Global Economic Outlook

Rapid rise in U.S Inflation stokes unease

- A key inflation measure released on 10 February 2022, showed that prices are climbing at the fastest pace in 40 years and broadening to touch nearly every corner of the American economy, heightening the risk that they will stay elevated for longer and that policymakers may have to react more aggressively.

- Markets tumbled after the government released Consumer Price Index data for January, which showed prices jumping 7.5% over the year and 0.6% over the past month, exceeding forecasts. More worrying were the report’s details, which showed inflation moving beyond pandemic-affected goods and services, a sign that rapid gains could prove longer lasting and harder to shake off.

- Investors speculated that the hot inflation would spur a decisive reaction from the Federal Reserve — possibly a big interest rate increase at the central bank’s next gathering in March, making money more expensive to borrow and spend could weigh on demand, slowing the economy and tamping down prices.

Ukraine War Clouds further spook markets

- With investors already fretting about inflation and rising interest rates, selling on Wall Street accelerated after Washington warned that Russia had massed enough troops near Ukraine to launch a major invasion, and that an attack could begin any day.

- If the Ukraine is attacked, the Fed may turn more dovish than the market currently believes as the war would make the outlook even more uncertain.

Domestic Outlook

Domestic industrial production slumps

- Industrial output slumped to a 10-month low of 0.4 per cent in December, dragged down by manufacturing, capital goods and consumer durables output along with an unfavourable base.

- In absolute terms, the general index level of the Index of Industrial Production (IIP) was higher than pre-pandemic levels seen in December 2019, but experts cautioned that the full impact of the restrictions in view of the Omicron variant of the Covid-19 pandemic may get reflected in the industrial output data next month.

- The IIP had registered a growth of 1.3 per cent a month ago and 2.2 per cent in December 2020.

- The biggest drag for the industrial output in December came from the 0.1 per cent contraction in manufacturing output, which accounts for 77.6 per cent of the weight of the IIP. Manufacturing output had grown 0.8 per cent in the previous month and 2.7 per cent a year ago.

RBI’s MPC springs a surprise

- The Monetary Policy Committee (MPC) unanimously chose to keep the policy rates unchanged. Accordingly, the policy repo rate remains unchanged at 4 per cent, the marginal standing facility (MSF) and the bank rate are unchanged at 4.25 per cent and the reverse repo rate at 3.35 per cent. The stance of the monetary policy continues to remain accommodative.

- Charting a course different from that adopted by most global central banks, the Monetary Policy Committee (MPC) of the Reserve Bank of India left the key policy rates unchanged and retained its accommodative policy stance to support the “uneven economic recovery” in the wake of the Covid pandemic.

- It was expected by most economists that the RBI would introduce some more measures to suck out the surplus liquidity from the system. In hindsight, the RBI’s dovish stance and maintenance of status quo does not seem unwarranted. Rising G-Sec yields combined with the need to nurture a nascent recovery in economic growth is likely to have both constrained and prompted the RBI to hold back rates. Further, its outlook of softening inflation and the possibility of lower government borrowings would have aided the decision on status quo.

RBI’s Optimistic Inflation Outlook

- The RBI remained optimistic on the inflation front. It expects inflation to ease to 4.5 per cent in the coming fiscal year from the projected inflation of 5.3 per cent for the current fiscal year.

- Rising international crude oil prices poses an upside risk to inflation. The price of Indian basket of crude crossed USD 90 per barrel and reached USD 92 per barrel by 10 February. A month ago it had just crossed USD 80 per barrel. This would feed into higher inflation.
But RBI expects inflation to ease going ahead. With inflation unlikely to be a major factor, there did not appear to be any urgency for the RBI to change its policy stance.

**Stable Growth Outlook**

- RBI maintained an optimistic growth outlook for the Fiscal Year 2022-23. The Government’s thrust on capital expenditure and exports are expected to enhance productive capacity and strengthen aggregate demand. This would also crowd in private investment.
- The conducive financial conditions engendered by the RBI’s policy actions will provide impetus to investment activity. The various surveys done by RBI reveal that capacity utilisation is rising, and the outlook on business and consumer confidence remain in optimistic territory, which should support investment as well as consumption demand. The prospects for agriculture have brightened on good progress of winter crop sowing.
- The RBI has projected real (adjusted for inflation) gross domestic product (GDP) growth projection at 7.8 per cent for 2022-23. The real GDP growth at 9.2 per cent for 2021-22 takes it modestly above the level of GDP in 2019-20, the policy panel said. But the projection is marginally below the lower limit of the band of 8-8.5 per cent in the Economic Survey of 2021-22 and well below the IMF’s forecast of 9 per cent.

**Interest rate outlook**

- Globally, central banks have been tightening the monetary policy to control inflation. In the US, Federal Reserve Chairman Jerome Powell signalled last week that the US central bank would begin steadily raising interest rates in mid-March.
- The Bank of England raised interest rates to 0.5 per cent. A near 30-year high inflation rate in December pressured Britain’s central bank to raise rates for a second meeting in a row, taking Bank Rate to 0.50%.
- But nearly half of the Monetary Policy Committee (MPC) members voted for a hike to 0.75%, making further tightening next month more likely.
- We expect the 10-year benchmark bond to trade in the range of 6.65-6.80% in the week of 14-18 February 2022.

**Domestic interest rate movement remains volatile**

- Indian markets are dictated by the trend in the US. Consumer price inflation in the US rose 0.6 per cent from the prior month and 7.5 per cent a year ago, the biggest annual gain since February 1982.
- When interest rates rise in the US, the gap between rates in countries like India reduces, giving less incentive for foreign investors to pump money into other markets as they prefer to invest in their home markets.
- The RBI’s decision to keep policy rates unchanged is in contrast to the actions of central banks of major economies.
- G-Sec yields have been rising for the past two months. A host of factors have contributed to this trend. Gradual fall in surplus liquidity, pick-up in SCB credit, unanticipated high central government borrowing target contributed to the rise. The RBI’s status quo appears to be an effort to calm the bond market.
- The unchanged policy appears to have somewhat succeeded in this effort. Weighted average yield on G-Secs with 10-year residual maturity declined by 7 basis points.

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