NABARD

DEAR
ECO WATCH
Issue 39/ 14-18 Feb 2022

Global Economic Outlook

Inflation continues to soar across the globe

- Britain's consumer price inflation rate hit 5.5% in the 12 months to January, the highest since 1992 when the economy was feeling the after-effects of a late-1980s spending boom driven by Margaret Thatcher's tax cuts and big pay deals. The CPI is set to top 7% in April 2022. The Bank of England thinks it will then start to slow but will still be above 5% in a year's time.
- Inflation in the United States has already surpassed 7% to reach its highest since the early 1980s, and in the euro zone it hit a record 5.1% in January.
- Japan's core consumer prices rose for a fifth straight month in January but at a slower pace than in the previous month, boosting the likelihood the country's Central Bank will lag behind other economies in raising interest rates. Consumer inflation is expected to pick up in the coming months due to surging energy prices, while last year's mobile phone fee cuts are also set to fall out of calculations and will no longer be a drag on prices.

Some Signs of Economic Recovery in Eurozone

- The euro zone economic recovery regained momentum this month as an easing of coronavirus restrictions gave a boost to the bloc's dominant service industry, a survey showed, but consumers faced prices rising at a record rate.
- IHS Markit's Flash Composite Purchasing Managers' Index, seen as guide to overall economic health, jumped to a five-month high of 55.8 in February from 52.3 in January, significantly above the median 52.7 forecast in a Reuters poll.

Domestic Outlook

Industrial Activity Stagnates

- Reserve Bank of India's Order Books, Inventories and Capacity Utilisation Survey (OBICUS), shows that average capacity utilisation of manufacturing units stood at 68.3 per cent in the September 2021 quarter, up from 60 per cent in the June 2021 quarter. This is a substantial improvement. But, it may need to rise further to have an impact on fresh investments.
- Industrial activity appears to have remained bleak in January 2022. The IHS Markit manufacturing PMI, which measures economic activity in India's manufacturing sector, fell by 6.4 per cent y-o-y to 54. The decline in December 2021 had been less pronounced, at 1.6 per cent.
- Business confidence seems to have sobered a bit. According to RBI's industrial outlook survey, 67.6 per cent of the 1,082 manufacturing companies that were surveyed expected improvement in overall business situation in the next quarter, i.e. January-March 2022. The percentage in the preceding round of the survey had been much higher, at 73.1 per cent.
- Fast-frequency data for January 2022 that is available for select industries also indicates subdued industrial performance. Sales of passenger cars and two wheelers continued to fall y-o-y, by 14.8 per cent and 17.2 per cent, respectively. Tractor production declined by 24.9 per cent. Consumption of petroleum products and conventional electricity generation also fell marginally, by 0.2-0.4 per cent. Coal and finished steel were the exceptions, with an increase in production of 6.3 per cent and 1.2 per cent, respectively. Increased restrictions on mobility in January 2022 led to a decline in goods transportation activity by roadways and ports.

Consumer Sentiments remain optimistic

- Consumer sentiments have been rising in February 2022. During each of the three weeks that ended in the month, the Index of Consumer Sentiments (ICS) was higher than it was in any week since the last week of March 2020 when India first came under a severe lockdown because of the COVID-19 pandemic. With this record, February 2022 is heading towards registering the highest ICS since the lockdown.
- This is hugely important because it implies the continuation of a trend of rising consumer sentiments that began in July 2021. A nearly sustained growth in the ICS over eight months implies momentum, which in turn implies sustained improvement in household sentiments.

Inflation continues to be a pain point

- Headline CPI inflation (year-on-year) for the month of January 2022 edged up to 6.0 per cent from 5.7 per cent a month ago.
- A month-on-month decline in CPI by around 30 bps was more than offset by a large unfavourable base effect (month- on-month change in prices a year ago) of around 65 bps, resulting in the increase in headline inflation by around 35 bps between December 2021 and January 2022.

Prepared by Saad Bin Afroz (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

- Food group inflation was the main driver, rising 5.6 per cent in January from 4.5 per cent in December. The decline in food price momentum by around 1.1 percentage points was subdued by an unfavourable base effect of around 2.1 percentage points.
- Vegetables prices moved out of deflation in January. Price increased on a year-on-year basis in respect of cereals, meat and fish, eggs, milk, pulses and spices while inflation in oils and fats, fruits, sugar and confectionary, non-alcoholic beverages and prepared meals and snacks moderated.
- After remaining in double digits for eight consecutive months, fuel inflation moderated to 9.3 per cent in January from 11.0 per cent in December. LPG and kerosene inflation moderated, and electricity prices continued to remain in deflation in January. CPI fuel (weight of 6.84 per cent in the CPI basket) contributed around 10 per cent of headline inflation in January.

Interest rate outlook

- Globally, central banks have been tightening the monetary policy to control inflation.
- A potential invasion of Ukraine by neighbouring Russia would be felt across a number of markets, from wheat and energy prices and the region's sovereign dollar bonds to safe-haven assets and stock markets.
- Russian and Ukrainian assets will be at the forefront of any markets fallout from potential military action.
- Both countries' dollar bonds have underperformed their peers in recent months as investors have trimmed exposure amid escalating tensions between Washington and its allies and Moscow.
- Ukraine's fixed income markets are chiefly the remit of emerging market investors, while Russia's overall standing on capital markets has shrunk in recent years amid sanctions and geopolitical tensions, somewhat cushioning any threat of contagion through those channels.
- The Bank of Israel is expected to keep short-term interest rates unchanged, its 15th such decision in a row, although analysts believe rapid economic growth and rising inflation will push rates higher in the coming months.
- The Bank of England raised interest rates to 0.5 per cent. A near 30-year high inflation rate in December pressured Britain's Central Bank to raise rates for a second meeting in a row, taking Bank Rate to 0.50%.
- But nearly half of the Monetary Policy Committee (MPC) members voted for a hike to 0.75%, making further tightening next month more likely.
- The European Central Bank kept its key interest rates unchanged, but it left the door open to an interest-rate increase later this year.

Domestic interest rate movement trade in thin range

- The interest rate movement continued to be affected by the Ukrainian crisis and pull out of the FIIs for Indian market.
- While the rise in crude oil prices, put upward pressure on the yields, the growing demand for secure instruments in these uncertain times kept the increase in interest rates in check.
- RBI had also cancelled two weekly bond auctions on account of the good cash position of the government.
- The cancellation of the auction turned very positive for bond yields, which were sharply rising after higher borrowing figures were announced in the Budget. Yields have eased around 12-15 bps in the last two weeks and are currently trading in a very thin range.

Table 1: Weekly Benchmark Bond Yield Movement (%)

Date	14-Feb	15-Feb	16-Feb	17-Feb	18-Feb
USA 10 year	1.99	2.05	2.02	1.96	1.91
India 10 year	6.68	6.70	6.72	6.72	6.70
India 5 Year	5.85	5.88	5.93	5.92	5.90
India 3 Month	3.71	3.70	3.68	3.67	3.66

- For the upcoming week, the interest rate would be under pressure. Yields may face upward pressure as crude oil prices continue to rise and the Ukraine crisis unfolds.
- We expect the 10-year benchmark bond to trade in the **range of 6.70-6.80% in the week of 21-25 February 2022**.