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ECONOMY OBSERVER

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Depreciation pressure on rupee remains high – Dun & Bradstreet

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"The leading indicators of the Indian economy i.e. GST collection, business confidence levels point to sustained resilience of the Indian economy till now and the slowdown in the pace of policy rate hike by the Central Bank will provide temporary support to growth. Nonetheless, the momentum of growth is expected to decelerate amidst worries of a looming polycrisis at a global level. In spite of rate hike, albeit at a slower level, India's real interest rates remain below the RBI's estimated natural rate of interest i.e. between 0.8% and 1 %. This suggests that there is scope for a further rate hike. Given the difficult external environment, that should not signal an end of the tightening cycle as it could worsen rupee, which is under strong depreciation pressure."

Real Economy

Even as domestic demand provides resilience to growth, elevated inflation (too high for too long), will impair demand for goods and services. India continues to hold its position as the fasted growing economy, nonetheless, growth concerns have accentuated amidst a difficult external environment. A sharp depreciation in rupee, imported inflationary pressures and widening of current account deficit, amidst volatile foreign investment inflows will subdue growth in FY23.

Price Scenario

The difference between CPI and WPI inflation has narrowed indicating pass-through of higher input prices to retail prices is near completion. Nevertheless, CPI inflation will remain high and ease below 6% by early FY24 as demand remains resilient, energy prices are expected to remain elevated and geopolitical risks keep prices of essential commodities elevated.

Money & Finance

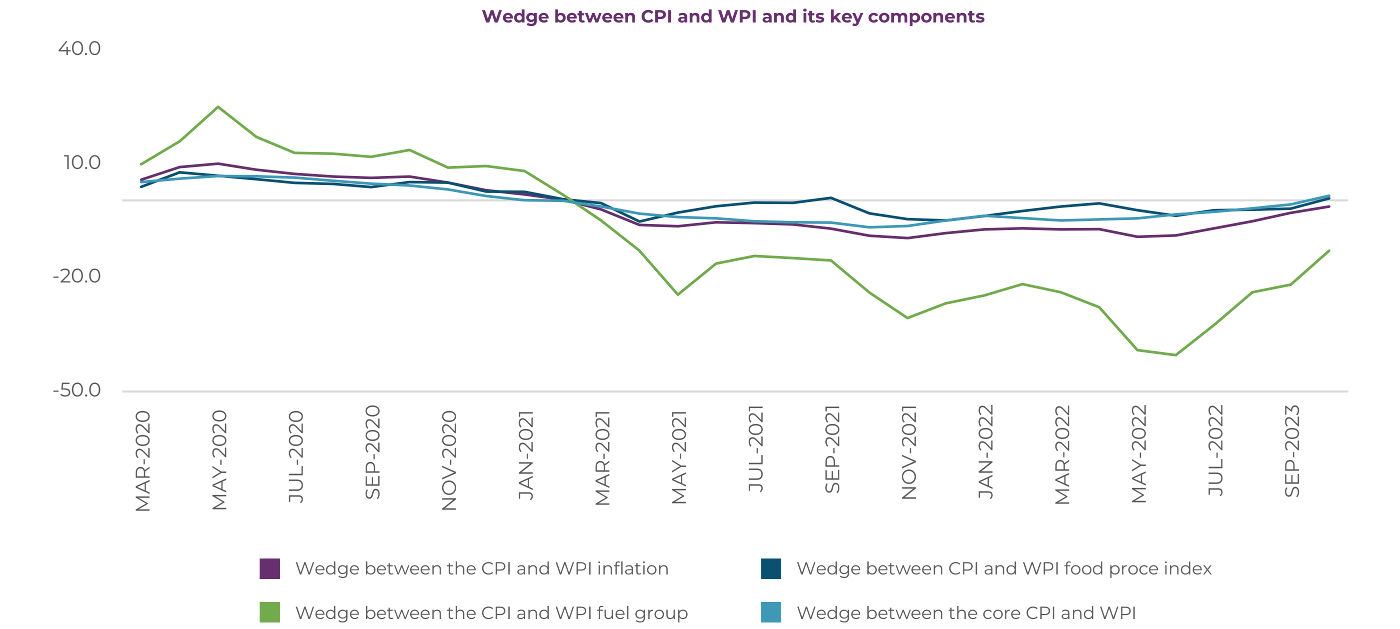
The slowdown in the pace of policy rate hike will provide temporary support to the momentum of growth in the economy. In spite of rate hike, India's real interest rate remains below the RBI's estimated natural rate of interest i.e. between 0.8 and 1.0%. This suggests that there is scope for a further frate hike. Given the deteriorating external environment, that should not signal an end of the tightening cycle as it could worsen rupee. Supporting currency and ensuring growth impulses are going to be difficult tasks for the Central Bank amidst the uncertainties surrounding the pace of global inflation and impending recessions. Nonetheless, as inflation continues to remain above the Central Bank's upper target limit and rupee continues to depreciate, monetary tightening phase is expected to continue and borrowing costs are slated to rise further.

External Sector

As fears of recession keep dollar elevated, trade deficit widens and the rising real effective exchange rate (REER) points to an overvalued rupee, rupee will continue to depreciate. Although the return of FPIs to the equity market (net investment in equity market in November) bodes well for rupee, the support might be temporary.

D&B's Economy Observer Forecast		
Variables	Latest Period	Previous period
IIP Growth	3.1% Sep-22	-0.7% Aug-22
Inflation WPI	8.39% Oct-22	10.7% Sep-22
CPI (Combined)	6.77% Oct-22	7.41% Sep-22
Exchange Rate (INR/US$)	80.32 Oct-22	80.23 Sep-22
15-91 day's T-Bills	5.83% Oct-22	5.90% Sep-22
10 year G-Sec yield	7.46% Oct-22	7.28% Sep-22
Bank Credit*	16.26% Oct-22	15.27% Sep-22

The wedge between CPI and WPI narrows



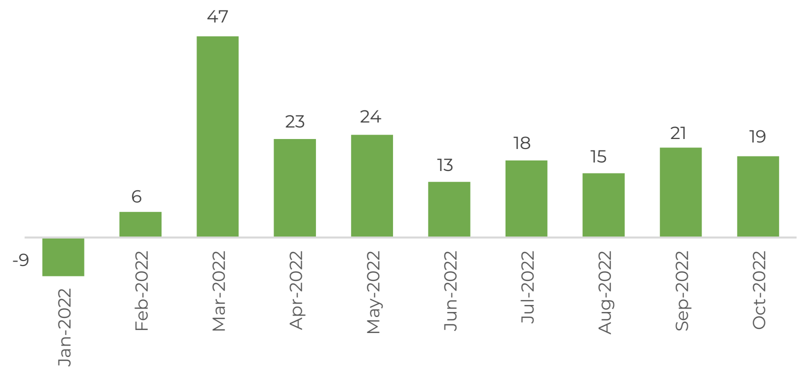
Source: MOSPI

The gap between CPI and WPI inflation, both headline and core inflation, has narrowed, indicating pass-through of higher input prices to retail prices is near completion

- As the gap narrows and WPI inflation moderates to a single digit in October, from the double digit growth witnessed since Apr 2021, this indicates the magnitude of pass-through from wholesale to retail inflation in the coming months to be lower.
- Nonetheless, uncertainties to the inflationary outlook persist, especially from geopolitical issues, outlook for the US dollar and hence imported inflation.
- While retail inflation has also eased to 6.8% in October, from 7.4% in September, it is expected to remain above the central bank's upper target limit at least till March 2023, because of adverse global supply shocks and resilient domestic demand.
- The monetary tightening phase is thus expected to continue, although the pace will be lower, and previous policy rate hikes are yet to be transmitted to the broader spectrum of interest rates.

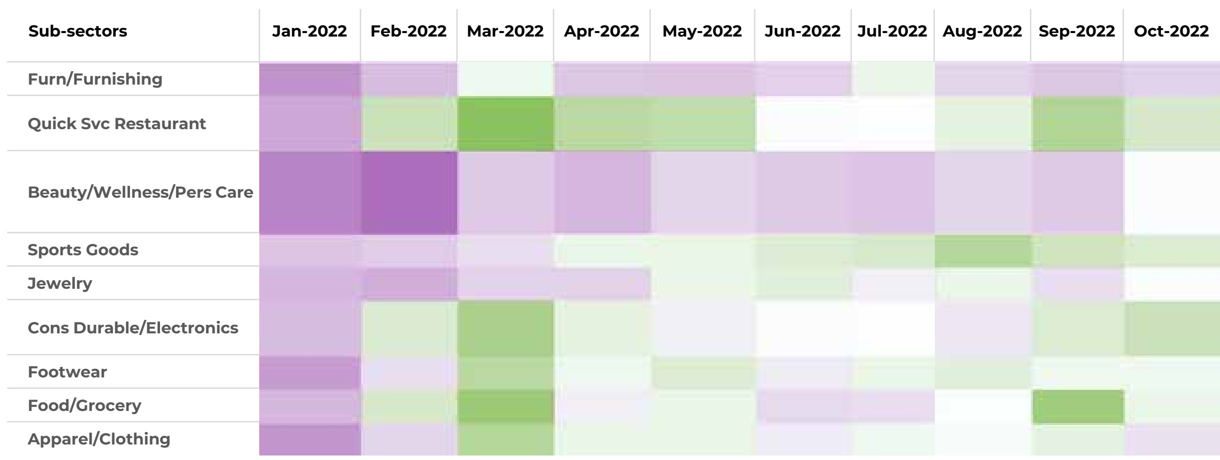
Recovery in retail sales over pre-pandemic level remains moderate even during the festive month

Retail sales: All sectors (Growth over 2019



Source: Retail Federal Association of India, Havers Analytics

Retail sales: Sub - sectors (Sales growth over 2019)

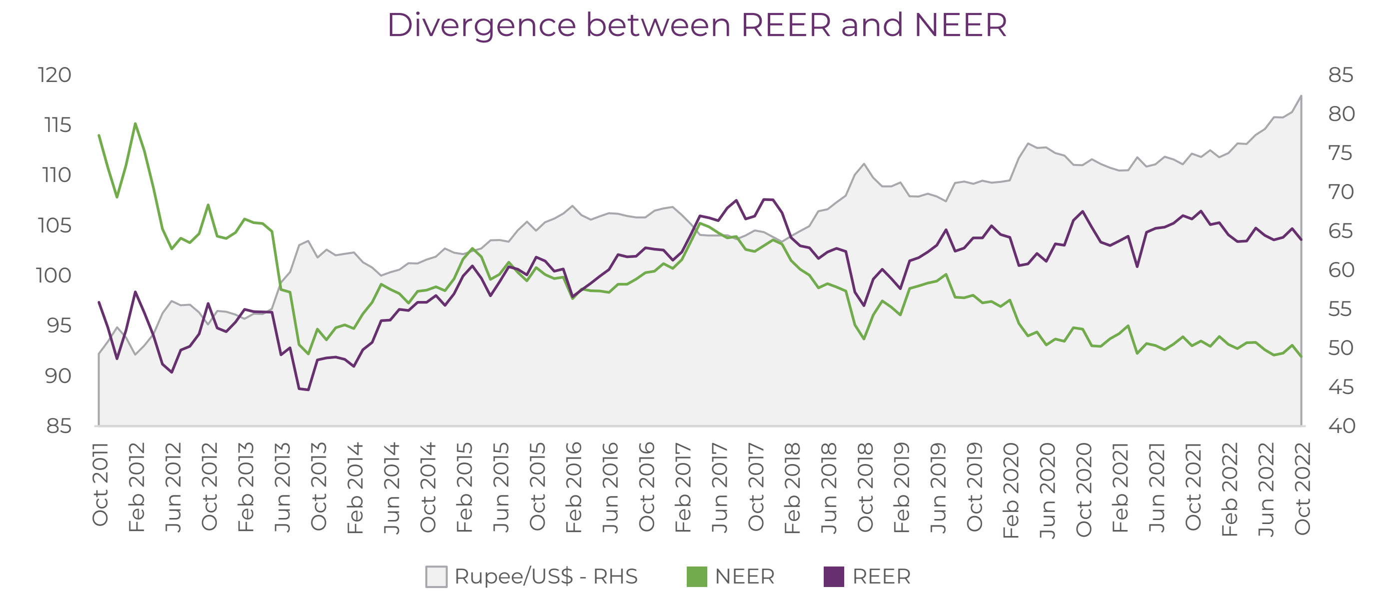


Note: Green indicates strong growth over 2019 levels and purple indicates negative or weak positive growth rates compared to 2019 levels:

High inflation, volatility in financial markets and uncertainty over economic growth prospects appear to have weighed upon consumer spending during the festive season.

- Data from survey conducted by the Retail Federal association show that recovery in retail sales, a proxy for consumer demand, appears to be less robust than expected.
- After recovering strongly in March, recovery in retail sales compared to the pre-pandemic levels failed to hold strong ground especially during the festive season.
- As consumers were expected to spend heavily during the festival season in October, after two years of restricted (Covid-19) festive celebrations, the lack of recovery noted in the apparel/clothing and furnishing followed by food/grocery and jewellery segments were contrary to expectations.
- Data shows that retail inflation in September, barring April 2022, were highest since February 2014. Further, inflation in clothing and food and beverages in September were highest since August 2013 and December 2020 respectively.

While imports remain expensive (falling NEER), gain from exports remain elusive (rising REER)



Source: RBI

The growing divergence in the values of nominal effective exchange rate (NEER) and real effective exchange rate (REER) in the recent years is a cause of concern

- A falling NEER indicates depreciation of rupee in nominal terms i.e. imports are becoming more expensive, and therefore increase in imported inflation.
- On the other hand, the rise in REER indicates value of rupee in real terms in appreciating, i.e. higher prices of Indian goods compared to its export partners, which erodes the benefits of cheaper exports. Rising REER also indicates further depreciation pressure on rupee.
- As imports increases in value terms and export slows down dragged by deteriorating global demand, current account deficit is expected to widen up to at least 3.3% of GDP in FY23, beyond its sustainable level of 2.5%-3.0%.
- Even as deteriorating external environment adds to the downside risk for growth, India's remains relatively insulated owing to its resilient domestic demand and lower share in global trade (1.8% share in global exports in 2021)

RBI monetary Policy

The Central Bank to announce a rate hike and expectations are that the pace of rate hike will be lower after delivering a 50 bps rate hike for three consecutive times

RBI Consumer Confidence Survey

The survey, a proxy for demand, helps to gauge how consumers perceive and expect about the overall economic, employment and price scenario and their willingness to spend. The survey states current perceptions (vis-à-vis a year ago) and one year ahead expectations of consumers on general economic situation, employment scenario, overall price situation and own income and spending across 19 major cities.

US FOMC meeting (Federal Open Market Committee Schedule)

With the Federal Reserve approving a fourth consecutive three-quarter point interest rate increase In November, watch out for the Fed's quantum of rate hike at its final meeting of the year on Dec. 13-14.

Research Team

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