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Global Economic Outlook

- **High energy, mixed monetary policy:** Amid the high inflation and increasing rates, Fed has re-emphasized the regional differences in inflation pressures and the variety in policy responses. The People's Bank of China cut rates, and the Bank of Japan stayed pat. The European Central Bank seems conflicted towards tightening, while for the Fed and the Bank of England, rate hikes seem imminent.
- In the euro area, survey indicators of activity point to a soft start of the year. The December inflation print showed several pockets of strength, and we expect consumer price inflation to decelerate more gradually in 2022, but remain below 2% by year-end.
- In the UK, a new Prime Minister would likely find it hard to radically alter the path of fiscal policy. Though labour market data was weaker than expected, we think higher than expected inflation again makes a February rate hike very likely. This is despite downside risks to fourth-quarter GDP from weak retail sales and inflationary headwinds.
- In Japan, the Bank of Japan revised up its CPI forecasts and no longer views price risks as skewed to the downside, but still projects inflation well below its 2% target out to March 2024 and dismisses the prospect of normalization under current conditions. Omicron has put COVID risk back in the spotlight.
- In Emerging Asia, while most central banks in the region remain focused on supporting economic growth, the tide is turning in favour of monetary policy normalisation. While leaving policy rates unchanged, Bank Indonesia announced hikes to banks' reserve requirement ratio, and Malaysia appeared to signal a subtle shift to a more neutral policy stance.
- **U.S. leading economic indicator rises strongly**: In the US, we expect the Fed to signal at the January Federal open market committee (FOMC) meeting that its lift-off criteria have been met and a first-rate hike in March is likely, even as incoming data point to temporary softening in activity from the intensification of Omicron infections.

Domestic Outlook

- **India likely to go back to the real GDP growth trend of 6.5%:** In 2021, global equity markets attained new all-time highs driven by strong corporate earnings growth even in the face of COVID restrictions, supply chain disruptions, rising oil prices, and higher labour costs.
- Going forward in 2022, global equity markets are likely to continue climbing a wall of worries on a number of fronts – growth peaking out, high inflation, US Fed accelerating its pace of tapering and rate hikes, slowdown in China, new COVID variants, high valuations, etc.
- Going forward, over the next three years, we believe India is likely to go back to its real GDP growth trend of around 6.5% with all three drivers of the economy firing.
  a) **Consumption:** Discretionary consumption is picking up after COVID and should sustain given a young demographic with rising incomes and aspiration levels.
  b) **Investment:** Real estate is at a beginning of a new cycle, private sector investment is expected to pick up, and government spending on infrastructure development is expected to remain strong. India should continue to see strong FDI (foreign direct investment) inflows.
  c) **Exports**: Given the robust global economic recovery, exports have already recovered, and the outlook remains positive. IT service companies have a good tailwind and China+1 strategy is helping sectors like textiles, chemicals, manufacturing, etc.
- India's external debt position (import cover, external debt/GDP) is superior to other emerging markets. Hence, the country is better prepared for policy tightening globally in 2022 and beyond.
- **Sentiments recovering in January:** Consumer sentiments had fallen in December 2021 after five consecutive months of increases. The index of consumer sentiments fell to 57.6 in December 2021 after having risen from 47.7 in June to 60.3 in November.
- It had risen by an impressive 26.4 per cent point between June and November 2021. The fall in December was surprising and was substantial at 4.5 per cent.

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- Now, trends were seen in the intra-month fast frequency data for January 2022 indicate that the index of consumer sentiments is recovering somewhat hesitatingly from that December 2021 fall.
- **Centre's paddy procurement reaches 606.19 lakh tonne in 2021-22 season:** Of the total procurement, 186.85 lakh tonne of paddy has been procured from Punjab, followed by 82.62 lakh tonne from Chhattisgarh, 69.08 lakh tonne from Telangana, 55.30 lakh tonne from Haryana and 56.49 lakh tonne from Uttar Pradesh of the ongoing marketing season.

Interest Rate Outlook

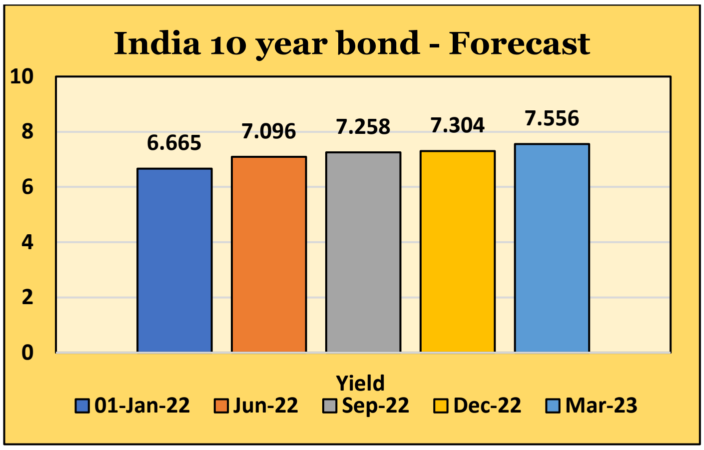
- **RBI to conduct overnight VRR auction of ₹75,000 crore:** Reserve Bank of India said it will be conducting an overnight variable rate repo auction under liquidity adjustment facility (LAF) for an amount of ₹75,000 crore.
- It will continue to rebalance liquidity conditions in a non-disruptive manner while maintaining adequate liquidity to meet the needs of the productive sectors of the economy.
- **Hardening bond yields - Centre to put a lid on gross borrowing in FY23:** The Central government will likely keep its gross market borrowing target for the next fiscal close to the likely FY22 revised estimate of ₹12-13 lakh crore to prevent any flare-up of bond yields, as the economy still faces substantial price pressure amid strong external headwinds.
- The net market borrowing is expected to be ₹3.8 lakh crore lower than the gross level in FY23. Yet, the Centre's borrowing will likely remain at an elevated level (in excess of ₹12 lakh crore) for a third straight year in the wake of the Covid outbreak.
- The bond market is nervously awaiting the government's Budget announcements. The yield on the benchmark 10-year government securities (G-secs) has topped 6% since June 3, 2021. It hit a two-year high on January 17 before easing a tad to 6.63%, with risks to the upside.
- The Centre's weighted average cost of borrowings in FY21 was at a 17-year low of 5.79%, thanks to a regime of low-interest rates that prevailed.
- Brent crude oil prices are hovering around a seven-year high and raw material costs are on the rise globally. With inflation hitting a 40-year high in the US, the Federal Reserve is expected to accelerate the pace of tapering its asset purchases and hike the interest rate earlier than expected in 2022. This may put pressure on the RBI to start raising the benchmark lending rate early next fiscal if retail inflation, which hit a six-month peak of 5.59% in December, remains stubbornly high.
- On top of this, if the Centre goes ahead with the planned ceasing of GST compensation to states from FY23, their fiscal deficit will go up, raising their borrowing requirements.
- Against such a backdrop, it may choose not to crowd out borrowing plans of states and private players. Instead, the Centre may tap the National Small Savings Funds more aggressively to part-finance its fiscal deficit should the situation so warrant, apart from relying on the listing of certain categories of G-secs on global bond indices to raise funds.

Table 1: Weekly Benchmark Bond Yield Movement (%)

Date	17/01	18/01	19/01	20/01	21/01
USA 10 year	1.79	1.86	1.83	1.84	1.76
India 10 year	6.64	6.63	6.60	6.61	6.63
India 5 Year	6.04	6.06	6.06	6.05	6.06
India 3 Month	3.57	3.58	3.57	3.68	3.70

Source: CMIE, www.worldgovernmentsbonds.com

- We expect the 10 year benchmark bond to trade in the range of 6.6-6.7 in the week of 24-28th January 2021.



- The India 10 Years Government Bond Yield is expected to be 7.096% by the end of June 2022.