NABARD

DEAR
ECO WATCH
Issue No. 105/ 26 June – 16 July 2023

1. Global Economic Outlook

US inflation falls to months low. US inflation in June 2023 fell to its slowest rate since March 2021, and has come as the latest sign that the Federal Reserve's programme of interest rate hikes is bearing fruit. CPI in USA dropped more than expected from an annual 4% to 3%, with a smaller dip in the "core" measure which strips out volatile food and energy costs from 5.3% to 4.8%.

This positive development has come in the backdrop of bleak unemployment data. Non-farm payrolls increased by 2,09,000 jobs in June 2023, the smallest gain since December 2020. The data for May 2023 was revised lower to show payrolls rising 3,06,000 instead of 3,39,0 00. The labour market in USA is still tight, and this along with positive inflation data dampens the expectation of more rate hikes by Federal Reserve in the forthcoming Fed meet.

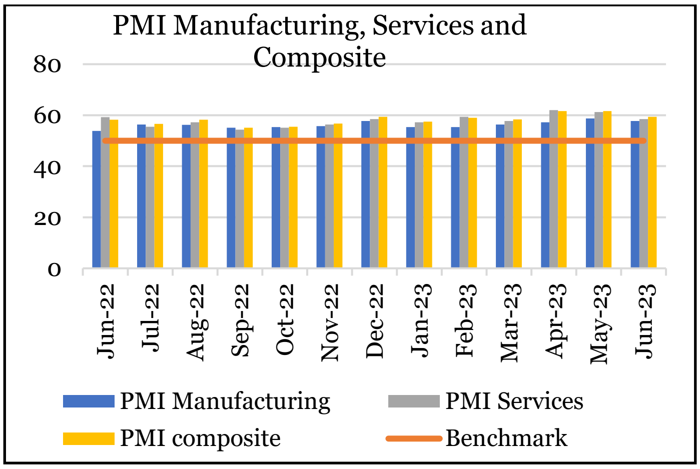
Consumer sentiment near two-year high in US. With the inflation environment improving considerably, Americans are growing more optimistic about the economic outlook. Consumer sentiment vaulted to the highest level in nearly two years in July 2023. The disinflationary trend has raised cautious optimism that the economy could avoid a recession this year. Economists also believe an expected interest rate hike from the Federal Reserve later this month would be the last in the U.S. central bank's fastest monetary policy tightening cycle since the 1980s.

China's economy struggles to gain traction. Monthly data for industrial production, retail sales and fixed investment in China are expected to show a marked slowdown in June 2023. Retail sales growth, in particular, slid to 3.3% from 12.7% in May 2023. Economists are focusing on the latter figures to get a fuller picture of China's recovery. The signs so far have been disappointing: manufacturing activity is contracting, deflation is looming, export demand is falling, and recent holiday spending was subdued.

2. Domestic Economic Outlook

Frail global demand may challenge FY2024 growth outlook: Finance Ministry. The Finance Ministry in its latest Annual Economic Review report for the month of May 2023 added that the factors that can constrain the pace of growth include "escalation of geopolitical stress, enhanced volatility in global financial systems, sharp price correction in global stock markets, high magnitude of El-Nino impact, and modest trade activity and FDI inflows owing to frail global demand". If these developments deepen and dampen growth in the subsequent quarters, the external sector, may challenge India's growth outlook for FY2024.

India's Manufacturing PMI in June marks second-fastest expansion of the year. In June 2023, India's manufacturing sector demonstrated significant growth, positioning itself as the second-fastest expansion of the year, albeit at a slightly slower pace compared to May 2023. The S&P Global India services PMI fell to 58.5 in June 2023 from 61.2 in May 2023. New orders and output rose sharply despite the sub-indexes easing moderately from May 2023, driven by both domestic and international demand. Foreign demand grew for the 15th straight month.



Source: CMIE

Industrial production rises in May 2023. India's industrial production rose to 5.2% in May 2023 from 4.5% in April 2023, mainly due to good performance by the manufacturing and mining sectors. The factory output growth measured in terms of the Index of Industrial Production (IIP) stood at 19.7% in May 2022, mainly due to a lower base effect.

Gap in kharif sowing narrows down to 4%. However, paddy area deficit now 10%. Because of 'active' monsoon rains over northwest, central and southern parts of the country in the last one week, deficiency in paddy transplanting has declined to

Prepared by Neha Gupta, Manager
Editorial Team: Dr. K.C. Badatya (CGM), Dr. Vinod Kumar (GM) and Smt. Balwinder Kaur (DGM)
Published by Department of Economic Analysis and Research (DEAR), NABARD Head Office, Mumbai

9.8% from 23.9% a week back. However, key paddy growing states – Jharkhand (-46%), Odisha (-28%), West Bengal (-13%), Bihar (-33%) and Telangana (-27%) are still reporting deficient rainfall. According to agriculture ministry data, 53.6 million ha (MH) have been covered under the kharif crops by 14th July 2023, a decline of 4.2% compared to the previous year. As on 7th July 2023, the gap was 8.6%.

Rural recovery subdued. Real wages shrink for 16th month. The rural recovery may be some time away given real wages in the hinterland contracted for 16 straight months to March. High inflation has hurt rural incomes crimping purchasing power. Moreover, unemployment seems to be relatively high with the demand for work under the MGNREGS (Mahatma Gandhi National Rural Employment Guarantee Scheme) increasing in June 2023. About 44.23 million individuals opted for work in June 2023, up 2.3% year-on-year, preliminary data from the rural development ministry shows. Demand for these jobs had also risen in May 2023.

CPI inflation rose higher-than-estimates on the back of food inflation. Measured by the Consumer Price Index (CPI), inflation surged to 4.81% in June 2023 after hitting a 25-month low of 4.25% in May 2023 on an annual basis. CPI was pushed higher than expected due to a less supportive base and the onset of a surge in vegetable prices.

While food and beverages and miscellaneous items drove the sequential uptick in the YoY CPI inflation in June 2023, clothing and footwear, housing, and fuel and light recorded a decline. The inflation levels for food & beverage and fuel segments stood at 4.63% and 3.92%, respectively. For cereals, the inflation rate increased marginally to 12.71 % from 12.65% in May 2023.

Despite the high base, cereals recorded an inflation of 12.7% in June 2023, breaking a three-month streak of moderating prices. Spices recorded a sharp 19.2% inflation in June, while pulses prices rose 10.5%, milk by 8.6% and eggs by 7%.

The "tomato shock" would mean vegetable price inflation would resurge sharply this month, while cereals and pulses will also remain under pressure.

3. Interest Rate Outlook

Federal Reserve is closing in on end of rate hiking cycle. The Federal Reserve will likely need to raise interest rates further to bring down inflation (as inflation is still higher than Fed's target), but the end to its current monetary policy tightening cycle is getting close. The Fed has raised interest rates by 5 percentage points since March 2022 to bring down the highest U.S. inflation in four decades.

It is to be noted that Fed policymakers opted last month to forego a rate increase to give themselves time to assess the still-developing effects of the previous hikes in borrowing costs, even as most also expects at least two more increases by the end of 2023.

India bond yields track US 10-yr yield lower; inflation data in focus. Prompting on fall in inflation in USA and expectation of end of rate hike cycle, Indian government bond yields slumped as the 10-year U.S. yield fell below the key 4% level.

Benchmark Bond Yield Movement (%)

Date	26 June	30 June	3 July	7 July	11 July	14 July
USA 10 yr	3.71	3.83	3.86	4.06	3.97	3.83
Ind 10 yr	7.07	7.12	7.12	7.16	7.09	7.09
Ind 5 yr	7.02	7.08	7.09	7.13	7.08	7.07
Ind 3 M	6.75	6.71	6.73	6.72	6.71	6.71

Source: worldgovernmentbonds.com, CMIE

Indian government 10-year bond yield has eased in past few days (post 12th July) owing to favourable US inflation data. However, Indian inflation remains a worry for Indian yields warranting a longer higher interest rate cycle in India.

Yield for the period (17-21 July) is expected to remain range bound (7.00%-7.08%), as there are no major cues expected for the market during this period. However, US treasury movement to guide the movement of Indian government bond yield.