A Quarter and Four of Indian Economy

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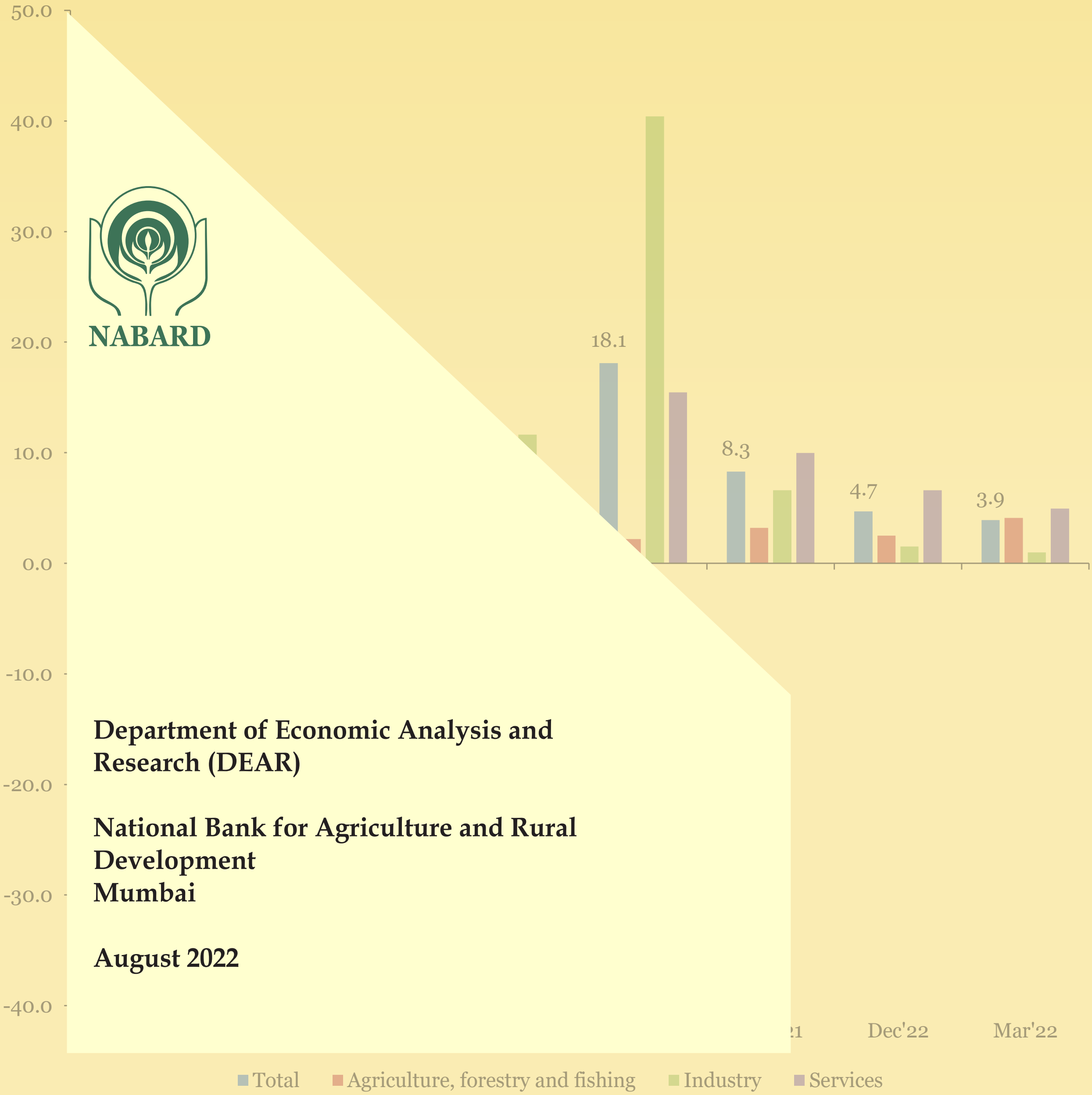

Department of Economic Analysis and Research (DEAR)

National Bank for Agriculture and Rural Development
Mumbai

August 2022

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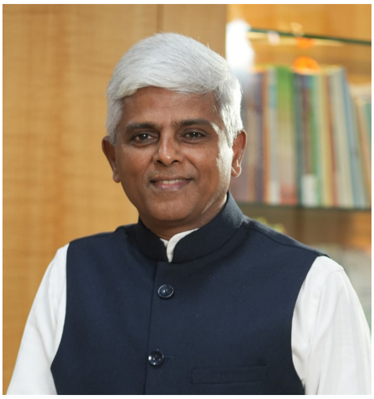
DMD's Message



For past two years, humanity has been going through unprecedented times with uncertainty still surrounding the COVID-19 and its prolonged impact posing a threat to the world exacerbated by current geo-political situation. In the interconnected world of the day, this has posed a challenge to India's roadmap for economic recovery as well.

Policy making in such times requires more informed approach with real time monitoring of the situation and planning for the unforeseen. To keep up with the recent happenings of the world and domestic economy, DEAR has come out with a new booklet named 'Four and a Quarter'. This booklet gives a quick view of what happened during last 5 quarters in Indian economy.

I am glad to underscore that the booklet is the culmination of weekly and monthly review of economy done by young economists of Department of Economic Analysis and Research (DEAR). I know any book on Indian economy during the present volatile times can turn stale the very next second. However, such overview looking back is absolute necessity for gaining insight and perspective amidst chaos.

I congratulate DEAR and its officers for bringing out periodical economy updates and the present booklet.

P. V. S. Suryakumar
02 August 2022

Preface

We have been passing through a very challenging period commencing from COVID-19 outbreak in the fourth quarter of FY 2020 followed by lockdown, pandemic induced monetary and fiscal policy measures, geopolitical conflicts and their impact on world economies, pangs of withdrawal of pandemic-induced monetary and fiscal stance, and so on. Indian economy has gone through all these travails and treaded the path of recovery to reach pre-covid levels for most parameters though certain sectors are yet to fully rebound. While agriculture has grown at the rate of 3.3% in FY2021 and 3.0% in FY2022, other sectors declined in the first year and recovered during the second.

While the four quarters of FY2022 have passed in a near normal way (read new normal) with Reserve Bank of India (RBI) continuing its stance and maintaining its policy rates at the same level despite market expectations otherwise, and Government of India (GOI) avowing its commitment to fiscal discipline, upward pressures on inflation continuing throughout, first quarter of FY2023 has seen RBI in action. That too surprising the markets with a 40 basis points (bps) hike in policy rate during the off-cycle monetary policy committee (MPC) meeting in May 2022 while also hinting further hike during regular MPC meeting during June 2022 when the actual hike was 50 bps. Markets kept on discussing if RBI is behind the curve or ahead, while the fact remained that having seen the possibility of inflation breaching the 6% mark beyond April 2022, RBI has changed its stand and the policy rate. The markets started factoring in the change in the RBI's stance and priority and also the fact that we are going through the rising interest rate regime which would increase borrowing costs as well. There are other developments in the external economy such as rate hikes in U.S. and other major economies, falling Rupee and increase in crude prices. These resulted in capital flight from India, widening current account deficit, and added to domestic inflationary pressures.

Thanks to Shri Shaji K V, DMD, who exhorted on us to give weekly and monthly economy reviews, we have been following Indian economy over last two years rather closely and publishing *EcoWatch* (weekly) and *EcoThink* (monthly).

Browsing these old bulletins recently, we relived several turns and twists of economy, post-pandemic prompting us to give an annual perspective of the Indian economy as it unfolded. Thus, this booklet is based on our weekly and monthly monitoring of the economy. We thank Dr.G.R. Chintala, ex-Chairman and Shri P V S Surya Kumar, DMD for their constant support and encouragement to do more and different.

Thanks are due to Smt Smita Mohanty, General Manager, CPD for taking out her precious time to read the booklet and suggesting improvements. We also thank Dr. Vinod Kumar, GM, DEAR for his suggestions and DGMs, Dr. Ashutosh Kumar and Smt Balwinder Kaur for their contributions to the monitoring Indian economy.

Our young economists in the Department for preparing informative periodical bulletins and senior officers for guiding them deserve lavish appreciation. We also thank NABARD officers who have been encouraging us through their generous appreciation. Feedback and suggestions are most welcome.

K J S Satyasai
02 August 2022

In this booklet....

List of Figures

Quarter and Four of Indian Economy

RBI surprised the market with its 40-bps rate hike in an off-cycle Monetary Policy Committee meeting on 04 May 2022 changing its policy stance and further hiking the rate in the regular June 2022 meeting. Thus, the quarter following a COVID-stuck financial year (FY2022) has changed the policy discourse. In this booklet, we chart out the Indian economy as we have seen week-by-week and month-by-month over the last five quarters.

The Fifth Quarter

In the wake of Ukraine Russian tensions, sanctions have worsened the inflation scenario across the world. Inflation in U.S. shot from 8.3% in April 2022 to 9.1% in June 2022. Similar situation exists in almost all the countries with inflation sky rocketing to 9.4% in the month of June 2022 in U.K. This has finally culminated in increase in interest rate hikes in many countries like U.S., UK, India and Eurozone etc. The nascent recovery of the world economy is now threatened by geopolitical tensions, inflation and monetary tightening. U.S. GDP already fell by 1.6% in the first quarter of 2022.

Inflation in India breached RBI's comfort band of 4/±2 in January 2022, touching 7.79% in the month of April 2022. Elevated inflation and monetary tightening by other central banks prompted RBI to increase the Repo rate. While the economic impact of geopolitical tensions still are mild with most high frequency indicators of demand in green zone, Indian economy might be impacted in coming months due to combined force of monetary and geo political factors.

The Four Quarters of FY2022

Powered by the vaccination drive and large monetary and fiscal policy support, global economy began to recover from the ravages of COVID-19 pandemic, as we entered into a new year 2021. Though, this had its palpable impact on the commodity prices especially of crude and base metals, leading to exacerbating the inflationary pressures created by supply constraints. In the first half of 2022, Delta variant of COVID-19 along with sticky inflation led to uneven recovery around the globe.

Economies across the world had regained some traction after the shock of delta variant in the first half of 2021. However, global economic prospects deteriorated markedly in the wake of new variant of COVID- Omicron, Ukraine and Russia tensions, its economic and financial ramifications and resultant sanctions in the second half of the 2021 and initial months of 2022. In July 2022 edition of World Economic Outlook, IMF expected the shock of the war to interact with the monetary tightening, financial market volatility, pandemic, and unequal vaccine access to cause global growth to decline to 3.2% in 2022 from 6.1% in 2021.

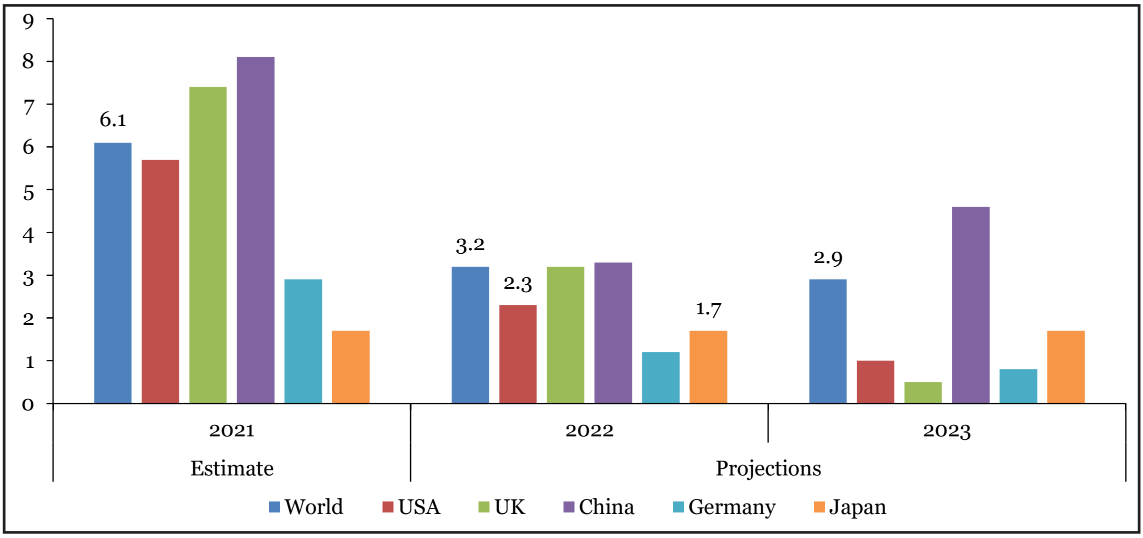
For India, the FY 2022 commenced on a positive note with favourable shifts in the country's macroeconomic landscape pointing towards an economic recovery and inflation taming back to the RBI's comfort band. This came as a sigh of relief for the people after a rather difficult FY 2021 which changed the world forever. India had turned this crisis into an opportunity and adopted the mantra of *Aatmanirbharta* which become the cornerstone of our strategy to put Indian economy back on track and the country on higher growth trajectory in the last quarter of the FY 2021 and FY 2022.

The FY2022 was a rather roller coaster ride with the devastating second wave of COVID-19 causing havoc in April 2021 with most high frequency indicators turning red in that month which waned away by the month of June 2021. The impact of Omicron variant in January 2022 turned out to be mild as showcased by two-wheeler sales, tractor sales data though GST e waybill generation did slowdown. Geopolitical tensions, inflation and monetary tightening across the world have turned the outlook for the FY 2023 uncertain.

The Global Factor

After a year of uncertainty surrounding the COVID-19 outbreak and the way out of this health emergency, vaccination drive had brightened the recovery prospects across the world. This aided the expansion of world output by 5.9% in the year 2021 after contracting 3.1% in the year 2020 (Figure 1).

Figure 1: Growth in Output of World Economy (%)



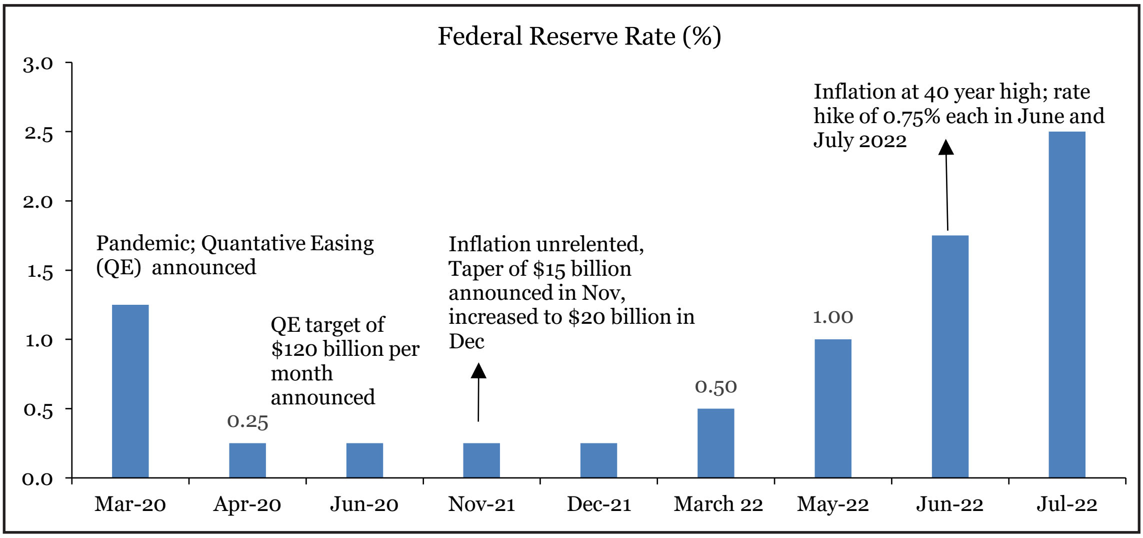
Source: IMF World Economic Outlook, July 2022

Outbreak of delta variant have resulted in longer-than-expected supply disruptions, feeding inflation in many countries. This was exacerbated by demand bounce back further straining the supply chain and leading to higher inflation across the globe. Inflation in USA had breached the target level of 2% through the year of 2021 and 2022. Situation is pretty much similar in Euro area and other countries in the world.

Inflation in U.S. shot up to 4.2% in the month of April 2021, which was the largest gain since September 2008. This proved to be the beginning of elevated inflation not just in USA but most countries of the world, leading to a dilemma amongst the policy makers regarding the nature of inflation (transitory or not) and timing of reversal of expansionary policies across the globe.

The Omicron outbreak and ensuing geopolitical tension have further worsened the inflationary pressures. U.S. inflation touched 9.1% in June 2022 from 5.4% in July 2021. Policy makers across the globe had undertaken expansive policy to aid economic recovery, however, persistent inflationary pressures have compelled them to prepone the policy normalisation. After keeping its benchmark interest rate anchored near zero since the beginning of the COVID pandemic, U.S.'s Federal Reserve raised its rates by 25 basis points in the month of March 2022, followed by 50 basis points in May 2022 and 75 basis points in June 2022 (Figure 2).

Figure 2: Trend in Federal Reserve (U.S.A's Central Bank) Policy and Rate



Source: Reuters

Central banks across the world have started to hike interest rates to tame inflation including Bank of England which has hiked rates for 5 consecutive times since December 2021. The shock of the war along with the monetary tightening, financial market volatility, pandemic, and unequal vaccine access will have palpable impact on world economy.

Interest rate hike in USA has been causing the dollar to appreciate against all currencies except Russian Rouble. Dollar Index breached the level of 100 in the month of May 2022 and have been increasing steadily since then. This increase itself will export inflation to other countries through their currency depreciation. Rate hike is expected to slow down the economic recovery and has fanned the fears of stagflation across the globe. These global factors will continue to impact Indian economy's prospects in the coming months.

The Great Indian Rebound

Indian economy bounced back in the FY 2022 with GVA at basic prices increasing by 8.1% in comparison to the contraction of 4.8% in the FY 2021. Indian economy recovered past its pre-pandemic level. This has been majorly on the back of concerted efforts on the part of monetary (Repo rate lowered from 5.5% to 4%) and fiscal policy makers with liquidity enhancement and AatmaNirbhar reforms and package playing the major role.

Compared to expansive fiscal measures around the world, India's policy response to the pandemic and the lockdown was relatively light on fiscal measures. Government of India announced ₹20 lakh crore-package post-first lockdown in 2020 to revive the economy and the Government's policy response primarily focused on directed credit to small businesses and individuals and a boost to capital spending. It is essential to understand that in an ordinary recession, the role of policy is to step up aggregate demand and raise output consistent with full employment of resources. The policy response during a pandemic induced recession depends on the public healthcare situation. With uncertainty due to the virus, large cash transfers may not translate into higher spending. Even if they do, they can be inflationary due to supply chain disruptions.

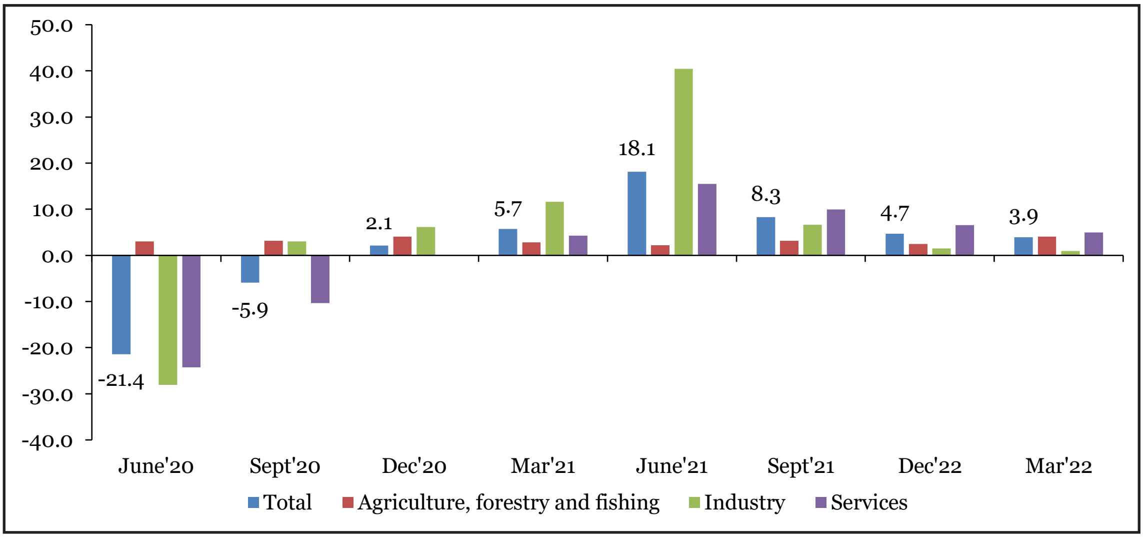
The 'AatmaNirbharBharat' package catered to various sections including migrant workers, agriculture sector, micro, small and medium enterprises and street vendors. It involved frontloading of transfers to farmers and distribution of free foodgrains. Subsequent measures focussed on boosting India's manufacturing sector through a series of Production-Linked Incentive schemes. This has been the backbone of Indian economic recovery.

As we stepped into a new FY 2022, we witnessed the outbreak of the second wave of the COVID-19 in April 2021 and its devastating impact on lives and livelihood of millions. But this time, localised lockdowns and higher pace of vaccination in the country helped Indian economy to keep up the growth momentum picked up in the last quarter of FY 2021 and GVA at basic prices increased by 18.1% in the first quarter of the FY 2022. With waning away of the impact of deadly Delta variant induced second wave, Indian economy grew strength by strength in the second and third quarter of FY 2022 (Figure 3).

The highly transmissible Omicron variant led to a sudden upsurge in the daily cases of COVID in the last quarter of FY 2022, however, the mild nature of the disease and its sudden downturn helped economy not to be affected adversely.

Turning to the impact of the war, the Indian economy has remained resilient so far on the strength of its own macro-fundamentals. Although GVA growth slowed from 4.7% in October-December 2021 to 3.9% in January-March 2022 - taking the annual growth in FY 2022 to 8.7% from 8.9% in the NSO's second advance estimates - more recent high-frequency indicators of economic activity suggest that momentum has picked up in the first quarter of FY 2023 in a broad-based manner.

Figure 3: Growth Trends of Gross Value Added (GVA) at Constant Prices (%) by Economic Activity



Source: CMIE.

The high frequency data very well corroborates our reading of the quarterly GVA data and also provides more micro-picture of the economy's recovery and the impact of second wave and third wave of the COVID-19.

As we can see a fall in many indicators like Domestic tractor sales (-25.5%), GST e way bill (-17.5%), Two-wheeler sales (-33.5%) and other indicators in the month of April 2021 which witnessed the Delta variant induced second wave in the country. This impact very much passed away by the month of June 2022 which is very well recorded in the positive high frequency data indicators (Figure 4).

Omicron variant was not as deadly as the Delta variant and did not impact the economy as much the second wave (Delta induced). This is also well documented in the passenger car sales (12.2%), two-wheeler sales (12.2%) and other such indicators in the month of January 2022.

Figure 4: High Frequency Indicators Change (Month-on-Month)(%)

	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22
Passenger Cars sale	1.2	-10.1	-70.6	192.2	7.2	-16.6	-40.8	61.6	-2.8	11.9	12.2	5.4	3.3	-18.24	9.93	6.68
Two wheeler sales	4.9	-33.5	-64.5	199.3	18.8	6.2	14.8	0.9	-31.9	-4.2	12.2	-8	14.1	-3	9.1	2.87
Domestic tractor sales	12.5	-25.5	-12.3	98.5	-40.9	-17.6	72.1	25	-44.8	-30.3	18.8	-1.5	40.3	22.4	-8.14	15.30
GST E way Bill	11.6	-17.5	-31.9	36.8	17.3	2.7	3.1	8.2	-16.8	17.1	-3.9	0.4	13	-3.7	-2.16	1.17
Finished steel	-1.7	-8.5	-8.1	3.6	-1.7	-0.5	2.7	6.9	-5.4	10	8.7	-11	7.41	-6.6	2.15	-0.64
Total GST Collection	9.5	14.1	-27.4	-9.6	25.4	-3.8	4.5	11.2	1.1	-1.3	6.6	-3.9	6.8	17.9	-15.9	2.65
MGNREGA person days gener ated	-16.9	33.1	9.1	21.6	-16	-26.7	0.1	-20.3	3.1	30.2	-9.4	0.1	-9.1	16.3	52.2	-4.02

Source: CMIE

The tense geopolitical situation in the month of March 2022 also did not have any impact as most indicators were in green especially the domestic tractor sales which grew by almost 40% in March 2022. However, we did see fall in e way generation, plateauing GST collection in the month of May and June 2022. Domestic sales of Two-wheeler vehicles have crossed pre pandemic levels and domestic tractor sales remains robust on account of good returns from Rabi crops.

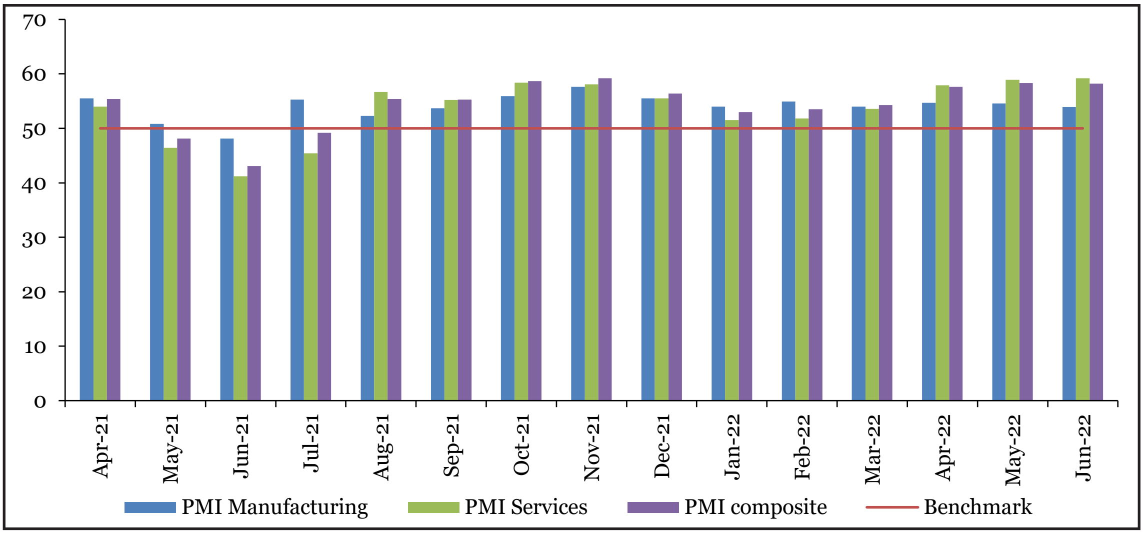
Demand for work under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) eased on a y-o-y basis in June 2022, reflecting the beginning of Kharif crop sowing in rural parts of the country and the consequent increase in demand for farm labour.

The Purchasing Managers' Index (PMI) of manufacturing sector has remained positive with reading remaining above the benchmark of 50 for 11 months in the FY 2021-22 (Figure 5). The localised nature of lockdown in the wake of COVID-19 in the months of April and May 2021 is also evident in PMI recorded above the mark of 50 on these months. The month of January 2022 also remained in the positive territory.

However, the touch sensitive service sector was left reeling under impact of localised lockdowns in the states in the wake of second wave and PMI services shrank in the months of May 2021- July 2021.

PMI data also corroborates the low impact of current geo political tension, with PMI services accelerating to 59.2 in June from 58.9 in May 2022, expanding at the fastest pace in more than 11 years.

Figure 5: Indian Manufacturing, Services and Composite PMI



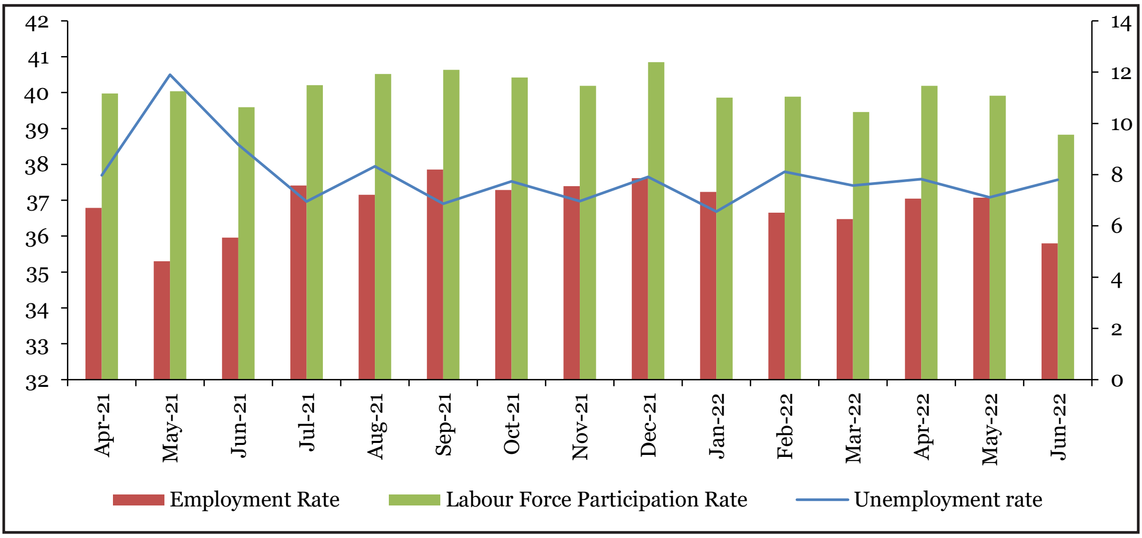
Source: CMIE

Indian unemployment rate which sky rocketed to 23.5% in the month of March 2021 due to the COVID-19 and resultant lockdown in the country came down to single digit at the beginning of the FY 2022. Though the second wave of the COVID-19 in the months of April and May 2021 witnessed an increase in unemployment rate, it eventually fell down to pre second wave level by the month of July 2021. It remained around 6-7% for the rest of FY 2022 showcasing the recovery and gradual opening up of the economy especially the touch sensitive services sector.

Labour Force Participation Rate (LFPR) is major indicator of generation of employment in the economy. A fall in the same points towards low employment generation forcing people to drop out of labour force. This fell below 40 since

January 2022. This points towards uneven recovery post pandemic. Since then LFPR has remained below 40 and touched the a year low level in June 2022. This is an indicator of higher level of unemployment than captured in the unemployment data.

Figure 6: CMIE Unemployment Rate, Labour Force Participation Rate and Employment Rate

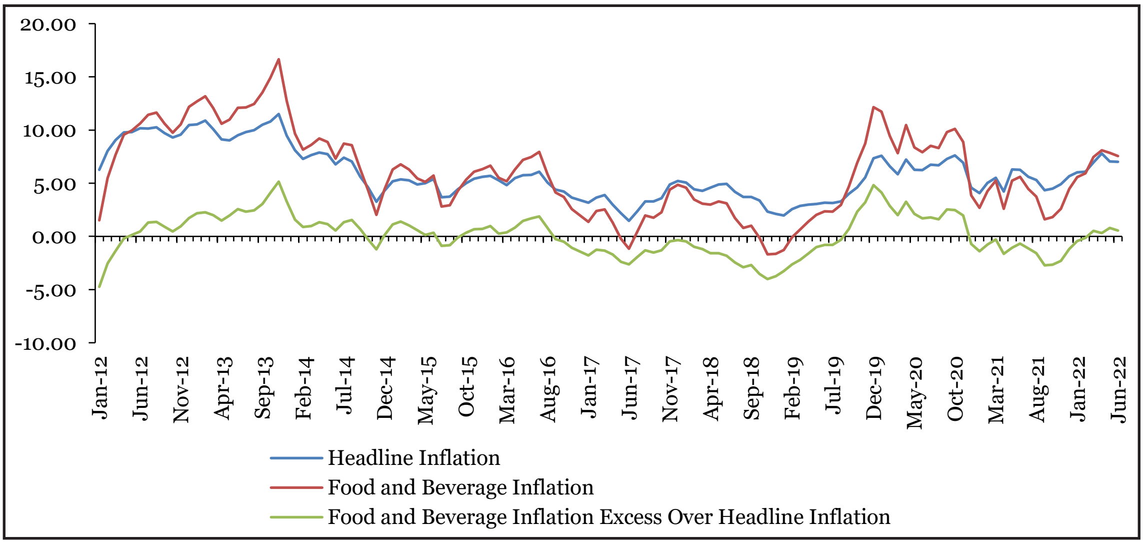


Trends in Inflation-Expectations and Realities

Inflation in India which breached the level of 6% for the larger part of the year in FY 2021 remained range bound in half of FY 2022. Inflation remained elevated during 2021, across developing and developed countries, reflecting pandemic related supply and logistics disruptions, a rebound in global commodity prices and a release of pent-up demand.

In India, headline inflation breached the upper tolerance level of the inflation target during May-June 2021 (Figure 7), mainly driven by a sharp increase in inflation in all the three major groups – food, fuel and core - due to supply disruptions induced by the localised lockdowns in the wake of second wave of COVID-19.

Figure 7: Trends in Headline Inflation, Food and Beverage Inflation and Excess of Food and Beverage Inflation over Headline Inflation (%)



Source: RBI and CMIE.

Inflation in food and beverages remained the primary mover of headline inflation in FY 2022 although its contribution to headline inflation declined to 35.9% in FY 2022 from 54.8% a year ago. The excess of food and beverage inflation over headline inflation turned negative in the second quarter of FY 2022 (Figure 7) as fuel prices, scaled new peaks and reached an all-time high of 14.3% in October 2021 due to a sharp pick up in prices of liquefied petroleum gas (LPG) and kerosene.

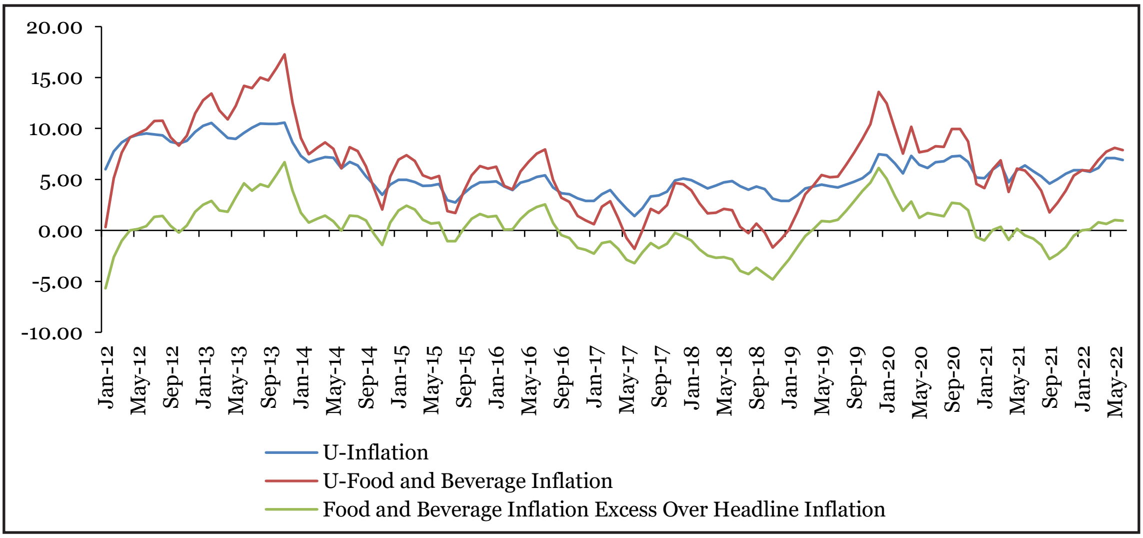
Headline inflation remained well within the tolerance band of targeted limit of 4 +/- 2 percentage points till the start of Q4 FY 2022. This has been mainly led by elevated commodity prices due to supply side bottlenecks on the back of the tense geopolitical situation on the back of Russia-Ukraine tensions. As per the Petroleum Planning and Analysis Cell (PPAC), the Indian basket of crude oil averaged $111.86 per barrel between February 25 and March 29, 2022. Headline inflation witnessed a decline to 7.04% in May 2022 from 7.79% in April 2022. It therefore appears that inflation may have peaked in May 2022. Several measures taken by the Government seem to be working at reining in inflation. Fiscal measures such as reducing the indirect taxes on fuel have directly helped bring down inflation in May 2022.

In May 2022, the Central Government announced a cut in excise duty on petrol by ₹8 per litre and on diesel by ₹6 per litre. It also announced reductions in customs duty on import of raw materials for plastic and steel. The price of petrol fell by 2.4% in May, and that of diesel dropped by 2%. Prices of these fuels in June were lower than they were in May. This has driven down the CPI in June 2022 to 7.01%.

Urban inflation has usually tended to be higher than rural inflation by an average of about 0.8 percentage points through most of 2021 — the only exceptions being August when both stood at 5.3% and May when rural inflation was 6.6% and urban inflation was 5.9% (Figure 8 and 9). Higher inflation in food and beverages, along with inflation in fuel and light and clothing, were the key factors driving up rural prices throughout FY 2022.

However, the more worrisome aspects of inflation are underestimation of

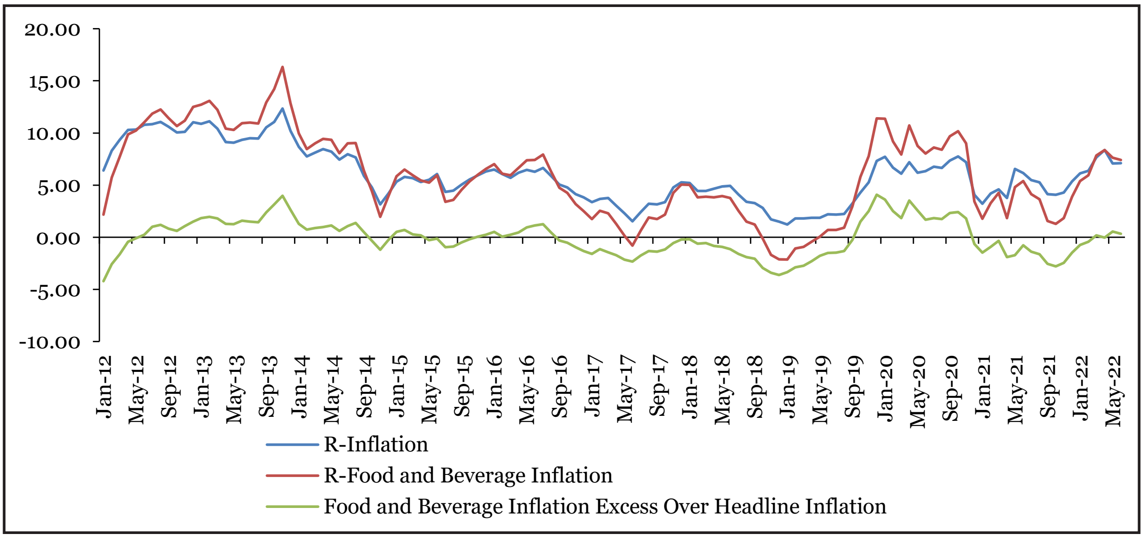
Figure 8: Trends in CPI-Urban, Urban Food and Beverage Inflation and Excess of Food and Beverage Inflation over Headline Inflation (%)



Source: RBI and CMIE

inflation due to change in consumption basket and spike in core inflation which is CPI (excluding food and fuel). During the extraordinary FY 2021, lockdowns, staying at home, and social distancing caused sharp declines in spending on items consumed or used outside the home. Households also curtailed consumption of non-essential items because of falling income, further boosting the importance of food and housing in their budget.

Figure 9: Trends in CPI-Rural, Rural Food and Beverage Inflation and Excess of Food and Beverage Inflation over Headline Inflation (%)



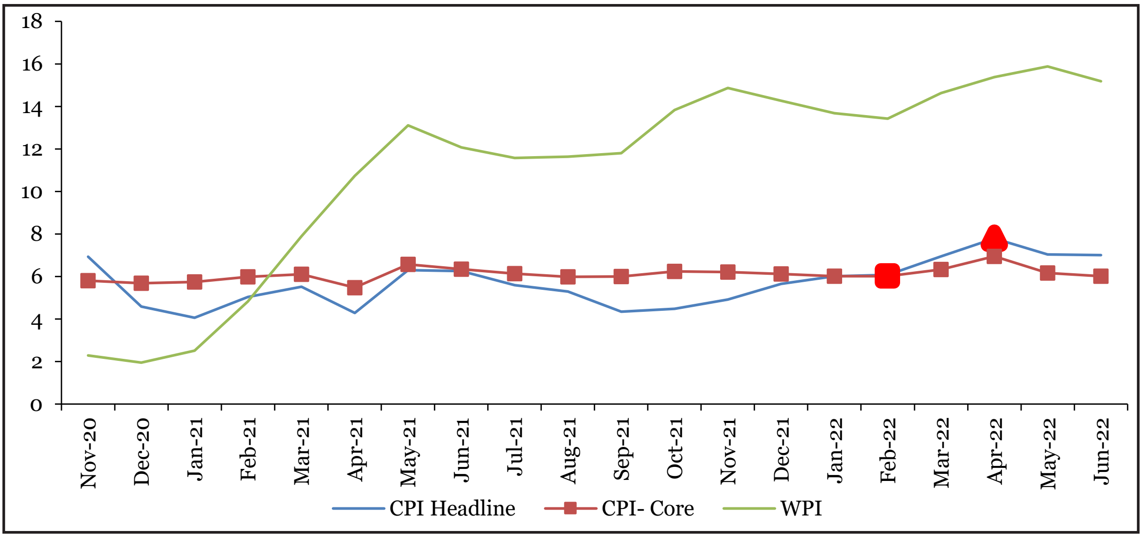
Source: RBI and CMIE

SBI Ecowrap (17th May 2021 edition) pointed at a similar situation in Indian context. It argued that the increase in fuel prices since December 2020, is having a direct impact on squeeze in consumption spending on discretionary items. They also re-estimated CPI, since December 2020 till April 2021, and concluded that re-estimated CPI was higher than CSO estimate (April 2021 computed inflation was at 5.35% as against 4.3%). This has happened as spend on oil in December crowded out the spending on other discretionary items, like health, grocery and utility services that was the trend in earlier months which is worrisome. In fact, the share of non-discretionary spend has jumped to 59% in April 2021 from 52% in March 2021. Expenditure on health during the pandemic years of FY 2021 and FY 2022 has also crowded out expenditure on other discretionary items. It also pointed that, item-wise inflation of Health CPI showed persistent month-on-month increase in inflation of non-institutional medicine, and X-ray, ECG, pathological tests etc. during the second wave. This however, does not get reflected accurately in CPI due to weightage of CPI not in tune with the actual expenditure.

Higher core inflation than the headline inflation (Figure 10) for most of the months in FY 2022 showcased the structural nature of the inflation. It means that inflation was more structural, with price rise being seen in non-food segments such as clothing, fuel and light, household goods, health, transport, and communication above 6%. As many of these prices are based on MRP principle and will not come down once increased. This reflects manufacturers are in the process of passing on the higher input cost to the consumer.

Inflation at the wholesale level in the FY 2022 remained in double digit territory for the whole year. Generally, wholesale inflation is lower than headline inflation, however, this trend has been reversed since March 2021 (Figure 10). Headline inflation rates has trailed behind the wholesale inflation rates by about 7.3% on average since March 2021. This may be on account of wholesalers not passing the price hike to retailers fully. In a recent article, Shweta Saini, Pulkit Khatri and Siraj Hussain calls this phenomenon 'Inflation-in-the-pipeline'. There is high probability of these price shocks finally being passed on to the final consumers.

Figure 10: WPI, Core CPI and CPI (y-o-y) (%)



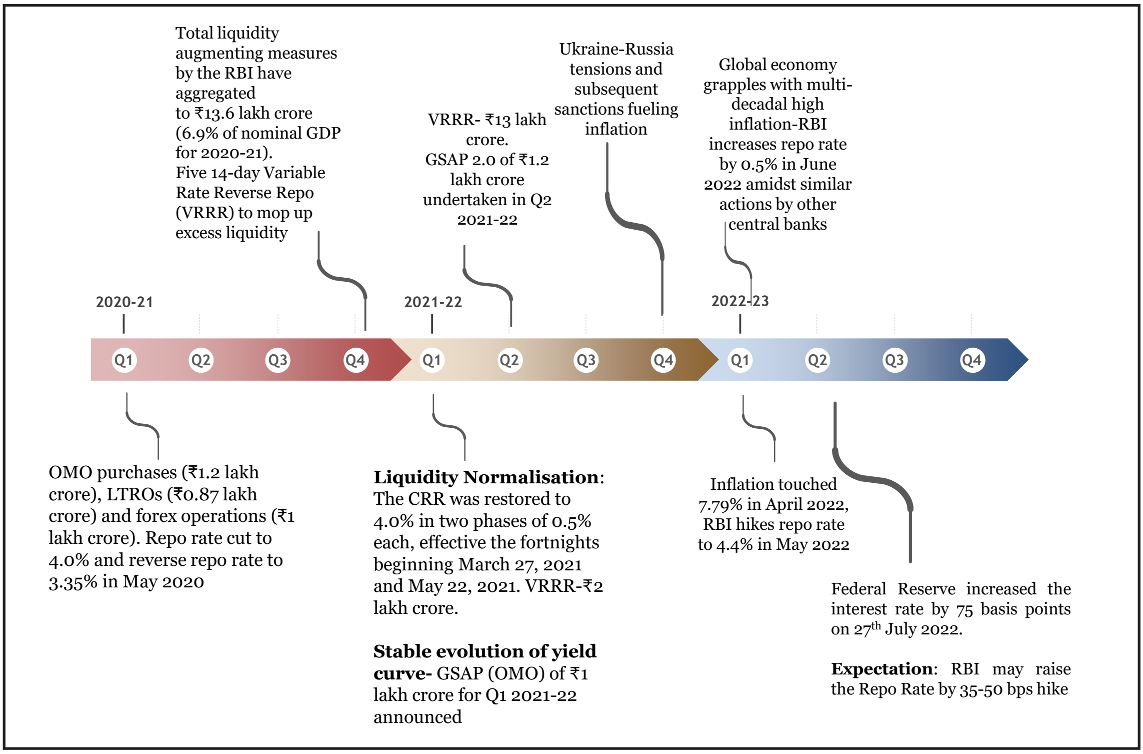
Source: CMIE, MOSPI

Interest Rate Movement

The COVID-19 pandemic triggered extreme risk aversion and elevated volatility in financial markets. Monetary policy and liquidity operations during FY 2021 were geared towards mitigating the adverse impact of the unprecedented economic devastation brought by the COVID-19 pandemic on the Indian economy. The monetary policy committee (MPC) cut the policy repo rate by 115 basis points (bps) during March-May 2020. Backed by conventional and unconventional liquidity measures, these actions bolstered financial market sentiments while ensuring orderly market conditions. Interest rates and bond yields declined across market segments and spreads narrowed in FY 2021.

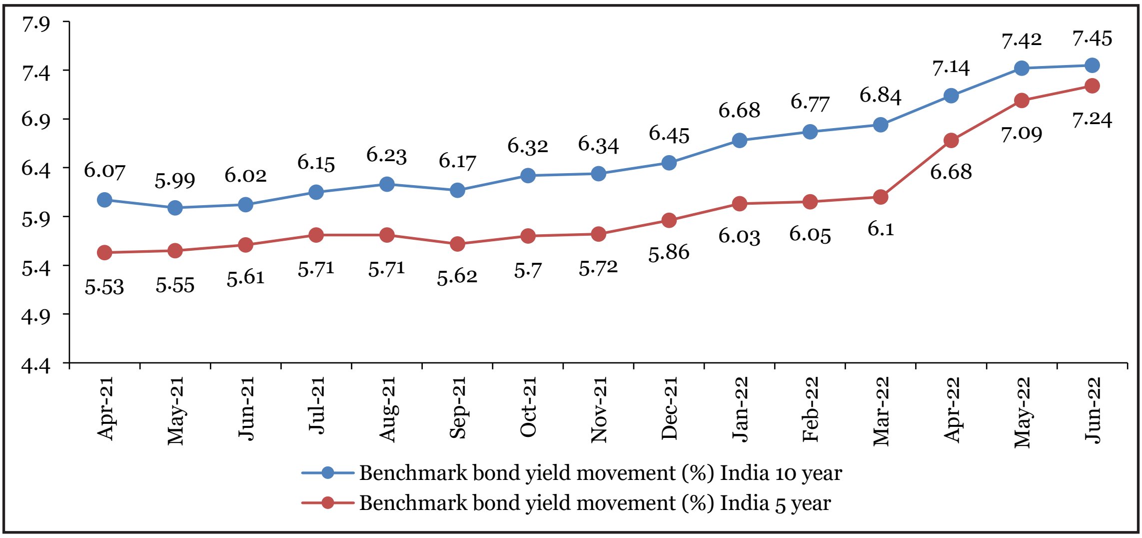
RBI announced G-Sec Acquisition Programme (GSAP) in April 2021's Monetary Policy Review (Figure 11). Under GSAP, RBI committed to purchase government securities of ₹1 trillion in the first quarter of FY 2022 in open market operations (OMO) in an effort to keep bond yields under check to keep government's borrowing cost low, which would have surged otherwise given the higher borrowing plan

Figure 11: Liquidity Management Steps Undertaken by RBI in Past Two Years



Source: Compiled by authors

Figure 12: Monthly Benchmark Bond Yield Movement (%)



Source: CMIE

announced by Central Government. This lent support to the benchmark 10-year government bond throughout first quarter of FY 2022. The 10-year G-sec yield softened by 12 bps during the quarter to close at 6.05% (Figure 12), trading in the range of 5.96-6.19% (on an intra-day basis).

A similar announcement in the Monetary Policy Review on 4th June 2021 was made for the second quarter of FY 2022. RBI announced GSAP 2.0 of bond purchases of ₹1.2 trillion. RBI also kept its policy rate i.e., Repo rate at 4% throughout FY 2022 to provide support to the economy. Though this measure lent some support to yields, but inclusion of non-benchmark government bonds in GSAP 2.0, rise in crude oil prices and Variable Rate Reverse Repo (VRRR) along with rise US treasury yields led to hardening of yields in Q2 of FY 2022 by 17 basis points. Similarly, all these factors along with higher-than-expected government borrowing announced in Union Budget 2022-23 led to further hardening of yields in Q4 of FY 2023.

In the first quarter of FY 2023, yields hardened further due to monetary tightening in U.S. and India. Yields hardened to 7.45% by the end of June 2022. With inflation now extending to core components, we might see another hike in September 2022 by Federal Reserve with further acceleration in government bond yields across the world.

Predictions and Predilections

The COVID-19 lockdowns in China and the resultant slowdown along with tighter financial conditions around the globe and negative impact of Ukraine-Russians tension paints a bleak picture for world economy in the coming months. IMF in its World Economic Outlook July 2022 edition has cautioned against a global economic recession. U.S. GDP contracted by 0.9% in Q2 2022 after contracting by 1.6% in Q1, 2022, stoking fears of recession in the biggest economy in the world and sounding alarm bells for the world economy as well. This comes in the backdrop of inflation reaching to a 4 decade high level and U.S's Federal Reserve with an aim to tame the inflation increasing the interest rate further by 75 basis points in July 2022 for second straight month.

The unrelenting inflation due to supply side bottlenecks exacerbated by geo political circumstances have been causing distress to policymakers and public alike in every corner of the world. In a recent blog for IMF, Krishnan Srinivasan (Director of the Asia and Pacific Department (APD), IMF) suggested that several economies needs to raise rates rapidly as inflation is broadening to core prices, which exclude the more volatile food and energy categories, to prevent an upward spiral of inflation expectations and wages that would later require larger hikes to address if left unchecked. He also pointed at the need for a more complementary approach between monetary and fiscal policy, with the need to tighten fiscal policy in countries facing elevated debt levels, providing a complement to monetary efforts to tame inflation.

India's economy recovered from the pandemic woes in FY 2021-22 and the momentum is also expected to continue in FY 2023, though there are some downside risk from geopolitical shock and global monetary tightening leading to capital outflows and pressure on Indian Rupee. Indian economy seems undeterred by this risk and the overall, sharp rebound and recovery of the economy is reflective of its strong resilience. The Union Budget 2022-23 envisioned the roadmap for 'India at 100' and gave a blueprint to steer the economy over the Amrit Kaal of the next 25 years. Big public investment for modern infrastructure and Production linked incentive scheme are expected to give big thrust to the economy.

While the inflation in India fell to 7.01% in June 2022 as against 7.79% in April 2022, it still poses risk to economic recovery and consumption expenditure. Although, the supply side interventions by the government continue to restrain the passing of elevated international crude oil prices to domestic headline inflation, the gap between WPI and CPI holds the risk of passing of input cost pressure to retail prices. We may also witness another repo rate hike to the tune of 0.35-0.5% in the month of August 2022 to tame inflation risks and also to remain in line with other central banks. Dr. D Subbarao, RBI's former Governor recently emphasized on effectiveness of monetary policy tools for taming the inflation even if driven by supply side bottlenecks. He asserted that higher inflationary expectation due to prolonged inflation can feed into higher inflation and requires monetary tightening.

The widening of gap between interest rate in U.S. and India, also poses threat of capital outflow from India and further depreciation of India Rupee fueling imported inflation in India. Krishnan Srinivasan (IMF blog) also pointed at the flight of capital from the Asian markets excluding China due to '**Tantrum Redux**'. Federal Reserve decision to decrease its monthly asset purchase program have led to a capital outflows comparable to 2013 and is especially worrisome for India which has experienced outflows to the tune of $23 billion since the Ukraine crisis. Recently, Dr. D Subbarao, former RBI Governor suggested that external sector situation today is quite different from Taper Tantrum, 2013. He also pointed that due to strong fiscal front, current account deficit (CAD) remaining under control, and a much higher foreign exchange reserve, Indian exchange rate with US dollar tracks Indian economy fundamentals closely.

In sum, as IMF blog prescribed, policymakers needs to handle the current dual problems of inflation and slowing growth rate by adopting complementary fiscal and monetary policy.

Epilogue : August 2022 MPC meeting

Though the booklet covers 5 quarters, since August 2022 MPC meeting is round the corner a few highlights of the decisions thereof are mentioned here for the benefit of the readers.

As anticipated, RBI raised Repo Rate by 50 bps to 5.40% as the current inflation remains above RBI's comfort zone. This is the third-rate hike by the central bank in this financial year.

The RBI Governor considered **retail inflation** to be uncomfortably high and expected it to remain above 6%. RBI's inflation projection for 2022-23 is

retained at 6.7%, with Q2 at 7.1%; Q3 at 6.4%; and Q4 at 5.8%, and risks evenly balanced, on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 105 per barrel. The CPI inflation for Q1 of 2023-24 is projected at 5.0%.

Bank rates and Marginal Standing Facility (MSF) rates have been adjusted to 5.65%, and 5.15%, respectively with Cash Reserve Ratio (CRR) left untouched.

The RBI retained the FY 2023 GDP growth forecast at 7.2% with Q1 (April-June) GDP growth forecast at 16.2%, Q2 (July-September) GDP growth forecast at 6.2%, Q3 (October-December) GDP growth forecast at 4.1% and Q4 (January-March '23) GDP growth forecast at 4%.

MPC is concerned that sustained high inflation could destabalise inflation expectations and that volatility in global markets is leading to imported inflation.

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