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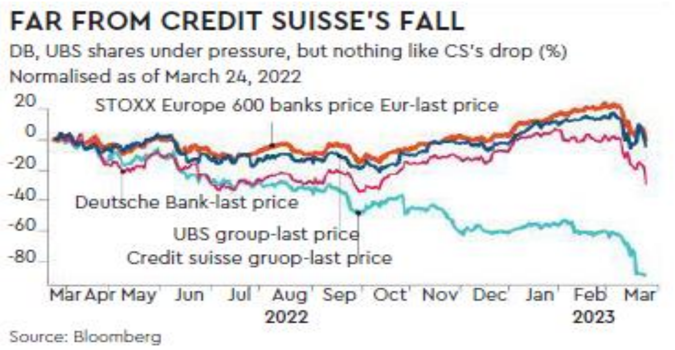
Global Economic Outlook

Banking crisis in Europe

Pressure on Deutsche Bank following the collapse of Silicon Valley Bank and Credit Suisse has raised fears of a new banking crisis in Europe. European banking stocks fell sharply as bank horror led to stress signals. Financial market stress indicators were again flashing warning signals more widely with the euro falling against dollar and bond yields sinking.



The bank was affected by a range of issues when it attempted to compete with Wall Street investment banking giants before 2008 recession. They followed a targeted attempt at revamping the structure of the bank, which entailed tough moves such as thousands of job cuts.

Shares in Germany's largest bank, Deutsche Bank have lost a fifth of their value so far this month. This has resulted in credit-default swaps which are used to protect against the bank's default, reaching levels that had not been seen since 2019.

UK inflation rises to 10.4%

British inflation unexpectedly rose to 10.4% in February 2023, pushed up by higher food prices and pricier drinks in pubs and restaurants. Economists polled by Reuters have forecast that the annual CPI rate would drop to 9.9% in February 2023 from January's 10.1% and move further away from October's 11-year high of 11.1%.

As per ONS chief economist, food and non-alcoholic drink prices rose to their highest in over 45 years with particular increases for vegetable items as high energy costs and bad weather across parts of Europe led to shortages and rationing. Overall inflation for food and non-alcoholic drinks rose to 18%, highest since 1977. Core inflation which excludes energy, food, alcohol and tobacco rose to 6.2% in February 2023 from 5.2% in January 2023. Annual inflation rate in services sector rose to 6.6%.

Domestic Outlook

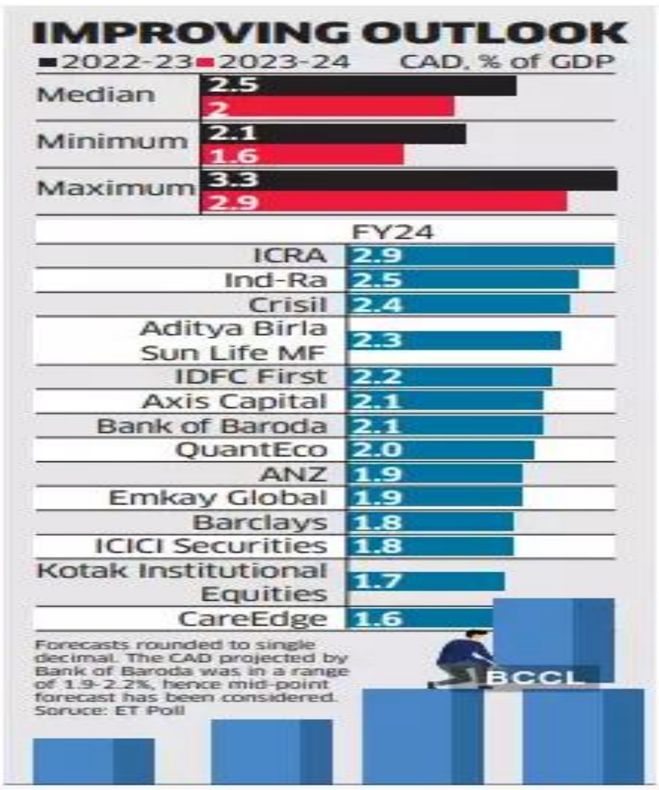
S&P retains India growth forecast at 6% in FY24

S&P global ratings has retained its economic growth forecast for India at 7% for the current fiscal and 6% for 2023-24. The rating agency expects retail inflation to fall to 5% in the new fiscal from 6.8% in current fiscal, but expects RBI to hike rate by 25 basis points following the recent spurt in inflation. According to them, CPI inflation should moderate to 5% in fiscal year 2024 but there could be upside risks including from weather-related factors. This medium-term forecast is due to two trends, (i) Covid induced output losses in emerging market economies, (ii) Shift in export market shares among Asian economies.

Current Account Deficit (CAD) narrowing in FY24

The CAD is expected to improve in FY24 but may not slip below 2% of the country's GDP. The median forecast of 14 economists pegged the current deficit at 2% of GDP in FY24, helped by softening global commodity prices and strengthening of services exports. The current account deficit for FY23 is expected at 2.5% of GDP, over double the 1.2% of GDP in the preceding year.

The forecasts in the poll ranged from 1.6% to 2.9% for FY24 and 2.1-3.3% for the current fiscal. While exports are likely to falter, imports will also weaken, and that will help narrow the trade deficit. The strong momentum in services sector export and remittances is likely to continue next fiscal year as anticipated by economists. The merchandise trade deficit eased in the past couple of months due to falling commodity prices after remaining elevated for the most of FY23. Services have provided a cushion to the trade balance in the last year. The $132.94 billion services trade surplus for April-February FY23 had helped keep the overall trade deficit contained despite a 43% jump in the merchandise trade deficit to $247.5 billion during April-February FY23 from $172.5 billion in the previous year.



Prepared by Deblina Patra, AGM
Editorial Team: Dr. K.C. Badatya (CGM), Dr. Vinod Kumar (GM) and Smt. Balwinder Kaur (DGM)
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Inflation Outlook

Rural demand to pick up with commodity inflation cooling

At a time when there are fears that an anticipated rainfall deficit due to the effect of El Nino might derail recovery in the rural markets, commodity price inflation is cooling off and that rural demand should start picking up with an improvement of farmers' incomes on the back of better realisations.

It is to be noted that the rural demand, particularly for FMCGs, remained stressed during the December quarter due to general inflationary pressure and rainfall deficit in some states. This can be avoided with green shoots of recovery in the rural economy on the back of a good harvest season, better realisation and expected government spending.

Farm income accounts for nearly a third of the total rural economy and rural wages another one-third, while one-third relates to other incomes. Rural wages are already up as per the data available, and the investment in infrastructure should provide impetus to the overall growth in rural economy.

Interest Rate Outlook

RBI likely to end its tightening cycle in April

With retail inflation remaining above the comfort level of 6% and following US Fed decision, the RBI too may go for a 25 bps hike in the bi-monthly monetary policy in April (3^{rd},5^{th} ,6^{th}) 2023. RBI has been raising benchmark rates since May 2022 to contain inflation which has been largely driven by external factors, especially the disruption of the global supply chain due to Russia-Ukraine war.

Inflation in Asia's third-largest economy was above the central bank's upper tolerance limit of 6% for the first 10 months of 2022 followed by two months of decline on softening food prices. While concerns on sticky core inflation is justified, it may be noted that average core inflation is at 5.8% over the last decade and it is almost unlikely that core inflation could decline materially to 5.5% and below as post pandemic shifts in expenditure on health and education and the sticky component of transport inflation with fuel prices staying at elevated levels will act as the constraint. By this logic, RBI may then have to go for more rounds of rate hikes.

US Treasury yields rise as bank fear eases

US bond yields rose this week as a US regulator back deal by First Citizens Bancshares to buy failed Silicon Valley Bank soothed wider worries about problems in the sector. The concerns, however, have not completely gone away as stress among small banks could hit small businesses hardest.

In addition to concerns about any contagion caused by developed market banking woes, markets have also been jostled by wild shifts in expectations about what central banks in the United States and Europe might do next.

Indian government bond yields are likely rise tracking similar move in U.S. peers, while a heavy debt sale from states will further weigh in the last week of the current financial year. Even with a hint of some resolution to banking crises, there is sell off in U.S. treasuries, and Indian bonds are also expected to see some impact.

U.S. yields rose with the 10-year yield rising above 3.50% on greater optimism that stress in the banking sector will be contained, and weaker demand for auction, which also pushed the two-year yield above 4%.

Indian states aim to raise at least ₹427.14 billion ($5.20 billion) through the sale of bonds later this week, which is the highest ever by states for a single auction, according to traders. States have raised ₹7.17 trillion through the sale of bonds in the current financial year, while the central government has raised ₹14.21 trillion.

The Indian government's borrowing for April-September 2023 is likely to be between 55% and 58% of its gross annual borrowing target of ₹15.43 trillion, government officials told Reuters earlier this month, and the government is likely to announce the schedule by end of this week. The borrowing calendar would be followed by the Reserve Bank of India's monetary policy decision on April 6, with broad expectations of 25 basis point (bps) hike.

Weekly Benchmark Bond Yield Movement (%)

Date	20-Mar	21-Mar	22-Mar	23-Mar	24-Mar
USA 10 years	3.48	3.60	3.45	3.41	3.37
India 10 years	7.33	7.35	7.35	7.34	7.31
India 5 years	7.20	7.23	7.23	7.21	7.16
India 3 months	6.81	6.78	6.78	6.78	6.76

Source: CMIE, worldgovernmentbonds.com

We expect benchmark 10-Yr bond to trade in the range of 7.29%-7.31% during the week (27 March 2023-31 March 2023).

The RBI has announced the weekly auction of Treasury bills and state government bonds or State Development Loans (SDLs) maturing on different dates. In this week's auction, the indicative yields for treasury bills are 6.71%, 7.20% and 7.22% for three months, six months, and 364 days, respectively. For state government bonds, Jammu and Kashmir (J&K), Haryana, Sikkim, Uttarakhand, Himachal Pradesh, Rajasthan, and West Bengal have some of the highest yields, at more than 7.7% maturing in different durations. The indicative yield is more than 7% for all state government bonds, with a minimum duration of five years and a maximum of 30 years.