Global Economic Outlook

US annual rate of inflation accelerated to 9.1% in June

- In June, the US annual rate of inflation accelerated from 8.6% to 9.1%. Economists had forecast a rate of 8.8%. The pickup in inflationary pressures, together with the non-farm payroll figures, led to the talk of a 100-basis points rate hike later in the month.
- High inflation has traditionally been thought to be a problem of emerging markets, given the strong underlying demand that’s characteristic of a growing economy.
- After two shocks, the COVID-19 pandemic followed by the Russia-Ukraine war, inflation as a phenomenon has entered uncharted territory. Supply shortages, unmet demand and too much money chasing too few goods are now an advanced-economy problem as well.

China’s gross domestic product (GDP) fell by 2.6% in second quarter

- China’s economy contracted sharply in the second quarter of this year as widespread coronavirus lockdowns hit businesses and consumers. Gross domestic product (GDP) fell by 2.6% in the three months to the end of June from the previous quarter. On a year-on-year basis, the world’s second-largest economy expanded by 0.4% in the April-June quarter, missing expectations of 1% growth.
- Major cities across China, including the major financial and manufacturing centre Shanghai, were put into full or partial lockdowns during this period.
- Many analysts do not expect a quick economic recovery for China as the government continues with its strict zero-Covid approach to slowing the spread of the coronavirus.

The European Central Bank (ECB) is set to deliver its first interest-rate hike since 2011

Analysts expect that the ECB will hike interest rate this week and it has already flagged a 25 basis points (bps) rate rise to contain inflation running at a record high 8.6%. It last raised rates in 2011. Its -0.5% deposit rate has been negative since 2014.

Retail inflation eases, but still over 7 per cent: A comparison with WPI inflation

India’s retail inflation (also known as CPI inflation/Headline inflation) eased in June 2022 (7.01%) from 7.04% in May 2022 as lower fuel and cooking oil prices offset higher services and food costs. Inflation in the food basket in June 2022 was 7.75% compared to 7.97% in the preceding month.

Domestic Outlook

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On the other hand, WPI inflation eased marginally from 30-year high of May 2022, but still remained stubbornly elevated at 15.18% in June 2022, suggesting the war on price pressure is going to be long and arduous. Importantly, the WPI inflation far outweighs price pressure in retail inflation, which stood at 7.01% in June. The wide divergence also means the pass-through of a recent spurt in input rates to finished product prices will likely continue in the coming months.

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ECB monetary policy

- Primary articles are a major component of WPI, further subdivided into Food Articles and Non-Food Articles.
- Food Articles include items such as Cereals, Paddy, Wheat, Pulses, Vegetables, Fruits, Milk, Eggs, Meat & Fish, etc.
- Non-Food Articles include Oil Seeds, Minerals and Crude Petroleum.
- In April, 2014 the government made a bold and well-thought-out decision to move to the CPI to measure the inflation rate in the Indian economy.
India 2023 GDP forecast to 4.7% by Nomura

The Indian economy has been climbing above pre-pandemic levels and the improvement in growth has been broad-based across consumption, investment, industry and the external sector. However, inflation still remains a sticky point despite the Govt’s recent fiscal steps to counter inflation. Though the CPI inflation moderated to 7.0% on an annual basis in May (Actual: 7.04% in May 2022 and provisional: 7.08% in June 2022) but has remained above the MPC’s tolerance band for the sixth straight month. In order to control inflation, it is expected that Central banks may hike rates aggressively even at the cost of sacrificing growth. The inflationary environment has led to reduction in growth forecast to 4.7% from 5.4% by Nomura. (Source: ET, CMIE)

Industrial Production growth zoomed to 19.6%

India’s factory output, measured by the Index of Industrial Production (IIP), came in at a 12-month high of 19.6% for the month of May, compared with a 6.7% growth reported in April, partly on account of the base effect. The projections by some of the agencies towards CPI inflation and IIP are given below:

Industrial production has been hit due to the pandemic since March 2020, when it had contracted 18.7% and grew by 27.6% in May 2021. In May 2022, the manufacturing sector’s output grew 20.6%, the mining output climbed 10.9%, and power generation increased 23.5%. (Source: IE, BS)

Increase in Employment Rate

After witnessing a steep fall in employment rate in June 2022, CMIE has estimated that the trend has been reversing in the current month. The unemployment rate stood at 7.29% on July 14, 7.46% on July 13, and 7.33% on July 12. Statistics shows that West Bengal has the lowest unemployment rate of 5.2%, while Haryana has the highest rate of 30.6%. The revival in rural employment is expected to be in the agriculture labourers with monsoon picking up in the coming weeks. (Source: FE)

India ranks 135 in gender parity

India’s overall ranking in attaining gender parity remained at a low 135, out of 146 countries as per the Gender Gap Report 2022 of the World Economic Forum (WEF). Iceland retained its place as the world’s most gender-equal country, followed by Finland, Norway, New Zealand and Sweden.

The cost-of-living crisis is expected to hit women hardest globally with a widening gender gap in the labour force, the WEF warned, adding it will take another 132 years to close the gender gap.

Interest Rate Outlook

The impact of US Federal Reserve’s announcement in November last year to taper its asset purchases was “moderate” on Indian financial markets largely due to the country’s strong external position in 2021 (Source: FE: Article published in the RBI’s monthly bulletin for July compared the impact of the two taper announcements (May 22, 2013 and November 3, 2021) by the US Federal Reserve (Fed) on Indian financial markets). In terms of changes in government bond yields, yield curve, and exchange rate, the impact of the Taper 2 announcement was found to be rather muted. In comparison to the Taper 1 announcement, movements in Indian equities, bond, and currency market volatility were also observed to be rather muted in the Taper 2 announcement period.

Explaining the differential financial market response during the two taper announcements, the authors said that the Taper 1 announcement caught the financial markets by surprise, and hence, led to a significant adverse reaction. The Taper 2 announcement, on the other hand, was somewhat anticipated by the financial markets given the past experience with Taper 1 and Fed communication subtly hinting at chances of taper in the periods leading up to the Taper 2 announcement period.

| Weekly Benchmark Bond Yield Movement (%) |
|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Date            | 11-Jul          | 12-Jul          | 13-Jul          | 14-Jul          | 15-Jul          |
| USA 10 years    | 2.989           | 2.969           | 2.935           | 2.958           | 2.926           |
| India 10 years  | 7.427           | 7.391           | 7.337           | 7.384           | 7.438           |
| India 5 years   | 7.216           | 7.179           | 7.097           | 7.149           | 7.197           |
| India 3 months  | 5.150           | 5.160           | 5.180           | 5.220           | 5.230           |

Source: worldgovernmentbonds.com & CMIE

We expect the 10-year benchmark bond to trade within the range of 7.42–7.50% in next week.