State of the Economy: Challenges of Sustaining Growth and Controlling Inflation *

By Dr M Govinda Rao, Chief Economic Adviser, Brickwork Ratings

In a surprise move, the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) decided to take a pause after increasing the interest rate in 6 consecutive meetings. It has increased the repo rate by 250 basis points (bps) since May 2022. The fourth quarter estimate of consumer price index inflation was 6.2%, which is much higher than 5.7% projected in the February MPC statement and yet, the Committee took the decision to pause. Considering the fact that the inflation rate, particularly the core inflation rate has remained sticky, the expectation in the market was an increase of 25 bps.

The reasoning for the pause was that the 250 basis points increase in the interest rate is still working through the system. MPC has also stated that this is only a 'pause' and not a 'pivot', and it would be ready to act should the situation be so required. However, since its own forecast of inflation in FY24 is 5.2% and the highest rate of inflation projected is 5.4% in the third and fourth quarters, one can expect the interest rate to remain stable for at least the next two quarters. Although the Committee gave explanations for the significantly lower inflation estimate for FY24 at 5.2% based on household expectations and the projections by other forecasters, there are significant downside risks. Nevertheless, the inflation projections look too optimistic, and the Committee seems to be more eager to accommodate growth concerns. Considering the decision of OPEC to cut down the output of crude oil, the risk is real. The erratic monsoon can create trouble on the food front. Despite the statement that the policy is being calibrated to align with the target of 4% in the medium term, it seems the MPC's focus seems to be soft-landing the economy within the upper bound of the target while accommodating growth concerns.

The MPC is quite optimistic about GDP growth in FY24 as well. The FY23 growth is projected at 7% and for FY24, the growth is estimated at 6.5%. The forecasts by most other forecasters are much lower. The World Bank projects growth at 6.3% and ADB at 6.4% and Nomura has projected growth at a much lower rate of 5.8%. The quarterly break up of growth shows the economy growing at 7.8%, 6.2%, 6.1%, and 5.9% respectively in the four quarters in FY24. In fact, the growth forecast in Q1FY24 at 7.8% looks very optimistic as this is over the high growth of Q1FY23 at 13.2%. Thus, there is no base effect and there are no indications of acceleration either.

Now that the monetary policy stance is known, the focus of the government will have to take measures to accelerate growth. This would require measures to deal with macroeconomic as well as structural issues. The major macroeconomic policy issue that needs to be addressed is arresting the

declining trend in savings and investment in the country. The gross capital formation as a ratio of GDP in constant prices declined from 39.6% in 2011-12 to 32.7% in 2021-22 and is projected to increase to 34% in FY23. Arresting this would require significant increases in both government capital expenditure and private sector investment. The Union budget has partially addressed the issue by increasing allocation to capital expenditure. However, it is doubtful whether the States would maintain their capital expenditures. Besides, with the fiscal deficit of the Centre budgeted at 5.9% of GDP in the Union Budget and another 3% in the State budgets, the aggregate deficit could be close to 9% of GDP. As the household sector's financial saving is just about 8.5%, there is hardly any borrowing space available to the private sector. The increases in the policy rate are yet to play their course, and as it does, the cost of borrowing by the private sector is likely to be high putting a dampener on new investments. The RBI has withdrawn a considerable amount of liquidity over the past year, but in the first half of FY24, the large volume of government borrowing to maintain the expenditure increase may require additional injection of liquidity to the economy including undertaking open market operations which could put additional pressure on prices.

Along with accelerating growth, expanding employment opportunities is going to be a major challenge. It is clear that the structural shift in the growth pattern towards the services sector where the employment opportunities for the large number of semi-skilled and unskilled persons joining the workforce is limited. Therefore, it is imperative to focus on accelerating investments in labour intensive manufacturing to absorb millions of new workers joining the workforce. In addition, the labour has to be absorbed also from the overcrowded low productive agricultural sector. Furthermore, to take advantage of the fast-changing geo-political situation occasioned by the deteriorating relationship of the US and Western powers with China and the adoption of China plus one policy by many investors from the developed West, important structural changes in labour reforms, land acquisition problems, governance improvements to improve the ease of doing businesses are necessary. More importantly, the tariff levels have shown a significant increase during the last 7 years, and this is particularly so in the case of many inputs. Exports can rise only when the economy is competitive, and experience has shown that protectionism does not help matters. The exports become non-competitive when the finished products have to bear high import duties on their imports, which are inputs to their exported products. If we have to take advantage of China plus one policy and expand the labour-intensive manufacturing sector, the government will have to reverse the protectionist trend and enter into many bilateral trade agreements, besides undertaking measures to undertake structural reforms mentioned above.

**** Views are personal.***

Contacts:

Investors & Media Contact
+91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

ABOUT BRICKWORK RATINGS

Brickwork Ratings (BWR) is India's home-grown credit rating agency built with the superior analytical prowess of the industry's most experienced credit analysts, bankers and regulators. Established in 2007, BWR aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. BWR provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. BWR has employed over 350 working professionals including credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes. BWR is committed to providing the investment community with products and services needed to make informed investment decisions. BWR is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by the Reserve Bank of India (RBI) to carry out credit ratings in India. BWR is promoted by Canara Bank, India's leading public sector bank. More information on Canara Bank is available for reference at www.canarabank.com

BWR Rating Criteria are available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings, a SEBI-registered credit rating agency, has also been accredited by the RBI, and it offers rating services for bank loan, NCD, commercial paper, bonds, securitised paper etc. BWR has Canara Bank, a nationalised bank, as its promoter and strategic partner.
BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over ₹ 10,00,000 Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹24,440 Cr have been rated.

DISCLAIMER

Copyright © 2023 by Brickwork Ratings India Pvt Ltd., 3rd Floor, Raj Alkaa Park, 29/3 & 32/2, Bannerghatta Main Rd, Kalena Agrahara, Bengaluru, Karnataka 560076.Telephone: +91 80 4040 9940. Fax: +91 80 4040 9941. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.
THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors,