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ECONOMY OBSERVER

MAY 2023

A prolonged pause in the policy rate is expected unless the FED pivots earlier– Dun & Bradstreet

> *"In India, softening of inflationary pressure is creating room for an extended pause in the policy interest rate. Despite the increase in lending rates, the bank credit to the commercial sector is strengthening, current account deficit has ...*

> In India, softening of inflationary pressure is creating room for an extended pause in the policy interest rate. Despite the increase in lending rates, the bank credit to the commercial sector is strengthening, current account deficit has eased, and inflation pressures have subsided, all of which indicate growing macroeconomic stability. It is, however, pertinent to remain vigilant against potential risks from increase in crude oil prices, probability of El Nino to create droughts conditions and unfavourable geopolitical developments.

Real Economy

With moderation in inflation (both retail and wholesale), there is room for both fiscal expansion and monetary policy accommodation, supporting domestic demand and in turn industrial activities. The decline in the wholesale prices may provide relief to corporates which continue to face higher borrowing costs. Exporters may continue to face challenges as global trade remains subdued. Dun & Bradstreet expects the Index of Industrial Production (IIP) to have grown by 0.5% - 0.7% during April 2023, partly due to the base effect.

Price Scenario

Dun & Bradstreet expects inflation to moderate as global commodity prices continue to ease and domestic supply side pressure ease and a slower INR depreciation reduces imported inflationary pressure. El Nino condition pose upside risks to our medium-term forecasts. Given the moderation in inflation, the Monetary Policy Committee (MPC) may opt for a prolonged pause in the interest rate cycle, unless the US FED pivots earlier. Dun & Bradstreet expects the Consumer Price Inflation (CPI) to be in the range of 4.1% - 4.3% and Wholesale Price Inflation (WPI) to be around (-) 2.6% - (-) 2.4% in May 2023.

Money & Finance

Dun & Bradstreet expects Indian G-sec yields to remain rangebound and largely unchanged in May 2023 compared to the previous month. Retail inflation print came below the Reserve Bank of India's (RBI) upper tolerance limit for the second consecutive month raising hopes that the MPC would maintain status quo in the June policy meeting. We expect bank credit to continue strengthening, potentially reaching a multiyear high (~11 year) in the month of May 2023, an indication of sustained economic recovery. Survey conducted by Dun & Bradstreet supports this expectation; firm's demand for short and long-term funds for Q2 2023 have touched 11-year and 2-year high, respectively. Dun & Bradstreet expects the 15-91-day Treasury Bills yield to remain at around 6.8%-6.9% and 10-year G-Sec yield to be 7.0%-7.2% for May 2023.

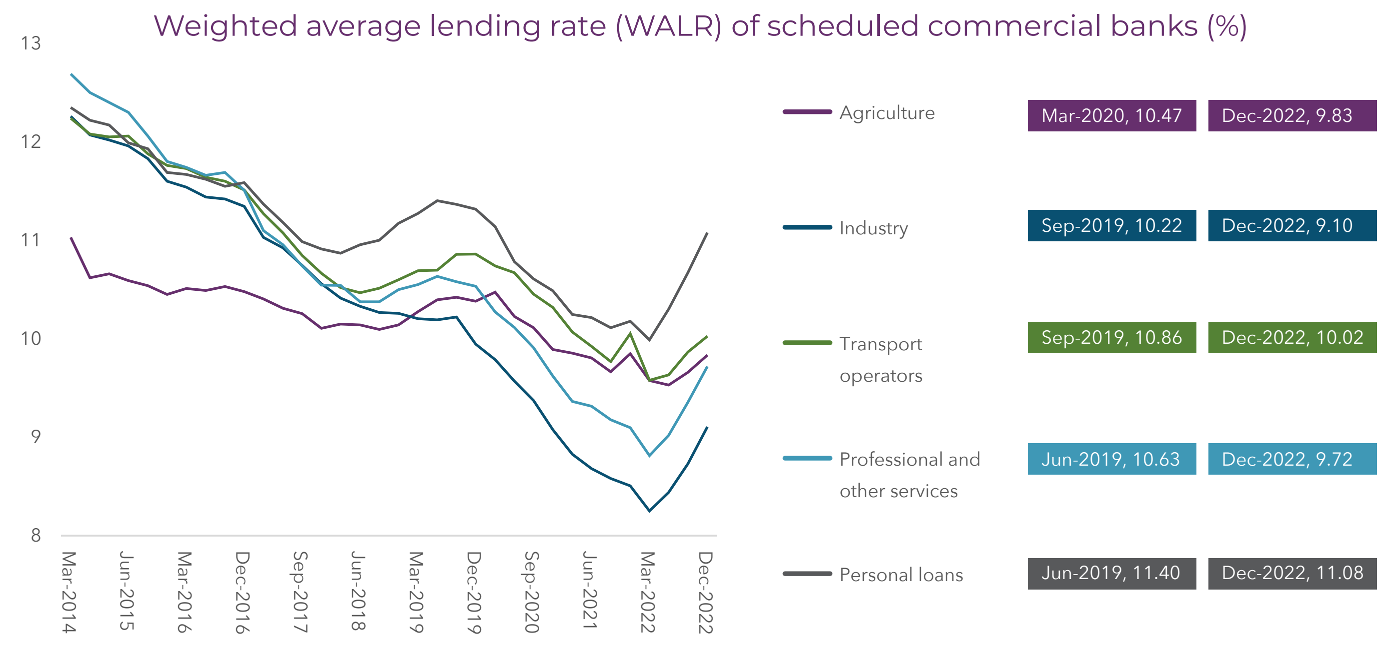
External Sector

Rupee is likely to remain under pressure in the month of May 2023. The Indian economy is exhibiting resilience to external headwinds and is expected to perform better compared to other emerging countries. The rate hike by the US Federal Reserve in May 2023 and concerns over the US debt ceiling is supporting dollar causing depreciating pressure on rupee. However, the domestic currency may remain resilient in the medium term led by narrowing of current account deficit (CAD) and foreign capital inflows. Dun & Bradstreet expects rupee to depreciate to 82.2 per US$ during May 2023.

D&B's Economy Observer Forecast

Variables	Forecast	Latest Period	Previous period
IIP Growth	0.5% - 0.7% April-23	1.1% March-23	5.8% Feb-23
Inflation WPI	(-) 2.6% - (-) 2.4% May-23	-0.92% April-23	1.34% March-23
CPI (Combined)	4.1% - 4.3% May-23	4.70% April-23	5.66% March-23
Exchange Rate (INR/US$)	82.2 May-23	82.03 April-23	82.29 March-23
15-91 day T-Bills	6.8% - 6.9% May-23	6.8% April-23	6.9% March-23
10 year G-Sec yield	7.0% - 7.2% May-23	7.18% April-23	7.36% March-23
Bank Credit	16.5% May-23	15.92% April-23	15.01% March-23

Lending rates in 2023 is likely to surpass the 2019 level

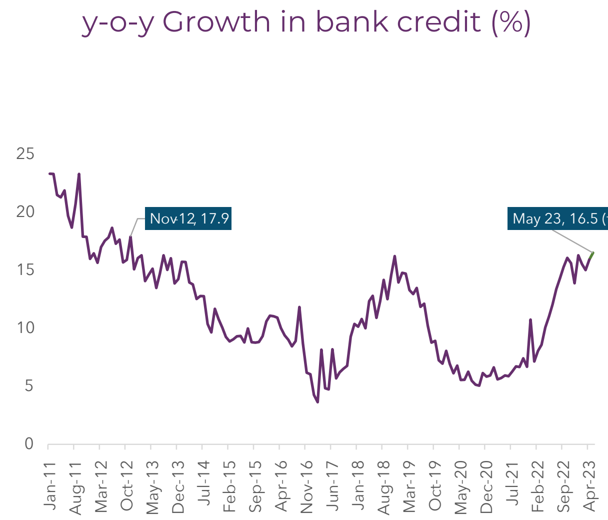


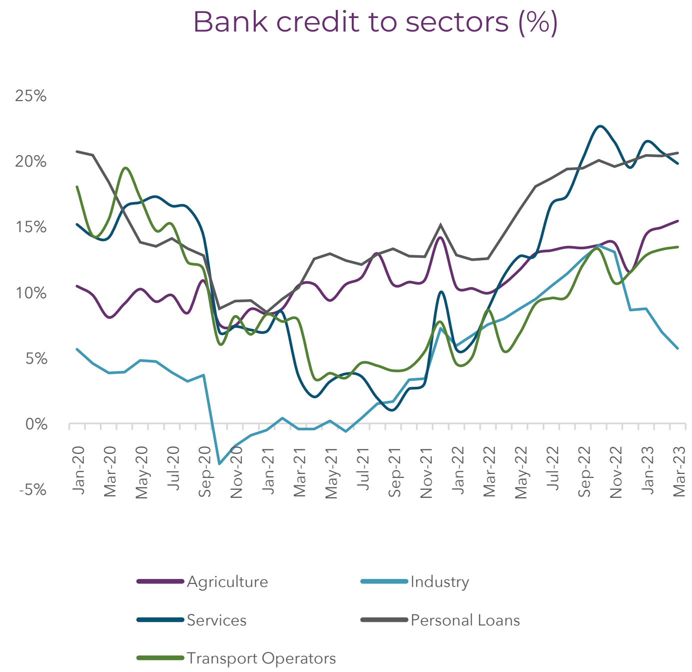
Source: RBI

Given the lag in the monetary policy transmission, lending rates are expected to continue to increase and surpass the pre-pandemic level of 2019 in 2023

- Between May to December 2022, the Monetary Policy Committee (MPC) increased the repo rate by 225 basis points and further increased it by 25 basis points in February 2023 before pausing the rate hike cycle in its April policy meet. With the moderation in inflation, the MPC might go for a prolonged pause unless the FED pivots earlier.
- Between May 2022 to November 2022 the weighted average lending rate on fresh rupee loans of the scheduled commercial banks has increased by 135 basis points and by March 2023 it has Increased by a total of 175 basis points.
- Sector-wise, increase in the lending rates in the personal loans category was the steepest followed by the services and industry since March 2022.
- Decline in the wholesale prices to provide relief to businesses in terms of lower input cost when faced with borrowing cost surge.
- However, profit margins may be affected due to increasing financing and debt servicing costs. Dun & Bradstreet survey reveals that the optimism for liquidity and profitability amongst CFOs across India fell sharply in Q2 2023 from the year-ago value.

.... Bank credit is strengthening, although credit growth to industries is moderating





Source: RBI

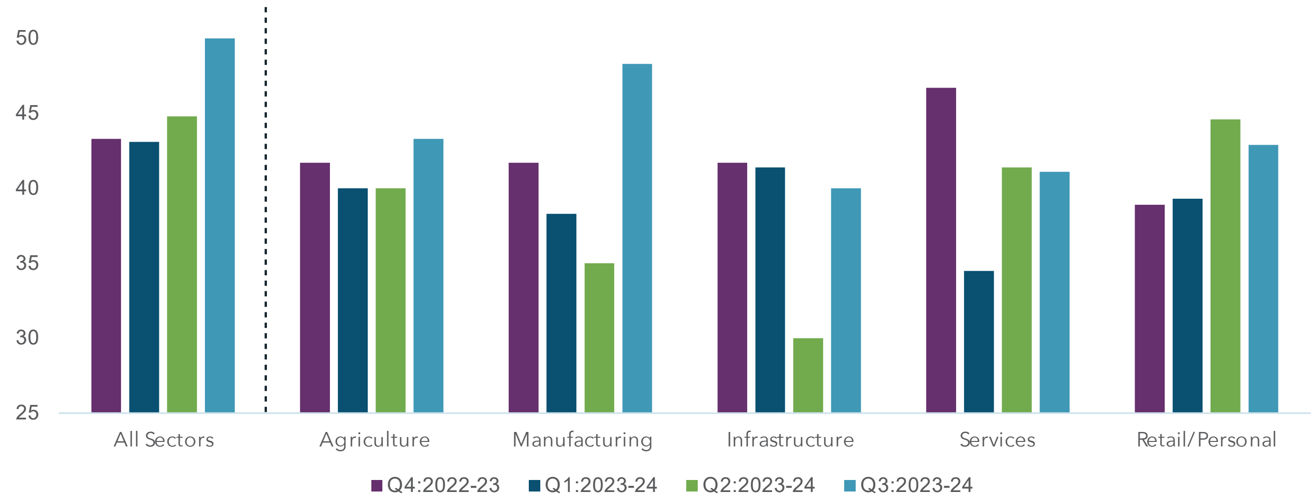
We expect bank credit to continue strengthening, reaching a multiyear high (~11 year) in the month of May 2023.

Even as the overall bank credit is growing strongly, the uneven pace of credit growth across different sectors evidences the underlying challenges faced by some of the sectors

- Increases in lending rates have not had the same impact on credit growth in all sectors as seen in the bank credit data released till March 2023.
- Credit growth to industries is found to have started moderating since December 2022, while credit growth to the agriculture sector, transport operators, services and personal loans segment have been steady or growing at double digits.
- The sectoral composition of bank credit shows that bank lending is growing in double digits in the mining, beverages, petroleum and the metals sector.
- Notably, credit growth to the aviation sector has witnessed an uptick since December 2022 after moderating for 12 months.
- Credit growth in the Gems & Jewellery sector has been negative since November; growth moderated for the engineering. Credit growth to the infrastructure sector has weakened rapidly from a near double digit growth in July 2022 to a negative growth in March 2023.
- Credit growth to large industries has been moderating while credit to small and medium enterprises is growing in double digits, although the pace of growth has moderated between October 2022 to March 2023
- On the other hand, household credit has witnessed a robust growth as seen in the growth in personal loans, vehicle loans and credit card outstanding indicating resilient consumer demand. Combined with the steepest increase in the lending rates for personal loans, unsecured credit could see increase in bad assets.

Bank surveys point towards a robust recovery in bank loans, especially for industry, by Q3 2023-24

Net response* of banks for expectation of loan demand across sectors (in percentage points)



Source: SIPRI
Net Response (NR) is computed as the difference of percentage of banks reporting increase/optimism and those reporting decrease/pessimism in respective parameter
Source: RBI

According to bank lending survey conducted by the RBI, bankers remain upbeat about the loan demand till Q3 FY24 and expect loan terms and conditions to remain easy.

- The Indian economy is expected to moderate in FY24 compared to last year. As demand for credit is a leading indicator of growth, forward looking quarterly credit demand data for different sectors would help in understanding how the sectors might perform during the year.
- As per the survey, bankers more most optimistic about the demand for loans from the manufacturing sector towards the end of 2023 compared to the infrastructure, services and the retail/personal sector.
- Demand for loans from the manufacturing sector is expected to remain subdued in Q1 and Q2 before picking up strongly in Q3 signalling a delayed recovery in the manufacturing sector.
- Services sector to remain tepid in Q1 with pick up from Q2 given the subdued global economic growth and increase in global financial instability. Loan demand from the services sector is expected by bankers to moderate in Q1 FY24, before picking up in the subsequent two quarters.
- The survey also reveals that the loan demand from the agriculture sector to remain robust till Q3 2024.

Monetary Policy Meeting

Watch out for the Monetary Policy Committee's decision on policy repo rate and its forecast on inflation when it meets in June, after it decided to pause the rate hike in its April policy meeting.

Consumer Price Index (CPI)

Watch out for Consumer Price Index (CPI) to be released for the month of May 2023 as the retail inflation dropped below the upper tolerance band of the RBI for two consecutive months of March and April.

RBI Consumer Confidence Survey

Watch out for RBI's bi-monthly Consumer Confidence survey scheduled to release in June 2023 which will provide an assessment of how consumers current perceptions (vis-à-vis a year ago) and one year ahead expectations on general economic situation, employment scenario, overall price situation and own income and spending. According to the previous release in March, consumer confidence continued to recover from the historic low recorded in mid-2021, though it remained in the pessimistic zone.

Financial Stability Report

The bi-annual Financial Stability Report reflects the collective assessment of the Sub-Committee of the Financial Stability and Development Council (FSDC) on risks to financial stability and the resilience of the financial system. Given the stress in the global banking system, the results of the stress tests conducted by the committee on the various financial segments in India is much awaited. As per the last report:

- Macro stress tests for credit risk revealed that SCBs would be able to comply with the minimum capital requirements even under severe stress scenarios.
- Stress tests for open-ended debt mutual funds showed no breach in limits pertaining to interest rate, credit and liquidity risks. Consolidated solvency ratio of both life and non-life insurance companies also remained above the prescribed minimum level.
- The gross non-performing asset (GNPA) ratio of scheduled commercial banks (SCBs) fell to a seven-year low of 5.0% and net non-performing assets (NNPA) dropped to ten-year low of 1.3% in September 2022.

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