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ECONOMY OBSERVER

MARCH 2024

Supply chain disruptions could derail inflation optimism: Dun & Bradstreet

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> The decrease in raw material prices has fostered optimism regarding inflation, despite the gradual increase in prices of finished goods over recent months, thereby supporting manufacturers' profit margins. However, this optimism concerning input price inflation may swiftly diminish due to dwindling inventories caused by ongoing supply chain disruptions. Shipments are experiencing prolonged durations and increased costs due to the rerouting of trade bound for the Red Sea. If these disruptions persist, they could impede further alleviation of inflationary pressures, thereby delaying decisions regarding rate cuts.

Real Economy

We expect growth in industrial activity to pick up from the month of February 2024 supported by strong growth in exports, benign raw material prices and to an extent by election related spending. Value of exports in February rose to 11-month high and grew strongly by 12% compared to last year. Dun & Bradstreet expects the IIP to have grown by 5.0% in February 2024.

Price Scenario

Retail inflation is expected to remain above 5% in March 2024 as food inflation remains high and sticky, especially, for vegetables and pulses. Moreover, the inflation rate in protein food items have also skyrocketed and is likely to remain high in the festive month of March 2024. Dun & Bradstreet expects the Consumer Price Inflation (CPI) to be 5.15% and Wholesale Price Inflation (WPI) to be around 0.1% for March 2024.

Money & Finance

High inflows in the debt market to keep yields in the long- term bonds in line with February. However, short-term yields are anticipated to stay range-bound in March 2024 compared to February due to year-end tax payments. Additionally, liquidity tends to tighten in March as banks typically record higher deposits on their books before the year-end. Dun & Bradstreet anticipates the 10-year G-Sec yield to be around 7.1% in March 2024, while we expect the 15-91-day Treasury Bills yield to remain at around 6.95%.

External Sector

We expect rupee to appreciate slightly in March 2024; Robust domestic growth along with low trade deficit and increase in forex reserves to support rupee. However, we expect rupee to deprecate in April, although slightly, as factors such as strengthening of dollar and disruptions in supply chain across major trade routes to continue to impact trade flows and investor sentiment. Dun & Bradstreet expects the rupee to appreciate to 82.8 per US$ in March 2024 and depreciate to 83.0 per US$ in April 2024.

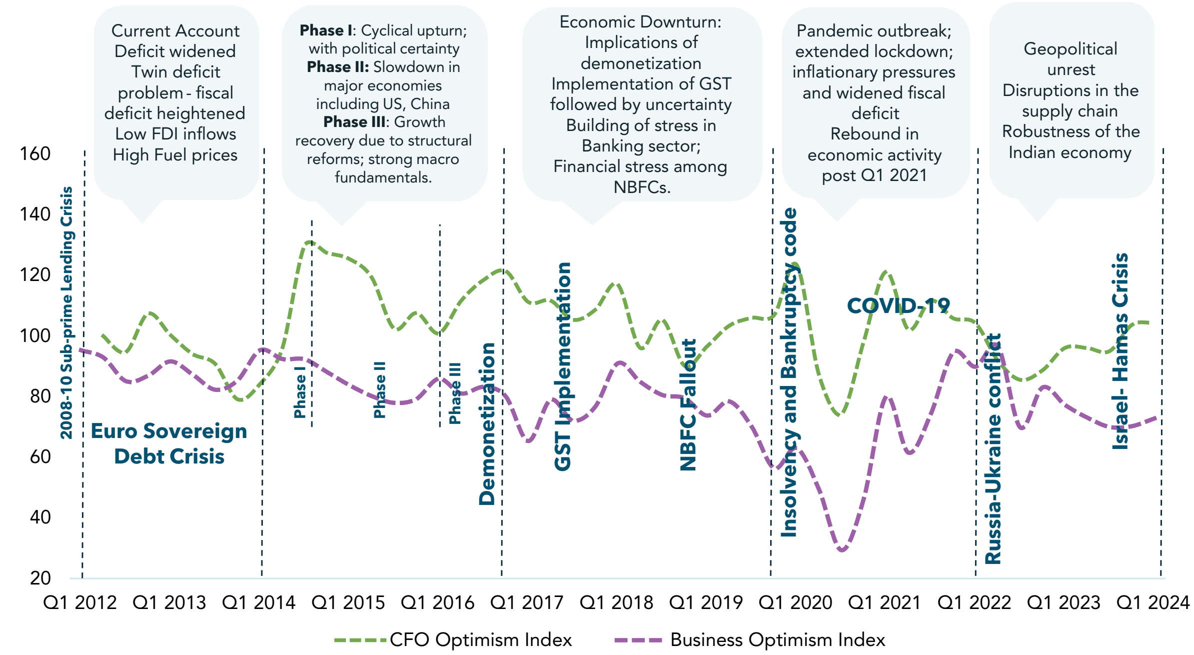
D&B's Economy Observer Forecast			
Variables	Forecast	Latest Period	Previous period
IIP Growth	5.0% February-24	3.8% January-24	4.2% December-23
Inflation WPI	0.1% March-24	0.2% February-24	0.27% January-24
CPI (Combined)	5.15% March-24	5.09% February-24	5.1% January-24
Exchange Rate (INR/US$)	83.00 April-24	82.8 March-24	82.96 February-24
15-91 day's T-Bills	6.95% March-24	7.03% February-24	6.97% January-24
10 year G-Sec yield	7.1% March-24	7.09% February-24	7.20% January-24
Bank Credit	20.0% March-24	20.5% February-24	20.3% January-24

Indian Economy over last decade: Through the prism of D&B Business optimism Index and CFO Optimism Index

Key Highlights

- The study encapsulates the responsiveness of our indices over the past decade, with every fluctuation experienced in the indices is a testimony of the business leaders and policy makers making a conscious choice between exuberance or risk aversion.
- Dun & Bradstreet Business Optimism Index has around 87% correlation with the overall economic growth (GDP) for the immediate next quarter over last decade. The release timing of the BOI just before the Quarterly GDP release substantiates the reliability and predictability of Index for business leaders shaping economic policies with either enthusiasm or caution.
- The indices have been able to predict key economic trends over the past decade and demonstrated strong predictive ability.
- The indices reflected after-effects of global financial crisis and Europe debt crisis and their impact on the India economy during period Q1 2012- Q1 2014 and the recovery that followed.
- The BOI index explains the relative underperformance of the economic growth during the period Q1-2012 to FY 2018 (average GDP growth around 6.5%) followed by the sharp deterioration during Covid-19 period for the first three quarters of FY2019-20 and the subsequent V-shaped recovery in the economy.
- India is voyaging on a transformative, resilient, and often detached from global economic fluctuations; fueled by robust domestic demand and strengthened investments in the post-COVID era.
- In the initial phases (2012-2019), domestic economy remained prone to global events that shaped its trajectory. However, a stronger domestic demand and investment story continues to provide significantly higher optimism viz a viz global economy. In a post COVID-19 scenario, Indian economy appears to chart its own growth trajectory, often relatively decoupled with the global economy.
- Our CFO index demonstrates that CFOs in India have traditionally been holding restrained outlook on the global macroeconomic situation and been able to minimize the financial risks.
- The Overall trend of mergers and acquisition activities in the country over past decade has been brimming around the long-term average trend line and shown more conservative approach.
- The optimism for domestic macroeconomic outlook has always been reactive to short-term views and based on high-frequency data, thus fluctuating across a wide spectrum- a minimum value of 27 in Q3 2012 (global financial crisis), a peak of 88 in Q3 2014 (post general election euphoria), dip to 31 in Q2 2020 (Covid-19 impact), and resurgence to 81 in Q1 2024 (super-performance of Indian economy).
- The index also trends transition from a phase of corporate deleveraging and risk aversion to a strategic shift towards placing bets on the long-term economic potential of India as evident from rising demand for funds post Q3 2021.

A chronological perspective- How do we read these numbers?



Source: Dun & Bradstreet

D&B Business optimism Index declined by 18% (y-o-y) in Q2 2012 reflecting the impacts of the US sub-prime crisis followed by the sovereign credit crisis in Europe. The global financial crisis reverberated into the Indian economy resulting in unfavorable external environment, currency depreciation, escalating current account deficit, and subsequent capital market volatility. The impact of pessimism on the global economic headwinds became more pronounced in the financial sector from Q1 2013, with optimism decreasing by 26% (y-o-y) in Q2 2013. The index for macro-economic scenario continued to slide down since Q2 2013 and witnessed steep decline of 32% (y-o-y) in Q4 2013. The fiscal situation remained bleak, with muted tax revenues amid weak economic growth accompanied by 23% downgrade in financial performance.

The BOI recovered by 12.2% year-on-year increase in Q3 2014 reflecting a turnaround in business sentiments. The year also marked the new government's actions alleviating political uncertainties and fostering increased confidence in India Inc. Measures to stimulate investment cycles substantially boosted the CFO optimism Index from Q3 2014 to Q2 2015. Macroeconomic optimism surged by 120% year-on-year in Q4 2014, with confidence in financial performance growing by 30% year-on-year.

For the period Q3 2015, the CFO optimism declined by 21% (y-o-y) which persisted until Q2 2016. Concerns related to economic slowdown in China, the European crisis, and rupee volatility continued being reflected in the Indices. However, the Indian economy recovered swiftly with stronger macroeconomic fundamentals leading to 6.7% (y-o-y) increase in business sentiment in Q3 2016 along with 15% rise in CFO confidence and a 25% improvement in the domestic macroeconomic scenario parameter.

The period from Q1 2017 witnessing impacts of demonetization resulted in 23% (y-o-y) decline in business optimism.

For the pre-Covid 2019 period, the CFO optimism saw 17% (y-o-y) decline in the second half of FY 2019. The global commodity prices including crude oil rebounded, Indian rupee saw depreciation and business landscape remained uncertain. Ongoing credit mis-allocation increased risks in the banking and the NBFC sector. Consequently, the tightened liquidity situation along with the subdued corporate performance led to 29% (y-o-y) decline in business sentiment in Q4 2019.

The period from Q1 2020 to Q4 2020 marked contraction in the economy a result of extended lockdowns and the BOI shrank by whopping 58% while CFO Optimism tanked by 33% (y-o-y) in Q3 2020. Business sentiment hit nadir as the prolonged outbreak disrupted production and supply chains for manufacturing companies, significantly lowering prospects for increased sales volume and net profits. Supply disruptions further heightened short-term inflationary pressures, reaching the lowest levels in 18 years in terms of stock and workforce size, disrupting the Indian economic journey. Fiscal position of the government was fractured with the high stimulus packages outpacing the revenue collection substantially widening the fiscal deficit to 6.8% (y-o-y) in 2021.

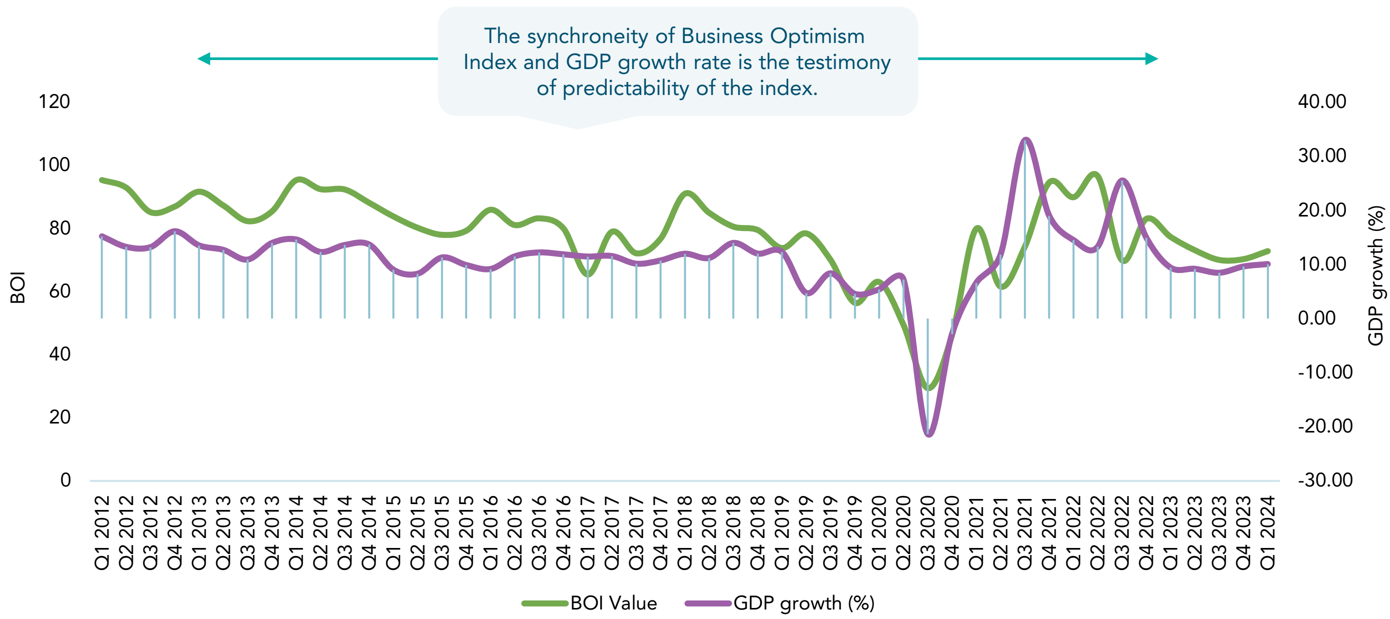
The second half of 2021 witnessed the recovery of BOI by 152% (y-o-y) in Q3 2021 as economic activities gained momentum post reopening along with greater push for the infrastructure despite the persistent inflation and upward trajectory of interest rates.

The BOI experienced a remarkable 57% (y-o-y) surge in Q2 2022 testimony of the relatively insulated Indian economy in contrast with the global geopolitical and macroeconomic uncertainties. Although 2023 also witnessed periods of weaknesses both in the BOI as well as CFO indices reflecting inflationary pressures in the economy, high interest rate scenario and a global geopolitical as well as macro-economic challenges. Nonetheless, the apparent financial stability, a robust investment push, ample liquidity within banking sector fosters optimism for the economy.

BOI as a lead indicator for overall economic growth

BOI as a lead indicator for overall economic growth has shown a correlation co-efficient of around 87% with the Gross Domestic Product (GDP) for the immediate next quarter.

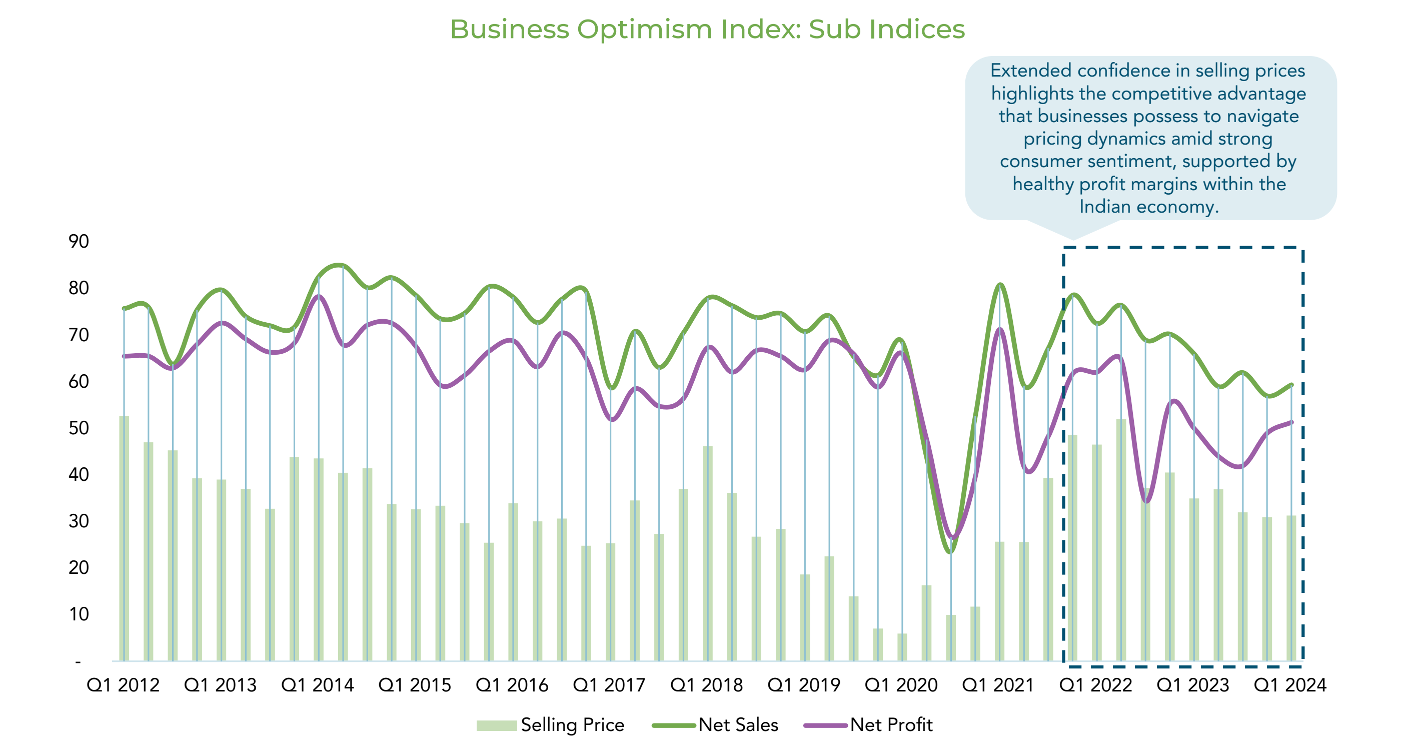
D&B Business optimism Index vs GDP growth (%)



Source: Havers, Dun & Bradstreet

Demonstrating its strong predictive ability as a lead indicator of economic activities, the BOI index explains the relative underperformance of the economic growth during the period Q1-2012 to FY 2018 (average GDP growth around 6.5%) and the sharp deterioration during Covid-19 period of first three quarters of FY2019-20 and subsequent V-shaped recovery in the economy. The BOI index for the period 2012-2019 remained at 82 on an average, collapsed to 47 during Covid-19 pandemic and recovered to 78 for the period from Q1 2021 till now.

The intermittent variations of the composite BOI index viz-a-viz the GDP performance in the upcoming quarter can be explained through the granular analysis of the index's specific components.

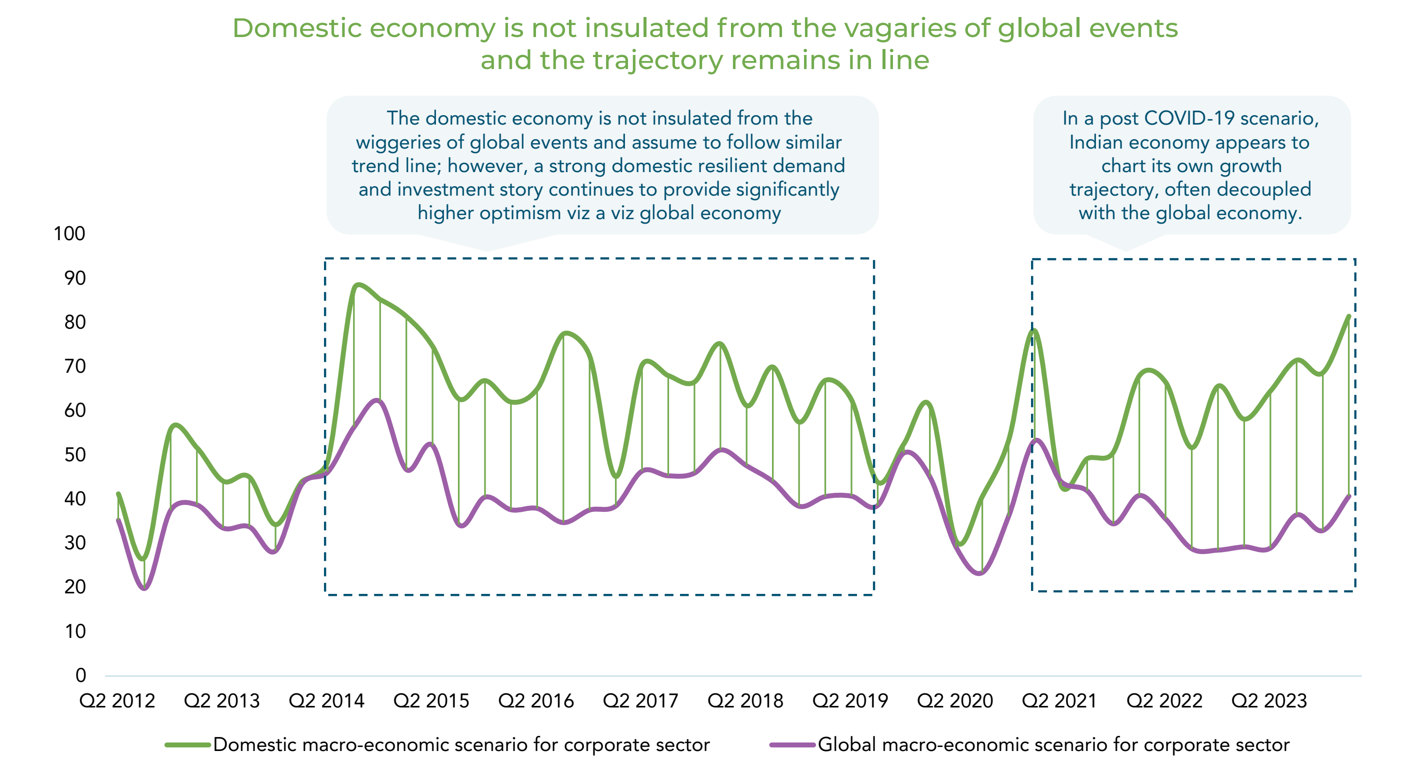


Source: Dun & Bradstreet

We observe the relative deviance of BOI with the GDP growth numbers for the period- Q1 2021-Q3 2021 where in the BOI value remained soft despite sharp recovery in the GDP. During this period, the index values for net sales, net profit and selling prices reflect the underlying trend of stronger revenues due to sudden upsurge in demand while the profitability jumped as the commodity prices were still tepid for the six-month period as the economy opened after Covid-19 related lockdown period. In the meantime, the selling prices only increased gradually taking effect over a wider time-period.

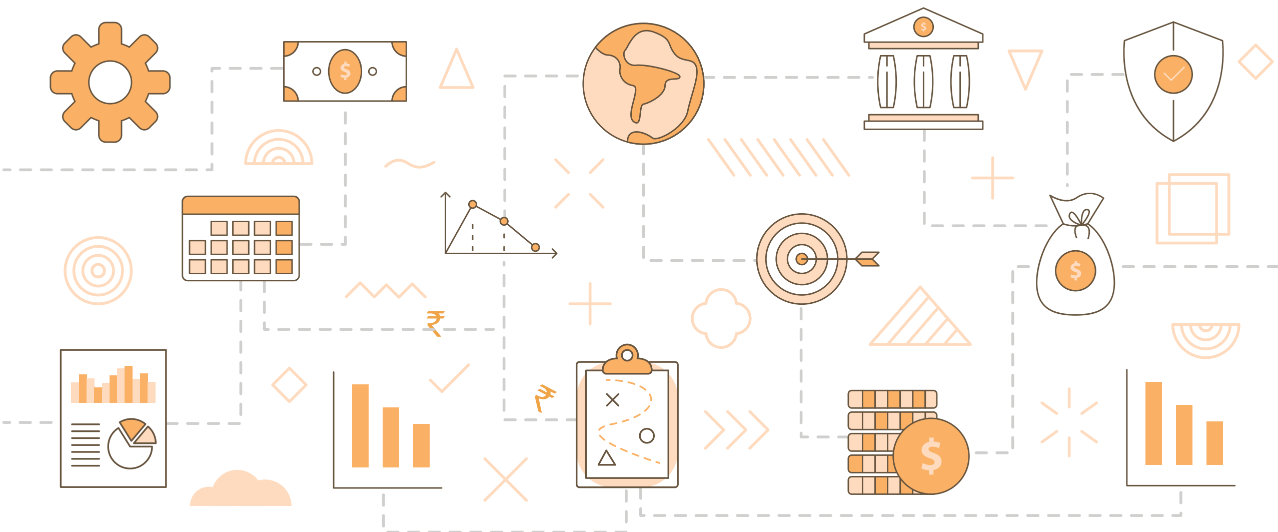
India's secular growth story

Transformative voyage of Indian economy decoupling from global events

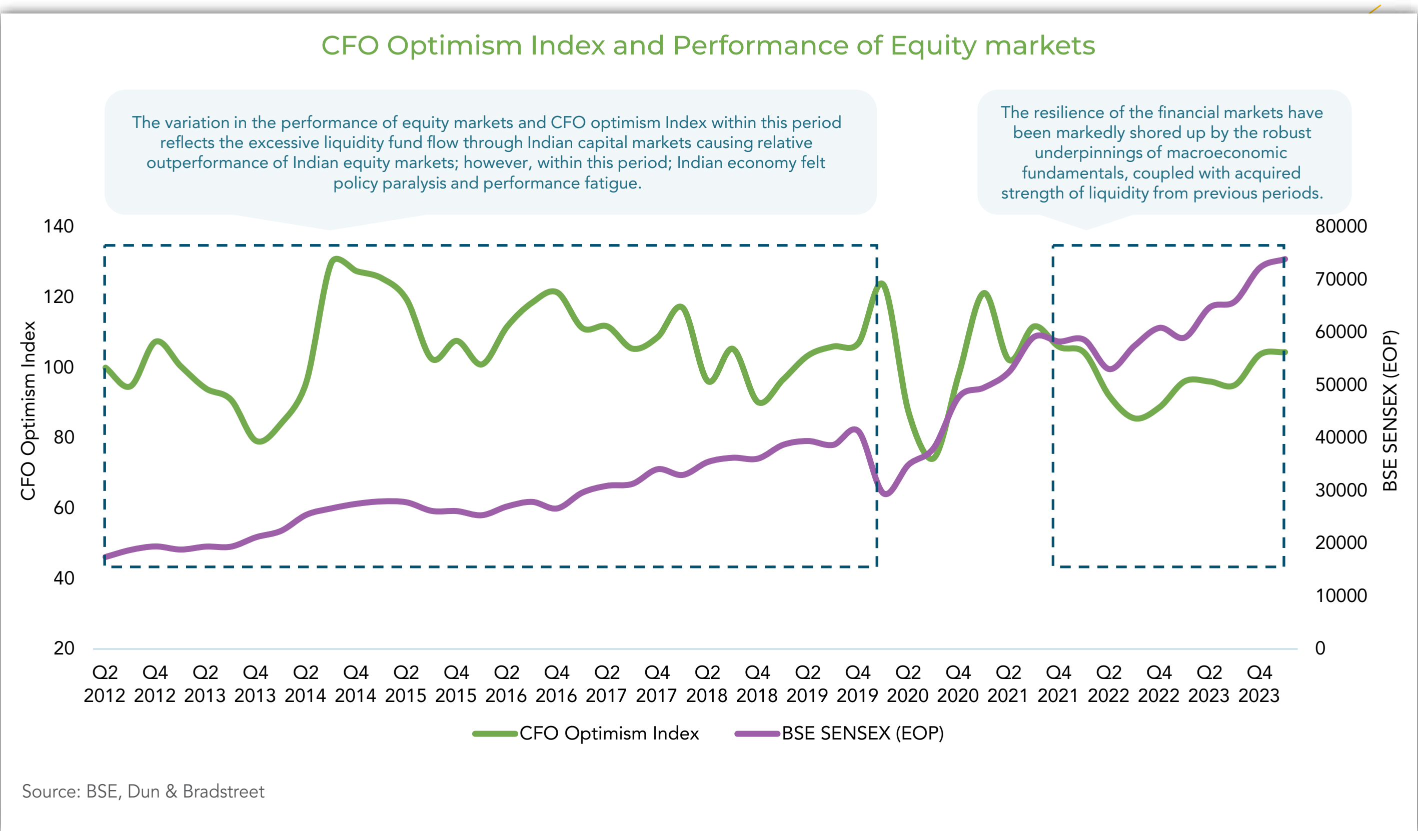


Source: Dun & Bradstreet

However, a stronger domestic demand and investment story continues to provide significantly higher optimism viz a viz global economy. In a post COVID-19 scenario, Indian economy appears to chart its own growth trajectory, often relatively decoupled with the global economy. Although external demand remains subdued with significant supply chain challenges; domestic growth pointers suggest robust economic growth backed by high public investment, growing consumption, and sufficient liquidity in the domestic market.

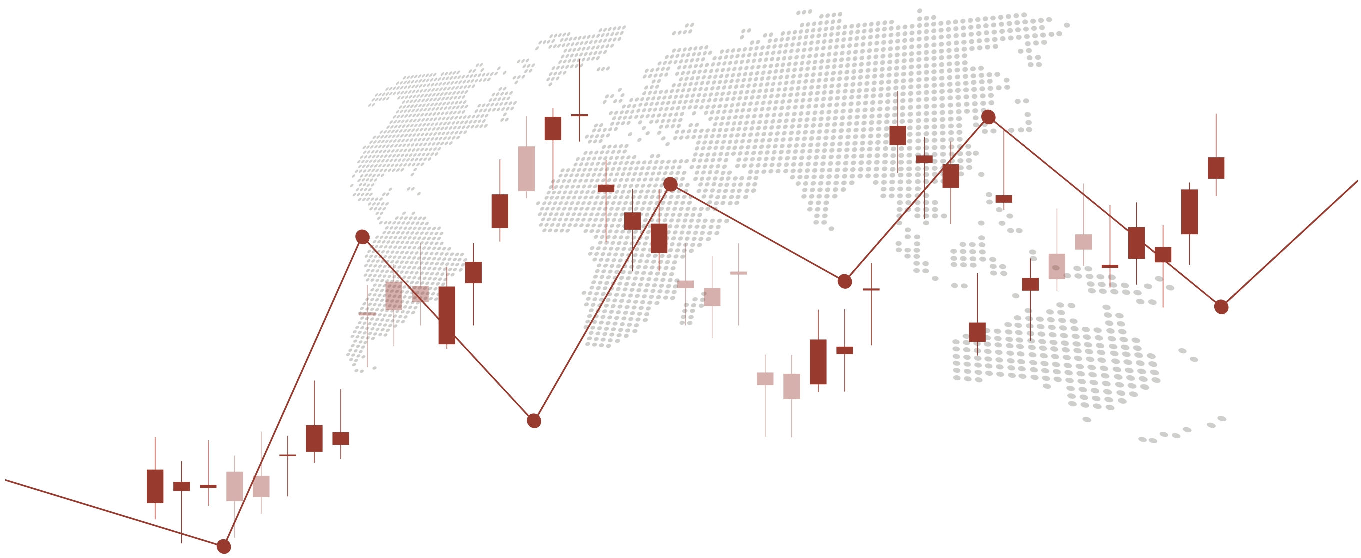


Upward trajectory of equity market primes India for superior returns among global equity markets, elevating financial optimism for CFOs.

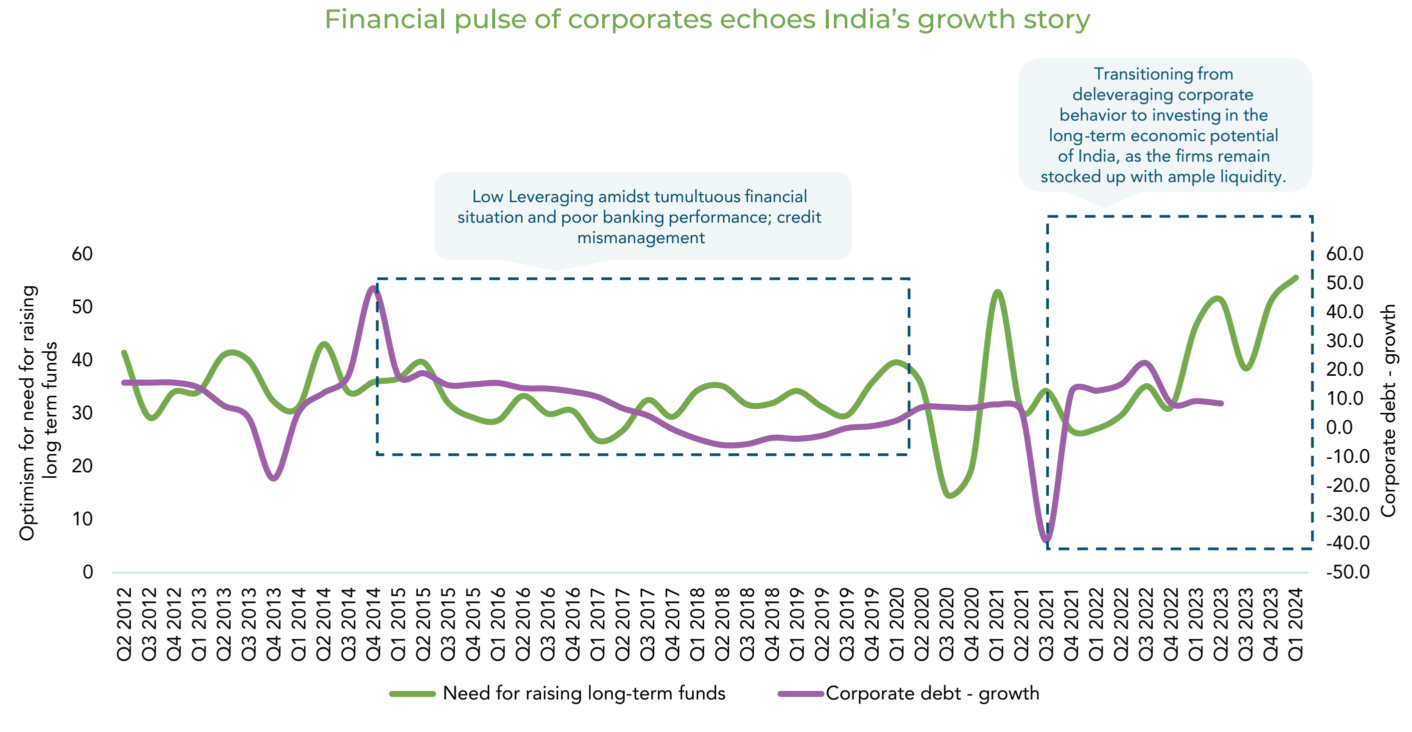


Source: BSE, Dun & Bradstreet

The progression of equity market underscores its resilient journey, fueled by an influx of foreign funds and a political turnaround accompanied with global maneuvering of macroeconomic policies that boosted liquidity, particularly from Q2 2014 to Q1 2016. Despite challenges following the implementation of GST and demonetization caused situation hiccups to the financial confidence, yet the equity markets maintained their ability to avoid jerks and jitters; further navigating the path of interconnectedness in global financial landscape. Post Q2 2022, the trajectory of the equity market signals a promising trend, poised to stimulate substantial returns in the Indian equity market within the Emerging Markets. This is driving the upswing in financial confidence supported by robust macroeconomic fundamentals, further bracing up the optimism among CFOs.



From deleveraging to strategic investments: Echoes of India's growth narrative



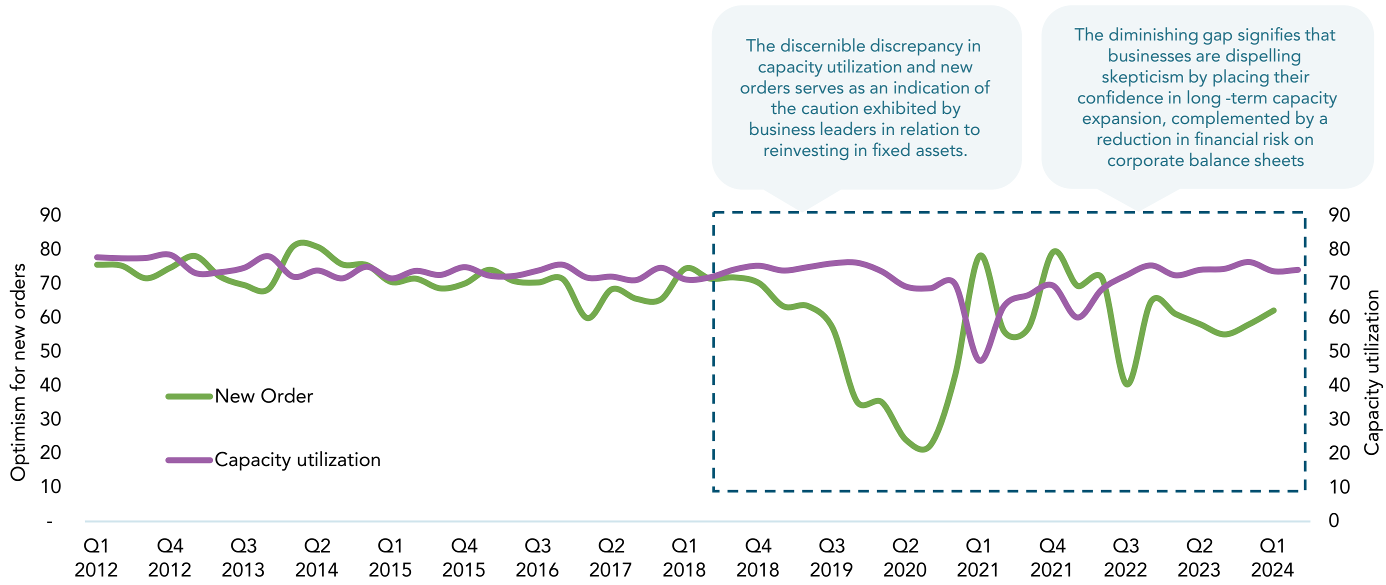
Source: Havers, Dun & Bradstreet

Transitioning from a phase of corporate deleveraging, the business landscape is now marked by a strategic shift towards placing bets on the long-term economic potential of India.

Strong credit availability and push for capacity creation over the long term complements the superior growth trajectory and optimism.

Betting on long term Capacity Creation

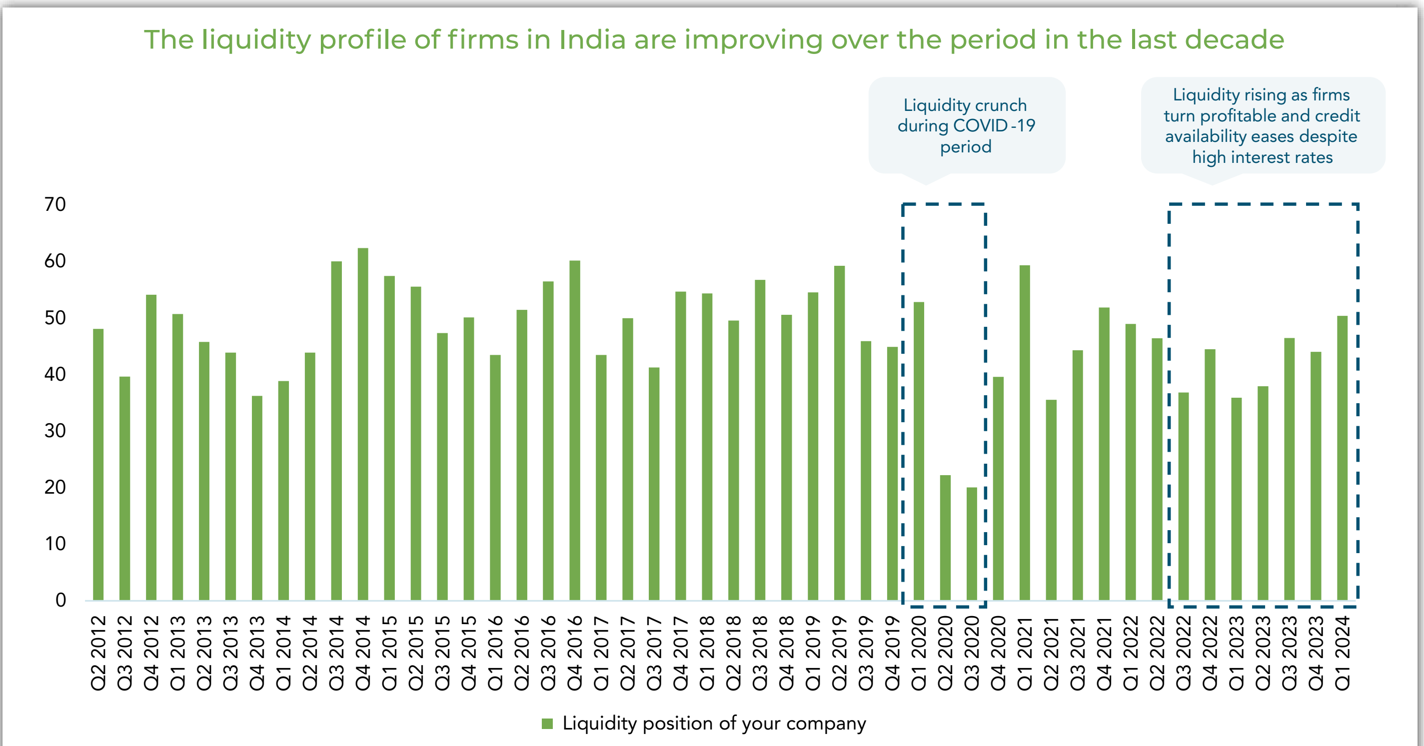
Gap between the trend for optimism on capacity utilization and new orders tell a story of romanticism with long term capacity creation and a situational hiccups on new orders and capacity utilization in the economy



Source: RBI, Dun & Bradstreet

Over the past decade, the capacity Utilization has hovered around the long-term trend with the intermittent period of subdued utilization during Covid-19 pandemic and a swift recovery afterwards. However, the capacity utilization took a while before it recovered to its long-term average in FY 23. At the same time, optimism for new orders reflect the economy's appetite to reinvest in fixed assets; it significantly dropped at the beginning of 2018 with challenges in capital finance and growing bankruptcies of NBFCs during the period. The COVID-19 pandemic dented the already subdued capacity building activity in the economy which could never retain back full gusto until very recently till the beginning of 2023.

Improving liquidity profile indicative of profitability and robust cash flows



Source: Dun & Bradstreet

Firms have been able to manage their profitability and cash flows, banking on cost reduction through lower commodity prices and prudent inventory management as well as growing consumption demand in Indian economy. This has resulted in surplus fund availability with the India Inc. which is being used to deleverage the balance sheet. At the same time, risk aversion is also increasing among the firms as they are less sanguine on the global macroeconomic outlook and financial stability.

IMF World Economic Outlook (WEO)

Watch out for the IMF forecast for global growth and inflation in the WEO issue to be released in the month of April 2024, given the growing risk to inflation from the ongoing supply chain crisis emanating from the conflict in the Red Sea. In the January 2024 release, the IMF forecasted that global growth would remain at 3.1% in 2024 and increase to 3.2% in 2025. It was also pointed out that high central bank rates aimed at curbing inflation and reduced fiscal support due to high debt levels are dampening economic activity. Inflation has been declining more rapidly than anticipated across most regions, attributed to tight monetary policies. The IMF predicted global headline inflation to decrease to 5.8% in 2024 and 4.4% in 2025, with a downward revision for the 2025 forecast.

IMF Global Financial Stability Report

In the October 2023 report, the IMF noted that despite high core inflation in many advanced economies, central banks might have to maintain tighter monetary policies for longer than what markets anticipate. Emerging market economies have made progress in reducing inflation, but differences exist across regions. However, optimism regarding a 'soft landing' for the global economy, where inflation slows down and recession is avoided, had improved financial conditions since the April 2023 Global Financial Stability Report.

RBI monetary Policy

The RBI monetary policy committee has kept the policy interest rate on hold for the sixth consecutive meeting held in February 2024. Given the upside risk to retail inflation from the food price inflation and the global supply chain disruption, watch out for the RBI’s assessment of inflation and growth for the upcoming quarters when the monetary policy committee meets during 3rd to 5th April 2024.

RBI Consumer Confidence Survey

To gauge consumer demand in urban areas, keep an eye on the trend in consumer confidence from the RBI's bi-monthly survey. This survey gathers current perceptions compared to a year ago and expectations for the next year from households regarding the general economic situation, employment prospects, overall price trends, personal income, and spending habits across 19 major cities.

Order Books, Inventories and Capacity Utilization Survey

The RBI is expected to release its report on Order Books, Inventories and Capacity Utilization Survey for Q3 2023-24 that captures the demand scenario of the Indian manufacturing sector with respect to capacity utilization, growth in new orders and Inventory to sales ratio. At the aggregate level, the capacity utilisation (CU) in the manufacturing sector increased to 74.0% in Q2 2023-24 from 73.6% in the previous quarter.

Analysis - Economic Research Team

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