dun & bradstreet

ECONOMY OBSERVER

DECEMBER 2023

Expect retail inflation above 6% in December, likely to keep lending rates higher for longer– Dun & Bradstreet

“India's GDP is poised to surge by 7% in FY24, fueled by significant government and private sector investments. Despite climbing lending rates, non-food credit...”

"India's GDP is poised to surge by 7% in FY24, fueled by significant government and private sector investments. Despite climbing lending rates, non-food credit growth is at a decadal high indicating promising growth momentum. Besides, both consumers and small businesses signal optimism for robust growth. As India continues to log a high growth rate among major economies, it also demonstrating growth with sustainability, having achieved some of its commitments to reduce green-house emissions ahead of the schedule. Besides, India's introduction of the Green Credit initiative at COP28 has garnered international backing, showcasing its commitment to global environmental sustainability through a fully digital and tradable instrument on the world stage."

Real Economy

Despite weak external sector, industrial activity continues to gain momentum. Resilient demand and flow of credit supporting industrial activity. Besides, strengthening of rural demand, along with election related expenditure and government spending on infrastructure might have supported industrial activity in November 2023. Dun & Bradstreet expects the Index of Industrial Production (IIP) to have grown by 6.0% in November 2023.

Price Scenario

Despite the winter season, food prices are inching upwards, which is likely to prevent a policy rate cut by the Central Bank in the subsequent monetary policy meeting scheduled in February. Further, geopolitical risk is imparting uncertainty to crude oil prices which is also likely to heighten inflationary pressures. Retail inflation is thus expected to inch up to and remain above 6% in December, setting the stage for lending rates to remain high for an extended period. Dun & Bradstreet expects the Consumer Price Inflation (CPI) to be 6.2% and Wholesale Price Inflation to be around 1.5% for December 2023.

Money & Finance

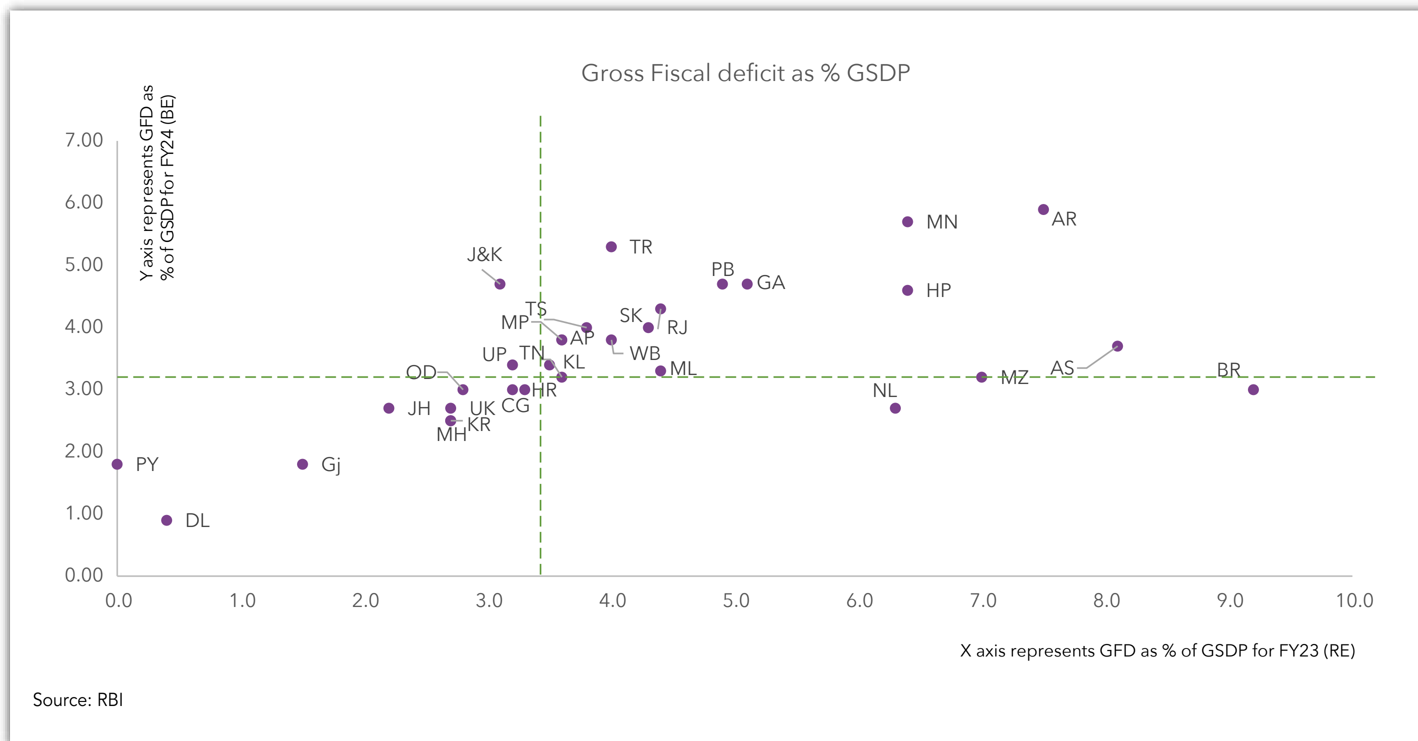
Persistent retail inflation, potential delay in policy rate cuts, and tight liquidity conditions are poised to maintain high yields. Dun & Bradstreet anticipates the 15-91-day Treasury Bills yield to reach 6.7%, with the 10-year G-Sec yield projected at 7.45% in December 2023.

External Sector

The rupee is expected to gain a foothold, after the dovish stance taken by the US FED in its December 2023 meeting, indicating to cut the policy rate by 75 basis points in 2024. Weak dollar, FII inflows, lower trade deficit, strong momentum in domestic growth and positive investor sentiment, witnessed in the strong equity markets is expected to support rupee. Dun & Bradstreet expects rupee to remain unchanged at 83.3 per US$ in December 2023 compared to last month and is likely to depreciate to 83.6 per US$ in January 2024 given the uncertainty around oil and food prices.

D&B's Economy Observer Forecast			
Variables	Forecast	Latest Period	Previous period
IIP Growth	6.0% November-23	11.7% October-23	6.2% September-23
Inflation WPI	1.5% December-23	0.26% November-23	(-)0.52% October-23
CPI (Combined)	6.2% December-23	5.55% November-23	4.87% October-23
Exchange Rate (INR/US$)	83.6 January-24	83.3 December-23	83.3 November-23
15-91 day T-Bills	6.98% December-23	6.94% November-23	6.89% October-23
10 year G-Sec yield	7.35% December-23	7.27% November-23	7.35% October-23
Bank Credit	19.5% December-23	20.6% November-23	19.7% October-23

Fiscal peformance of states



Source: RBI

States have shown enhanced fiscal performance since the post-pandemic era, witnessing a decline in both debt and deficits accrued during the COVID-19 crisis. In the fiscal year FY21, the collective state fiscal deficit stood at 4.1% of Gross State Domestic Product (GSDP). This figure decreased to 2.8% in the fiscal year FY23, below the budget estimate of 3.2% and also below the Centre's prescribed limit of 4%.

- States overall fiscal performance has improved thankfully due to the better performance of most of the states; a handful of states are yet to be fiscally prudent.
- In FY23, 14 states had GFD to GSDP ratio of 4% and above (in FY23, the Fiscal Responsibility Legislation (FRL) threshold for States' GFD was 4% of GSDP. This was brought to 3.5% in FY24 with a buffer of 0.5%). In FY24(BE), 14 states budgeted GFD to GSDP ratio of more than 3.5% out of which 10 states had more than 4.0%.
- However, reflecting further improvement from the previous year, overall, 19 states and UT have budgeted a decline in the fiscal deficit in FY24. States like Bihar, Assam, Mizoram, Nagaland and Himachal Pradesh have budgeted the most decline.
- This fiscal consolidation holds significance on multiple fronts. Firstly, despite a substantial decline in revenues during the peak of the COVID-19 crisis, states have collectively demonstrated fiscal prudence. Secondly, states efficiently reassigned their spending priorities, swiftly containing the fiscal deficit. Fourthly, the reduction in the fiscal deficit is attributed to a blend of adjustments on the expenditure front, augmented Goods and Services Tax (GST) collections, and increased tax devolution owing to robust central revenues. Lastly, the formalization of the unorganised sector is widening the base and driving the momentum of tax collections.

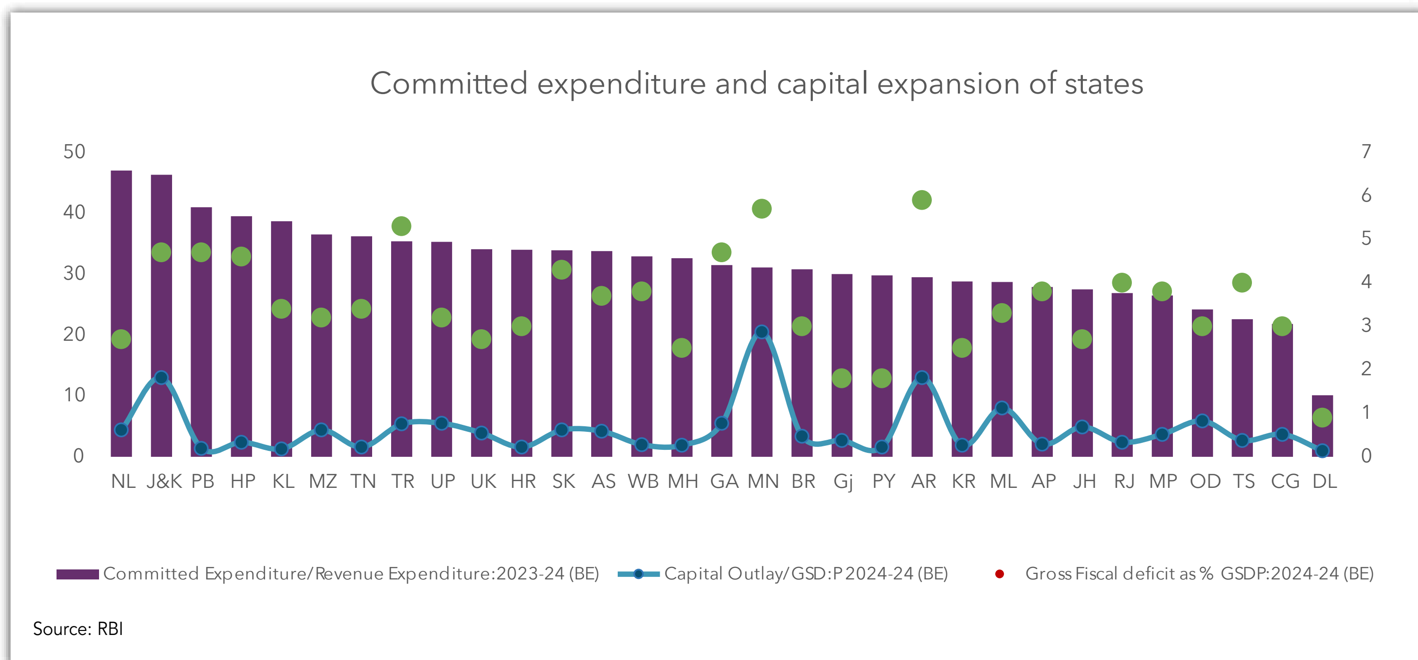
Debt Scenario

Source: RBI

The debt-to-GDP ratio of states decreased to 27.5% by March 2023, down from its peak of 31% in March 2021. Nevertheless, on an individual basis, certain states still maintain a high debt-to-GDP ratio.

- In FY23, 22 states surpassed the national debt to GSDP average of 27.1%. For FY24, 23 states have budgeted their debt of GSDP ratio above the national average of 27.6%.
- During FY23, nine states recorded a debt-to-GDP ratio exceeding 30%, with a high double-digit debt service ratio. Moving into FY24, ten states reported a debt-to-GDP ratio surpassing 30%, accompanied by a high double-digit debt service ratio.
- In the aftermath of COVID, the proportion of outstanding market loans within the total debt has steadily risen and is projected to reach 66% by the conclusion of March 2024. The anticipated persistence of higher interest rates, (due to the potential delay in policy rate cut owing to the rise in retail inflation) is expected to amplify the debt service obligations of the states.
- In FY24,10 states have projected fiscal deficit surpassing 4% of GSDP, contrasting with the all-India average of 3.1%. These states also exhibit debt levels exceeding 30% of GSDP, while the national average stands at 27.6%. Among them, 7 states have a debt service ratio in double digits, ranging from 10% to the highest at 22%. Any additional allocation towards non-essential goods and services, subsidies, transfers, or guarantees in theses States could significantly destabilize their fiscal situation, potentially disrupting the overall fiscal consolidation achieved in the past two years.

Committed expenditure, capital outlay and fiscal deficit of states



States with high committed expenditure (comprised of interest payments, pension and administrative expenses) as a percentage of revenue expenditure have comparatively lower capital outlay (as % of GSDP), and higher fiscal deficit than others.

- Increased committed expenditure limits states' ability to allocate funds toward growth-oriented expenses. Elevated interest rates and the contemplation of some states to revert to the Old Pension Scheme (OPS) would further escalate states' committed expenditure.
- The return to the OPS by some States and potential shifts by others could significantly strain State finances. According to RBI estimates, if all States switch back to OPS from the National Pension System (NPS), the fiscal burden might be 4.5 times higher than NPS, amounting to an additional burden of 0.9% of GDP annually by 2060. This move could escalate the pension load for previous OPS retirees until the 2060s, impacting the pension system. Reverting to OPS would signify a regressive step, undermining prior reforms and jeopardizing the interests of future generations.
- Analysis of state expenditure allocation for FY24 (BE) revealed that 16 states had planned their committed expenditure below the national average of 32.5%. These states allocated an average of 5.2% of Gross State Domestic Product (GSDP) toward capital outlay and anticipated an average fiscal deficit of 3.4%.
- Conversely, the remaining 15 states, budgeting their committed expenditure above 32.6%, allocated their capital expenditure by an average of 140 basis points lower than the first 16 states. Additionally, these states projected a higher average fiscal deficit of 3.7%.

IMF ECONOMIC OUTLOOK

Keep an eye out for the IMF Economic Outlook, encompassing both the Global Economy and Regional Outlook. It would be meaningful to note whether the forecasts have deteriorated or improved from its earlier edition released in October. The IMF's October edition outlined a baseline forecast indicating a slowdown in global growth from 3.5% in 2022 to 3.0% in 2023 and further to 2.9% in 2024. This trajectory notably falls beneath the historical average (2000–19) of 3.8%. Advanced economies are anticipated to decelerate from 2.6% in 2022 to 1.5% in 2023 and 1.4% in 2024 due to the impact of tightening policies. Meanwhile, emerging market and developing economies are expected to experience a slight dip in growth from 4.1% in 2022 to 4.0% in both 2023 and 2024. Global inflation is predicted to steadily decrease from 8.7% in 2022 to 6.9% in 2023 and further to 5.8% in 2024. However, core inflation is forecasted to decline at a more gradual pace, and in most cases, inflation is not anticipated to return to target levels until 2025.

GLOBAL ECONOMIC PROSPECTS REPORT BY WORLD BANK

Watch out for the monthly edition of the Global Economic. According to its last publication, the World bank stated that Global economic growth is continuing to decelerate, with the decline in manufacturing and goods trade now extending its impact to services. In November, financial conditions relaxed, reflecting a belief in diminishing inflationary forces. Despite central banks raising policy rates to counter inflation, labor markets in advanced economies have remained constrained for the past two years. Excluding the effects of the COVID-19 pandemic, the proportion of advanced economies witnessing an increase in unemployment is currently at its peak since 2010. However, unemployment rates have begun to rise slightly, indicating a gradual easing in labor market conditions.

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