dun & Bradstreet thus, expects the 15-91-day Treasury Bills yield to average at around 4.9% -5.0% and 10-year G-Sec yield at around 7.4%-7.5% during June 2022.

External Sector

Aggressive rate hikes globally and higher US dollar strength implies higher deprecation pressure on rupee. Rupee faces a strong depreciating pressure from FII outflows as US FED hiked the interest rates by 75 bps followed by other Central banks. Widening of trade deficit as import bill surges and downside risks to growth is also adding to the downward pressure on rupee. With higher prices of crude oil and other crucial imports, the current account deficit is bound to widen, depleting foreign exchange reserves and weakening the rupee further. Dun & Bradstreet expects the rupee to be at 77.8 – 78.0 per US$ band during June 2022.

D&B INDIA FORECASTS	
ECONOMIC PARAMETERS	FORECAST
IIP Growth	6% - 7% May-22
Inflation WPI	16% - 16.5% Jun-22
CPI (Combined)	7.2% - 7.4% Jun-22
Exchange Rate (INR/US$)	77.80 - 78.00 Jun-22
15-91 day's T-Bills	4.9% - 5.0% Jun-22
10 year G-Sec yield	7.4% - 7.5% Jun-22
Bank Credit*	11.6% - 11.8% Jun-22

Increase in business optimism levels post crisis



Source: Department of Commerce

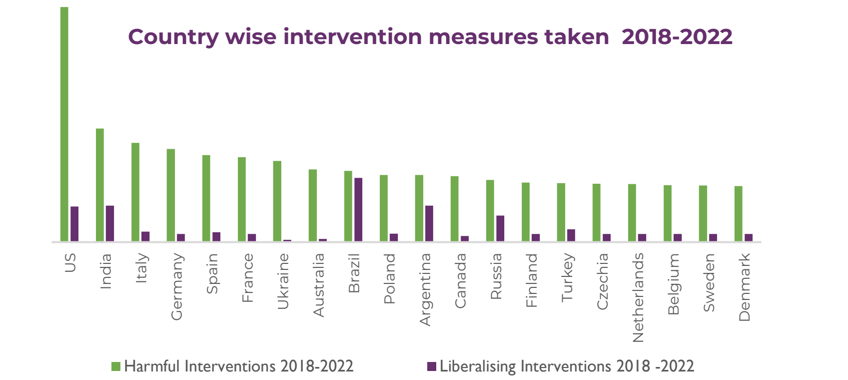
Business optimism level (BOI) fell to the lowest level during the pandemic, but staged a steep and strong recovery, rising by 68 bps over the next 9 quarters, compared to the previous episodes of crisis.

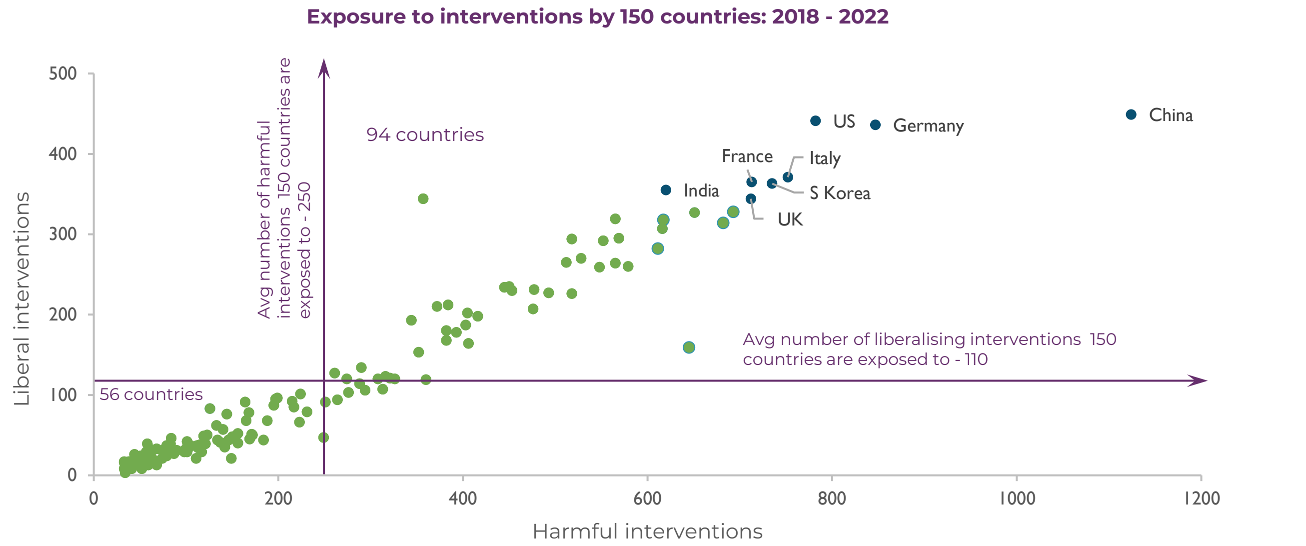
- During the financial crisis in 2009, optimism level fell sharply to 57. It took 9 quarters to reach the peak level in Q2 2011 before falling again: thus, recovering by 57 bps over 9 quarters.
- In the previous episode, soaring international crude oil prices led to a drop in BOI in 2004. Optimism level dropped to 51 and reached the peak level over the next 10 quarters.

Post pandemic recovery

- Optimism of firms in India for Q2 2022 surged to the highest level in 11 years
- Resumption in business activity has gathered a strong foothold post the 3rd wave with mobility gaining above pre-Covid levels.
- Contrary to expectations that firm level profitability would be impacted by the negative spillovers from the geo-political risk, our survey reveals that firms are confident of recording high profit level. Optimism level for net profit of firms recorded the highest in five quarters.
- Besides, given the buoyancy in the economic activity, firms are likely to hire at an increased pace as their optimism for hiring workforce is also at a 11 year high.

Interventions affecting goods & services trade and foreign investment

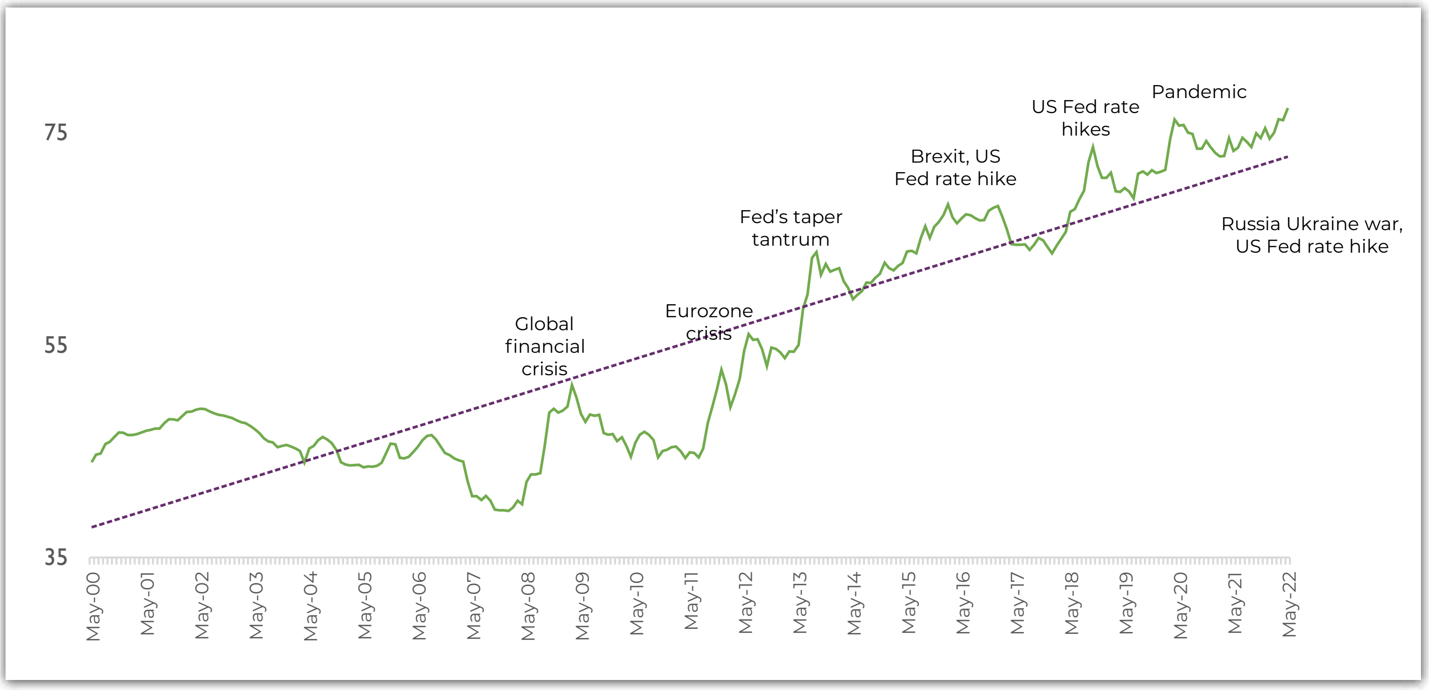




Note: data for 2022 is taken till 1st week of June 2022

- Countries undertake protective measures for their domestic industries against foreign competition which restricts the market access of foreign firms referred to as harmful measures or measures that improve the relative treatment of foreign firms often referred to as liberalizing measures.
- Harmful measures distorting global trade had witnessed a significant rise during 2021, almost triple the number taken by countries globally in 2018.
- The data collected by the global trade alert, a global trade policy monitoring agency, for 150 countries during 2018-2022 reveals the rise in such protective measures.
- The average number of harmful, export restrictive measures faced by exporting countries globally during 2018-2022 (end-May) is 250, while the average number of liberalizing interventions were only 110.
- Around 79% of India's exports are estimated to be at risk in 2021 due to discriminatory policy instruments implemented by countries.
- This share has doubled from 40% during the 2009, indicating how countries globally has increased their trade protectionist measures post the global financial crisis
- However, India is placed second amongst the top 20 countries that have taken the largest number of trade protectionist policies during 2018 to 2022.

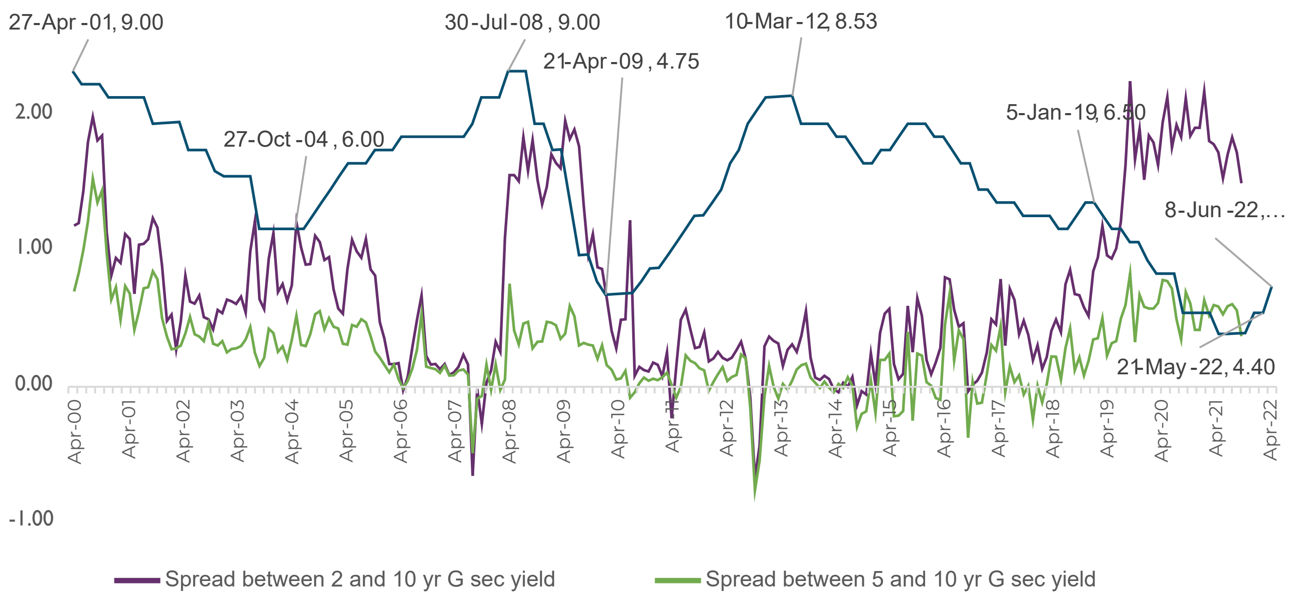
Rupee volatility lower than previous episodes of crisis; to be limited by huge forex reserves

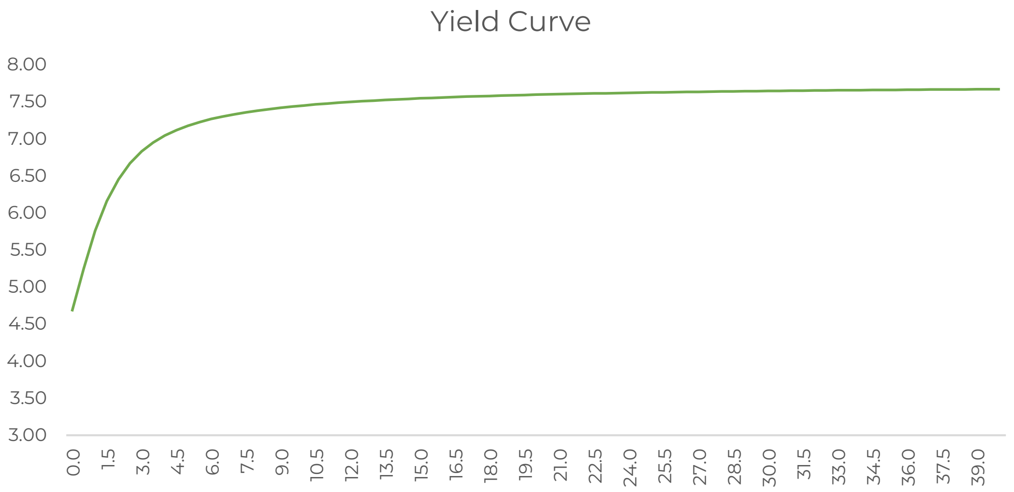


- The rupee is under pressure: it has fallen 7.9% against the dollar between (23rd Feb and 21th June) and touched record lows USD78.14 per rupee (closing value) owing to conflict between Russia-Ukraine and US Fed rate hikes.
- With higher prices of crude oil and other crucial imports, the current account deficit is bound to widen, depleting foreign exchange reserves and weakening the rupee further.
- Forex reserves got depleted to the tune of US$45.5 bn by 10th June from the high of US$642bn reached during October 2021.
- Near term volatility in rupee expected. Rupee could weaken and trade in a band of Rs 78-78.5 per US dollar, if crude oil averages between US$115 - US$120 per barrel (Brent Crude Oil)

Major events	Annualised daily volatility in Rs/USD exchange rate
Global financial Crisis	15.6%
Deepening of Euro Zone Debt Crisis & Weak Fundamentals	10.6%
Feds Taper Tantrum	17.3%
Brexit	4.2%
Fed rate hike	7.2%
Pandemic	6.0%
Russia Ukraine war and Fed Rate hike	5.8%

Yield curve to remain flat indicating more rate hikes and slowdown in growth





- The yield curve has turned flat and is likely to continue bear flattening, with shorter yields rising faster than longer rates indicating steep rate hikes and slowdown in growth.
- Bond yields are rising at a faster pace. The 10-yr bond rose by a higher 7.52% June (10th June; m/m basis), the fastest pace in around three years. While the 2-yr G-sec yield during May 2022 rose at a faster since around nine years.
- This reflects market expectations of sustained rate hikes amid a commodity super cycle.
- Higher fertilizer and motor fuels subsidy is triggering expectations of additional borrowing.
- Stubborn inflation and higher-than-budgeted government borrowing given additional sovereign borrowing required owing rising subsidy bills, is also weighing on the bond market.

RBI's Financial Stability Report -July 1, 2022

Reserve Bank will release the 25th issue of the Financial Stability Report (FSR), which reflects the collective assessment on risks to financial stability and the resilience of the financial system. Watch for the NPA levels sector-wise.

External Debt for Jan - March 2022 – June 30, 2022

Data for external debt for the period Jan - March 2022 would be released by 30th June. As of the last reported data, the external debt to GDP ratio had fallen marginally to 20.0% as at end- December 2021 from 20.3% at end-September 2021. While debt service increased to 4.9% of current receipts at end-December 2021 from 4.7% at end-September 2021.

India's International Investment Position (IIP) - June 30, 2022

The ratio of India's international financial assets to international financial liabilities had stood lower at 72.1% in December 2021 (73.4% in September 2021). Net claims of non-residents on India increased by US$ 21.1 bn during October-December 2021 from the previous quarter mainly due to an increase in foreign-owned assets in India combined with a decline in Indian residents' overseas financial assets.

Jul 6, 2022--European Central Bank Monetary Policy Meeting

Following its latest monetary policy meeting, the Governing Council announced it intends to raise its key interest rates by 25 basis points at its July meeting. The ECB expects a further hike at the September meeting, but said the scale of that increment would depend on the evolving trajectory of the medium-term inflation outlook.

Research Team

Dr. Arun Singh | Dipshikha Biswas | Raj Kiran

Please send your feedback to Dr Arun Singh, Global Chief Economist.

Dun & Bradstreet Information Services India Pvt. Ltd., 7th Floor, Godrej BKC, Bandra (East), Mumbai – 400051 | CIN - U74140MH1997PTC107813

Tel: 91-22-4941 6666 | Email: SinghArun@DNB.com | www.dnb.co.in