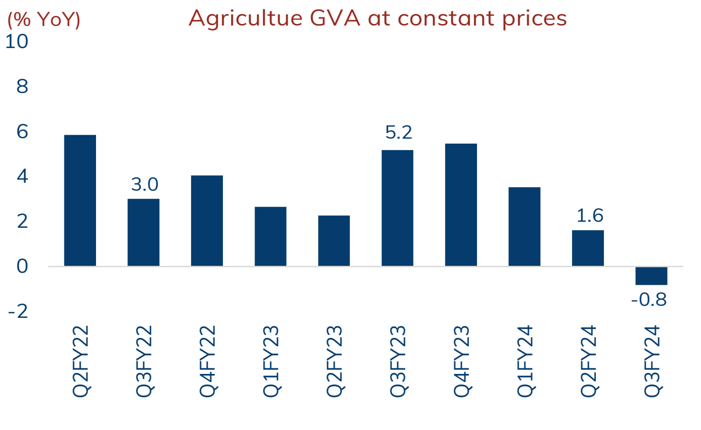
India economy update: March 2024

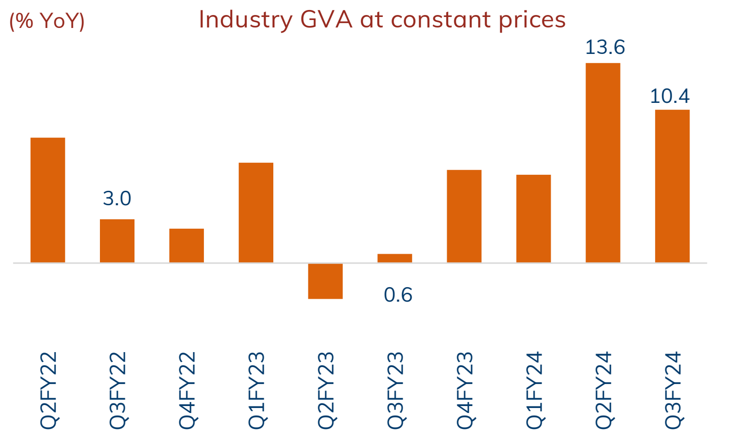
India Q3 GDP: Subsidies explain divergence between GDP and GVA growth

- Q3 GDP is recorded at 8.4% YoY, while GVA is recorded at 6.5% YoY. The divergence is on account of large drop in subsidy payout.
- Consumption demand remains weak at 3.5% YoY and so is the case with exports at 3.4% YoY. However, capital formation increased by 12.2% YoY with a broad-based increase seen in government, real estate and private corporate capex. Muted agriculture growth explains weak consumption. Services demand is buoyant on the back of travel, real estate and financial services. Both industry and services growth has been aided by margin expansion.
- Growth for FY24 is now estimated at 7.6% with FY23 growth revised lower to 7% (7.2% earlier). We expect GDP growth to moderate to 6.5% next year (RBI: 7%) with non-existent tailwinds of margin expansion and subsidy payout along with fiscal consolidation.
- While FY24 growth is ahead of MPC's estimate, the increase is because of net taxes. Weak consumption and exports imply muted core inflation and a normal monsoon should act towards pushing food inflation lower. Higher real rates open room for rate reduction but given delay in US Fed rate cut cycle (absent any risk-off), India's monetary easing cycle should also begin later than earlier

Agriculture GVA growth contracted in Q3 due to an uneven monsoon



Industry is driving GVA growth higher



Industrial production: Growth slackens, but consumer durables outshine

- Industrial production increased by 3.8% YoY in January 2024 compared with 4.2% in December 2023. On a MoM basis, index is up by 0.6%. Mining and electricity drove industrial activity higher followed by manufacturing. Manufacturing sector output was impacted by muted exports as well as lower FMCG output

- Capital goods along with infra and construction goods expanded by 4.1% YoY (3.6% in December) and 4.6% YoY (5.1% in December) witnessing a slight deceleration though long-term trends are positive.

- Consumer durables output expanded by 10.9% YoY (5.3% in December) which shows pickup in spending on discretionary items led by two-wheelers. FMCG output is still muted

- Industrial output during April-January 2024 has increased by 5.9% compared with an increase of 5.6% in same period last year. High frequency indicators show India's growth is holding up led by uptick in investment cycle and recovery in rural demand. Growth in Q4 is expected to be buoyant.

Retail inflation: Muted core, but food still elevated

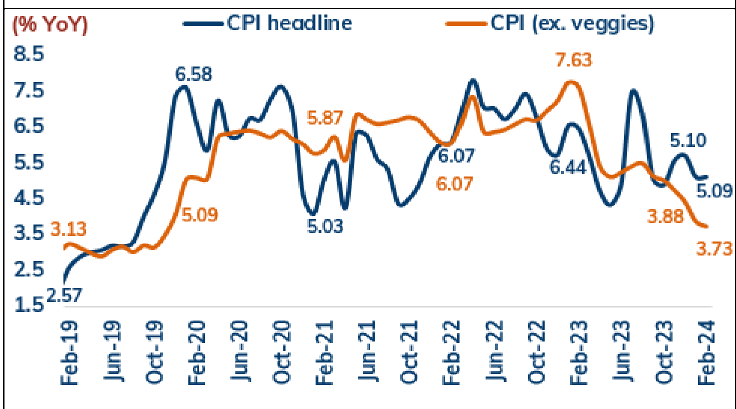
- CPI inflation eased to 5.09% YoY in February vs. 5.1% in January. Core inflation continues to move lower (3.3% YoY) even as food and beverages is sticky at 7.8% YoY. Food and beverages inflation is elevated on a YoY basis because of veggie inflation. Excluding it, food and beverages inflation is at 4.9% YoY. Outlook on food inflation is contingent on monsoon

- Core inflation is now at a series low with broad-based decline seen across categories led by healthcare, housing, household goods and services and clothing and footwear. Outlook on core inflation is benign given muted global demand for goods. In India's case even services inflation is contained given rural wage growth at 5.4% YoY

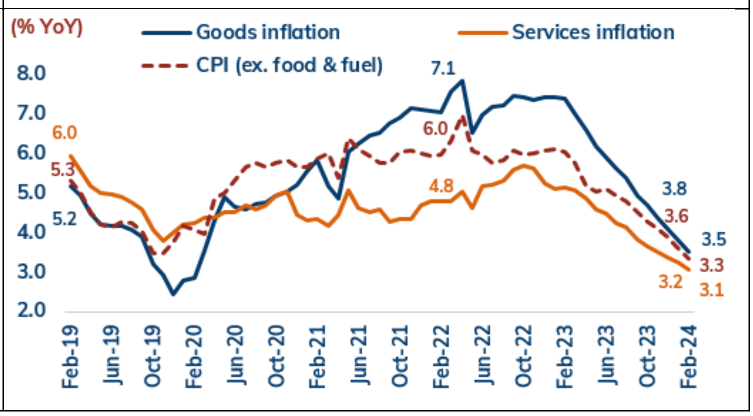
- The recent cut in LPG price imparts a disinflationary impulse of more than 0.1% to next year's inflation estimate. We expect CPI at 4.7% with a downward bias (RBI: 4.5%) which opens up room for monetary easing once MPC has more information on monsoon and US Fed trajectory

- We see change in stance in June or August with a shallow rate cut cycle beginning in October. Favourable conditions may imply RBI front loads rate cuts but given growth trajectory of 8% during April-December 2023, there is no pressing need to ease rates from a growth standpoint

CPI at 5.09% YoY (CPI ex. veggies: 3.73%)



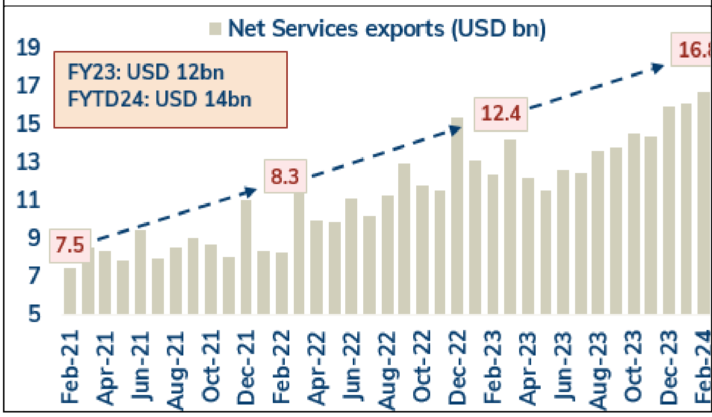
Goods and services inflation continue to ease



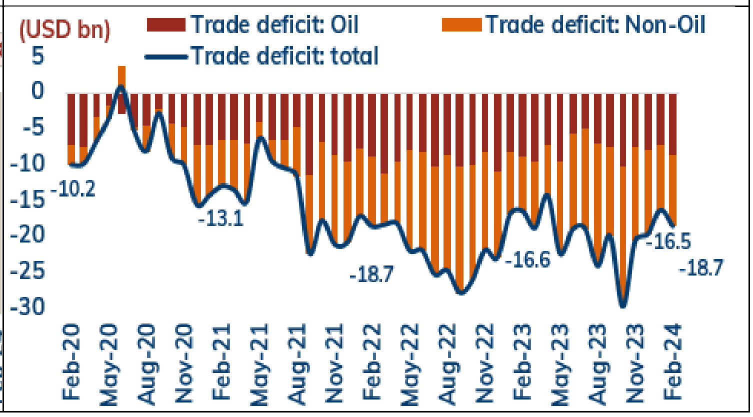
Merchandise trade

- Merchandise exports rose by 11.9% YoY to USD 41.4bn (12.2% MoM), led by non-oil (+13.7% YoY) and oil exports (+5.0% YoY). Imports rose by 12.2% YoY at USD 60.1bn led by higher gold (+134% YoY) and non-oil-non-gold imports (+8.8% YoY). Oil imports are flat on a YoY basis but have seen a MoM increase
- Services exports maintained momentum rising by +17.3% YoY and +3.6% MoM at USD 32.2bn. Service imports have risen by 2.8% YoY and 3.6% MoM at USD 15.4bn. Net services exports at USD 16.8bn (USD 16.2bn last month)
- Trade deficit increased on MoM basis to USD 18.7bn in Feb led by higher gold imports at USD 6.2bn from USD 1.9bn in Jan. Even oil deficit was higher however with substantial uptick in non-oil exports, non-oil-non-gold deficit saw a decline
- During FYTD24, merchandise exports have contracted by 3.5% YoY at USD 395bn, while services exports have risen by +6.8% at USD 315bn. Goods imports are now lower by 5.3% YoY at USD 620bn, while services imports have contracted by 2.0% YoY at USD 162bn.
- With FYTD24 trade deficit now at USD 225bn, we now expect overall trade deficit at USD 245bn (lower by USD2bn from earlier estimate). At the same time, net services exports are now expected around USD 170bn, implying a CAD of 0.9% of GDP in FY24 and 1.1% of GDP in FY25

Net Services exports steadily rising a positive



Trade deficit widened to USD 18.7bn in February



- While FDI repatriation is on the higher side, so are FPI inflows into India. Outlook for INR is positive amidst buoyant services exports and inflows into India. An increase in non-oil exports should give a boost to domestic manufacturing

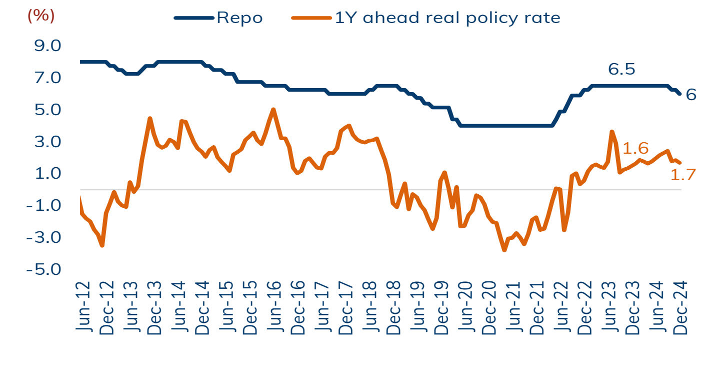
MPC keeps status-quo on rate and stance, optimistic on growth

- MPC voted to keep repo rate unchanged at 6.5% and retained stance of ‘withdrawal of accommodation’ with 5:1 vote each. Growth forecast for FY25 was revised higher to 7% (from 6.5% earlier). While the inflation forecast for FY25 was unchanged, near term quarterly forecasts were revised lower, including for Q4FY24
- After seeing a sharp increase in system liquidity deficits on account of build-up in cash balances and higher currency demand, RBI has provided large quantum of

liquidity via VRRs which is likely to continue till such time government does not deplete its cash balances (end-March)

- We believe US Fed policy and domestic food prices become crucial determinants of change in stance. With more clarity from US Fed and monsoon, change in stance is likely in either April or June (more likely). This is likely to be followed by a shallow rate cut cycle (50bps) from August or October onwards (October more likely)

Real rates are comfortably above the 1% mark



Interest rate differential between the MPC and the FOMC stands at 1%