NABARD

DEAR
ECO WATCH
Issue 36/ 24 – 30 Jan 2022

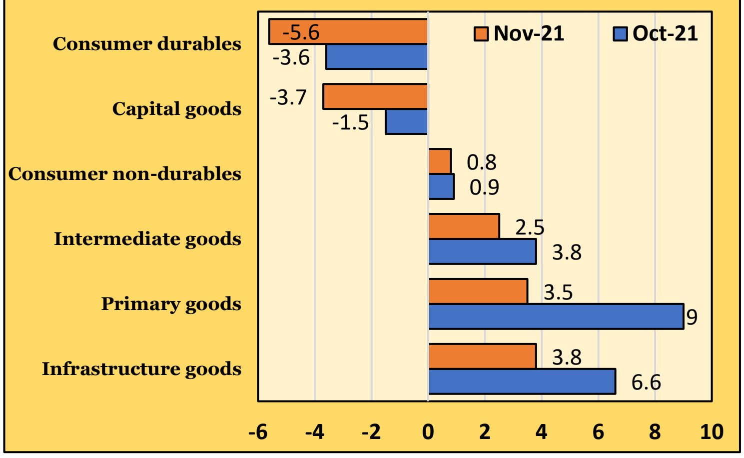
Global Economic Outlook

- **U.S. corporate bond spreads widen:** Investors pulled out of U.S. corporate bonds in tandem with weakness across the U.S. major stock indexes after the Fed signalled in a policy update this week that an interest rate hike could be coming soon and that it would push forward with policy tightening measures to fight unabated inflation.
- **Fed guidance on rates the following lift-off may remain foggy:** The U.S. Federal Reserve interest rate hike after its meeting this week but the pace of what follows may remain clouded as officials wait to see how inflation, the coronavirus pandemic, and the economy overall react in coming months.
- **Weaker U.S consumer spending, rising inflation pose dilemma for Fed:** U.S. consumer spending fell in December, suggesting the economy lost speed heading into the new year amid snarled supply chains and raging COVID-19 infections, while annual inflation increased at a pace last seen nearly 40 years ago.
- Wage inflation is also building up amid an acute shortage of workers. Private industry wages rose strongly in the fourth quarter, posting their largest annual gain since the mid-1980s. Mounting inflation pressures could force the Federal Reserve to aggressively hike interest rates, stifling growth.

Domestic Outlook

- Industrial recovery falters: The recovery in industrial production following the second wave of Covid-19 weakened in November 2021.
- Industrial production began to recover from the shock of the second Covid-19 wave in the September 2021 quarter. This was reflected in the index of industrial production (IIP), which rose above the corresponding pre-Covid level during this period.
- October 2021 continued to witness rapid improvement. But in November 2021, the index dropped below its corresponding pre-Covid level once again. Early data for December suggests that the recovery is likely to remain interrupted.
- The deceleration in industrial activity is likely to continue in December 2021. The Purchasing Managers' Index (PMI) for manufacturing fell to 55.5 in December 2021. This was 1.6 per cent lower than the corresponding year-ago level.

Industrial deceleration across sectors



- Fertiliser sales and electricity generation were among the only fast-frequency indicators that showed signs of improvement in December 2021.
- Fertiliser sales rose by 5.3% y-o-y in December 2021, compared to a 3.2% increase registered in the previous month.
- Conventional electricity generation also grew by 2.5% y-o-y in December 2021, up from 1.8% in November 2021. But it stagnated in the first 22 days of January 2022, remaining at the same level as seen in the corresponding period last year.
- **India's Q3 manufacturing outlook improves, cost of doing biz remains cause for concern:** The outlook for India's manufacturing sector seems to have improved in the October-December 2021 quarter even as the cost of doing business remains a cause for concern and hiring prospects remain subdued, according to a FICCI survey.
- An average interest rate paid by the manufacturers has reduced slightly to 8.4 per cent per annum as against 8.7 per cent during last quarter and the highest rate remains as high as 15 per cent. It highlights that cuts in repo rate in the last few months by RBI have not led to a proportional reduction in the lending rate.
- Extra Push - Capex outlay in FY23 pegged at ₹10.5 lakh crore: Capital expenditure by the Centre, PSEs owned by it and entities like NHAI and the Railways will likely be estimated at around ₹10.5 lakh crore in the next financial year, up about 9% over such expenditure estimated (BE) in the current financial year.
- Most of this extra central public capex, however, will likely be routed via Budget. The Centre via Budget may invest 18% more in FY23 than in FY22 at around ₹6.53 lakh crore to retain its budgetary capex at 2.5% of GDP as in FY22 (assuming 12.5% nominal GDP

Prepared by M. Dileep Chandra (AM)
Editorial team: Dr. K J S Satyasai (CGM), Dr. Vinod Kumar (GM), Smt. Balwinder Kaur (DGM)
Published by Department of Economic Analysis and Research (DEAR), NABARD Head Office, Mumbai

growth for next year over the advance estimate for the current year).

- The Centre is keen to retain the Budget capex target at 2.5% of GDP in the next financial year to give a boost to investment-led economic growth revival amid continued uncertainties due to Covid-19 pandemic.
- Gross fixed capital formation (GFCF) is seen growing 14.9% in FY22 compared with FY21 and up just 2.6% over the pre-pandemic year of FY20, according to the first advance estimates of national income.

Interest rate outlook

- **Asian markets performance mixed as traders weigh Fed's tighter policy; Apple earnings boost US Futures:** Asian stocks were mixed as traders weighed the Federal Reserve's pivot to tighter monetary policy, while U.S. equity futures climbed after strong Apple Inc. earnings bolstered sentiment.
- Japanese shares rose but Hong Kong and China retreated. State-run Chinese media tried to talk up equities, arguing they offer long-term potential following a slump. Contracts on the tech-heavy Nasdaq 100 outperformed after Apple Inc. rallied in extended trading on record sales.
- Treasuries were steady and the yield curve flatter. The dollar held gains, in part on solid U.S. growth data that reinforced expectations for Fed tightening to fight inflation. Oil headed for a sixth weekly advance, but gold nursed losses.
- **Indian bond yields fall after debt switch announcement, budget eyed:** Indian bond yields edged lower following the completion of a debt switch operation by the government and the central bank, which helped ease market borrowing concerns a day ahead of the budget.
- Of the total bonds being switched, 636.5 billion rupees worth were due to mature in the next financial year starting April.
- The debt switch reduces pressure on market borrowing as redemptions will now be much lesser, so in a way gives the government the option of borrowing less from the market.
- The benchmark 10-year bond yield was trading at 6.72%, down 3 basis points.
- **India to launch sovereign green bonds:** India will issue sovereign green bonds for funding green infrastructure, Finance Minister said in her Budget speech. Green bonds are debt instruments that differ from conventional fixed-income securities only in that the issuer pledges to use the proceeds to finance projects that are meant to have positive environmental or climate effects. Since its debut in 2007, the green bond market has been growing steadfastly.
- The money will be used for projects that will help reduce the carbon intensity of the economy. Sovereign green bonds will be part of the government's borrowing programme in FY23.
- The move is a big boost especially with India making aggressive strides towards a low-carbon economy with ambitious targets like achieving a robust 175 gigawatt of renewable energy capacity by the year 2022. Such targets require massive funding.
- **Union Budget May Have Spooked the Bond Markets:** Union Budget has received praise from several quarters for the focus on capital expenditure to boost the economy while introducing longer-term measures to restructure the economy.
- However, despite a positive response from the stock markets, the 10-year bond yield jumped up by 2.17 per cent. The change in yields has been quite sharp as compared to previous trading sessions.
- Since bond yields have an inverse relationship with bond prices, a higher bond yield implies that investors have been exiting their bond positions.
- Bond investors are spooked by the government's focus on increasing spending without any significant additions to its revenue. The difference between government revenues and government expenditures could either be a deficit or a surplus.
- With the government ramping up its expenses to bring back growth, but its revenues not increasing proportionately, the fiscal deficit is expected to widen.

Table 1: Weekly Benchmark Bond Yield Movement (%)

Date	24/01	25/01	26/01	27/01	28/01
USA 10 year	1.80	1.78	1.88	1.81	1.79
India 10 year	6.66	6.66	-	6.75	6.77
India 5 Year	6.07	6.05	-	6.12	6.12
India 3 Month	3.69	3.69	-	3.72	3.71

- We expect the 10-year benchmark bond to trade in the range of 6.75-6.85% in the week of 24-28th January 2021.