Global Research
& Risk Solutions

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INDIAN ECONOMY

CRISIL Insights

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Through the monthly CRISIL Insights Indian Economy series, we delve into how India's growth dynamics are expected to change for the remainder of this fiscal.

Walking in sync

The first half of February typically sees a confluence of fiscal and monetary policy announcements. The backdrop for such pronouncements this time was a resilient economy amid rising global shocks and uncertainties. With 7.3% gross domestic product (GDP) growth estimated by the National Statistical Office for this fiscal, India's performance has exceeded expectations. The major bugbear has been inflation, which though localized, has stayed above the 4% target of the Reserve Bank of India (RBI).

Both the budget and monetary policy were well coordinated to address this concern. The interim budget was what an interim budget should be.

It avoided populism in an election-bound year and reduced the deficit target to 5.1% of GDP for next fiscal. The overall fiscal impulse was lower, and government expenditure focus was on supporting the investment cycle and creating assets, instead of cash dole-outs. This makes the interim budget non-inflationary.

Although the non-inflationary interim budget smoothens the path for an easy monetary policy, the RBI has not shown any hurry to cut rates or even change stance as the inflation is some distance from the 4% target.

Headline inflation moderated to 5.1% in January as food prices softened a bit, and core inflation slid to 3.5%. But food inflation is still at 8.3%. The monetary policy is focused on preventing generalizing of food inflation, which is always a risk in a strong growth environment.

To be sure, the entire fiscal saw no change in stance or rates. This does not mean the RBI did not tighten monetary conditions. It has done so to improve monetary transmission and used macroprudential measures (read raising risk weights) to pre-emptively curb risks from a surge in retail credit growth.

In addition to domestic factors, global developments also influence India's monetary policy. Although inflation appears to have peaked, the timing and speed of rate cuts are difficult to ascertain as core and headline inflation in the United States (US) and Europe remain above central bank targets. We expect the US Federal Reserve and the European Central Bank to cut rates in June.

The RBI, too, could begin easing the monetary policy by then.

Focus on fiscal consolidation means that when the RBI decides to cut rates, the fiscal policy will not stand in its way.

MONEY AND BANKING	Industrial production	Inflation
Keeping it steady	Mild uptick	Easing a tad

MONEY AND BANKING

- The Monetary Policy Committee (MPC) of the RBI held rates steady for the sixth consecutive time at its February meeting
- It also held on to its stance of withdrawal of accommodation as it steadfastly pursues two goals — complete transmission of its 250 basis points rate hike in this cycle, and durably aligning headline inflation with its target of 4%
- Systemic liquidity in January remained in deficit, almost doubling from the December level as reflected at the RBI's liquidity adjustment facility window
- The repo rate remained above the marginal standing facility for third consecutive month
- In our view, slowing inflation (despite food price shocks), a smaller fiscal deficit and an imminent turn in the US Federal Reserve policy rates will allow the MPC to start cutting rates next fiscal
- But the MPC is wary of jumping the gun — on cutting rates and on changing its stance too soon — as inflation is not yet firmly under control. Hence, we expect the first rate cut in June, if not later

INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) growth improved to 3.8% on-year in December from 2.4% the previous month. The index grew 0.8% on-month after seasonal adjustments
- Growth in manufacturing picked up (3.9% on-year vs 1.2%), while growth in electricity (1.2% vs 5.8%) and mining (5.1% vs 7.0%) slowed
- Manufacturing growth was driven by consumer durables (4.8% vs -5.5%), infrastructure and construction goods (4.1% vs 1.7%), intermediate goods (3.4% vs 3.1%), capital goods (3.2% vs -1.1%), and consumer non-durables (2.1% vs -3.3%)
- Growth in primary good output, however, fell (4.6% vs 8.5%)
- While industrial activity has been relatively steady so far, it is expected to lose some momentum next fiscal as domestic and external demand moderate
- We expect slowing growth in manufacturing and services to lead to GDP growth of 6.4%, on average, next fiscal compared with 7.3% this fiscal

INFLATION

- Both Consumer Price Index (CPI) and Wholesale Price Index (WPI) inflation eased in January driven by easing food inflation. Inflation excluding food continued to decline further
- CPI food inflation decelerated to 8.3% from 9.5% led by cereals, pulses and spices. Vegetables inflation remained elevated
- Core CPI inflation eased to 3.5%, a 50-month low
- WPI inflation eased to 0.3% from 0.7% and remained in the positive territory
- CRISIL expects CPI inflation to average 4.5% in fiscal 2025 vs an estimated 5.5% this fiscal
- Cooling domestic demand, assumption of a normal monsoon along with a high base for food inflation should help moderate inflation next fiscal. A non-inflationary budget that focusses on asset creation, rather than direct cash support, also bodes well for core inflation

Interest rate	Rupee	Trade
Settling lower	Mild appreciation	Two gainful months

INTEREST RATE

- Yield on the 10-year benchmark government security (G-sec) eased for the third consecutive month to average 7.18% in January from 7.21% in December. On a month-end basis, the yield eased to 7.15% from 7.18% at the end of December
- The pressure on the yield from higher oil prices and tighter domestic systemic liquidity was offset by a further increase in debt foreign portfolio investment (FPI) inflows and continued softening of core inflation
- US Treasury yields hardened mildly after easing consistently for three consecutive months
- Indian G-sec yields eased due to softer domestic inflation, surging FPI inflows into the debt segment and the proposed inclusion of Indian bonds in one of Bloomberg's bond indices
- Hence, the spread between US and Indian government bond yields narrowed for the first time in three months
- CRISIL expects the 10-year G-sec yield to settle around 6.8% by March 2025, down slightly from an estimated 7% in March 2024

RUPEE

- The rupee exchange appreciated slightly to 83.1/$ in January from $83.3/$ in December following a lower trade deficit, inclusion in the JP Morgan (GBI-EM) index, and a positive growth outlook
- FPI recorded net outflows because of rise in US bond yields to 4.06% from 4.02%
- The rupee appreciated 0.2% on-month in January, while all other emerging market currencies depreciated
- The rupee remained one of the better performing emerging market currencies in January, seeing only a 1.5% decline, on average, against the dollar
- CRISIL expects the rupee to average to 83.5/$ by March 2025 compared with ~83/$ in fiscal 2024. While a narrower current account deficit is expected to support the local currency, volatile external financing conditions could exert some pressure

TRADE

- Merchandise exports strengthened in January, rising 3.1% on-year to $36.92 billion after 1.0% growth December
- Merchandise imports, too, grew at a similar pace — up 3% on-year to $54.41 billion from $52.83 billion in January 2023
- With exports doing better than imports on a sequential basis, merchandise trade deficit narrowed to $17.49 billion from $19.8 billion
- Services exports continued to grow positively, rising 1.3% on-year in December, while imports contracted
- The support from remittances and healthy services exports will keep India's current account deficit in check this fiscal

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

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