सत्यमेव जयते

Economic Diplomacy Division

Ministry of External Affairs

MONTHLY ECONOMIC REPORT

JULY 2023

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Introduction

The fourth quarter of FY23 saw stronger-than-anticipated growth, primarily fueled by robust domestic investment. This impressive performance prompted the International Monetary Fund (IMF) to revise India's real GDP growth projection for FY24 upwards by 20 basis points in its July 2023 World Economic Outlook (WEO).

The strength of domestic investment can be attributed to the government's unwavering commitment to capital expenditure, poised to be a driving force for future growth. In the FY24 Budget, the Union Government raised capital outlay by a significant 33.3%, increasing the proportion of capital expenditure in total expenditure from 12.3% in FY18 to 22.4% in FY24 (BE). The Union Government's initiatives have also encouraged states to boost their capital expenditure, with state capital spending rising by an impressive 74.3% year-on-year in Q1 of FY24, complementing the Central Government's 59.1% increase in the same quarter.

This enhanced provision for capital expenditure by the government has led to the crowding of private investment. This is evident in the performance of various high-frequency indicators and industry reports, all of which highlight the emergence of the early signs of a private capital expenditure upswing.

The June 2023 Monthly Economic Report highlighted the potential risks associated with elevated asset prices in financial markets. By August, a correction in stock prices was observed, coinciding with the increase in sovereign bond yields across advanced economies. Additionally, geopolitical and geo-economic concerns persist and will likely remain a significant factor for the foreseeable future. Therefore, prioritising the preservation of macroeconomic stability is of utmost importance.

This focus on stability serves several crucial purposes:

- Preventing Excessive Interest Rate Increases: Maintaining stability in the macroeconomy is essential to prevent a sharp rise in interest rates. This is critical to ensure that India remains an attractive destination for domestic and international investors.

- Enhancing India's Appeal: By upholding macroeconomic stability, India can underscore its relative attractiveness as a region of performance and promise for local and foreign investors.

- Sustaining Steady Economic Growth: A stable macroeconomic environment supports sustained economic growth. It provides a conducive backdrop for businesses to thrive and expand.

In the current circumstances, any policies aimed at preserving macroeconomic stability can be considered a form of macroeconomic stimulus. These policies are about stabilising the economy and promoting India as a reliable and appealing investment destination, thus supporting consistent economic growth.

Strong Investment activity to drive growth in the coming years

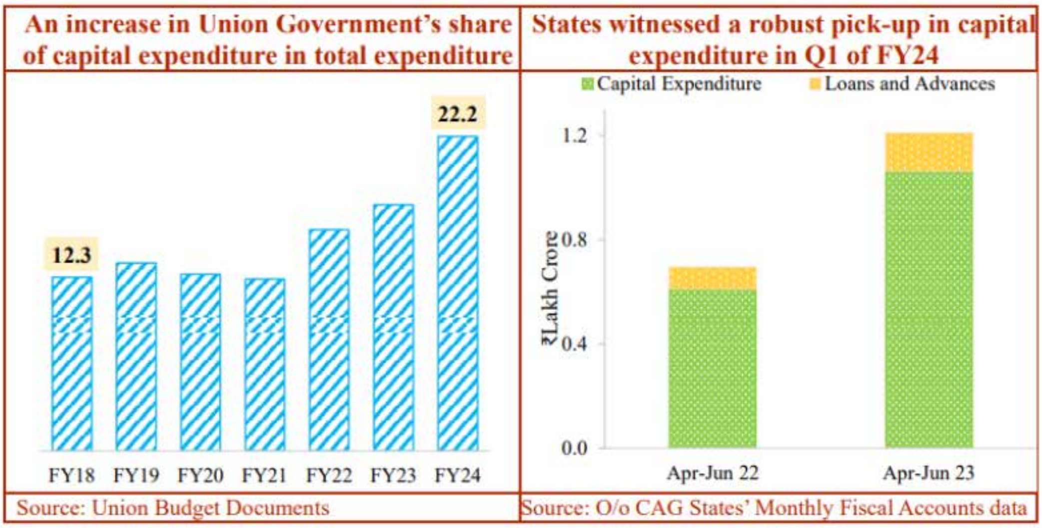
- IMF's July 2023 World Economic Outlook revised India's FY24 real GDP growth forecast, up by 20 bps to 6.1% from 5.9% in April 2023, driven by stronger-than-expected growth in Q4 FY23 due to robust domestic investment.

- The government's continued focus on capital expenditure boosts domestic investment, aligning with a long-term strategy to enhance productive assets and business sentiment.

- Capital expenditure and infrastructure investments substantially affect growth and employment, which is expected to drive growth in the coming years.

- According to the National Institute of Public Finance and Policy, every rupee spent on capex leads to a cumulative multiplier effect of INR 4.8. At the same time, revenue expenditure yields a cumulative multiplier of 0.96.

- Morgan Stanley predicts a new cycle in manufacturing and capex, estimating a 5% increase in their share of GDP by 2031, owing to the steady growth in these sectors as a percentage of GDP.



- Early release of funds through 'The Scheme for Special Assistance to States for Capital Investment' helps spread State investments throughout the year, contributing to substantial growth multipliers.

- Sustaining State capital expenditure growth and revenue expenditure rationalisation will assist in achieving the overall fiscal deficit target of 3.5% of GDP for FY24.

- The Central Government's focus on capex has driven its departmental arms and Central Public Sector Enterprises (CPSEs) to accelerate their capital expenditure.

- Out of INR 1.3 lakh crore interest-free loans for States in FY24, INR 600 billion has been sanctioned, with INR 300 billion disbursed.

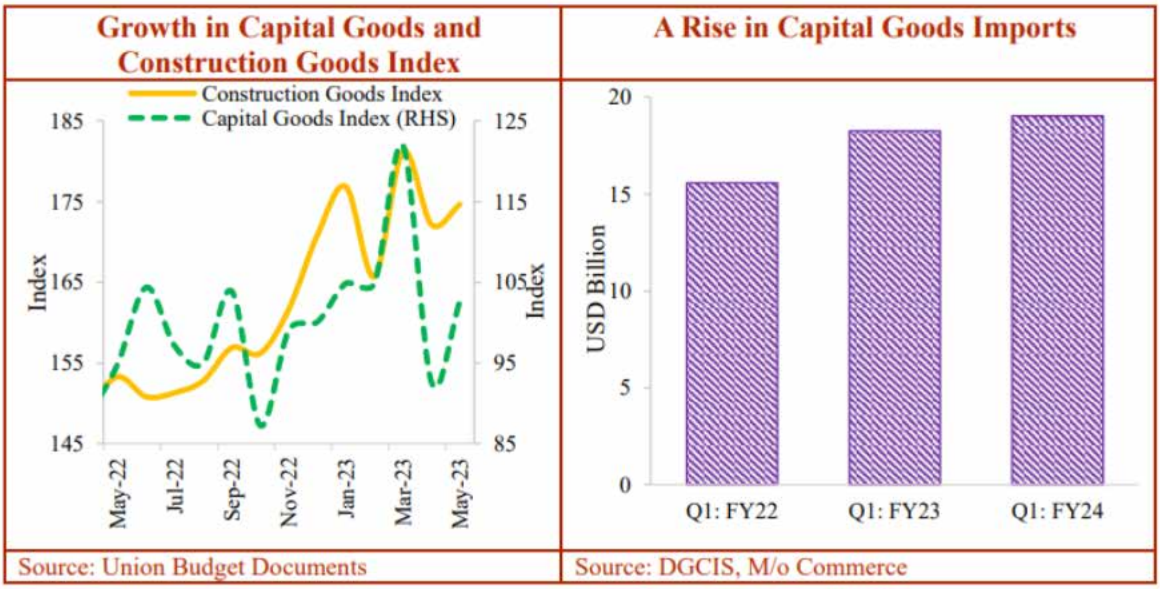
- 54 large CPSEs and five departmental arms have collectively achieved approximately 35% of their annual capex target of INR 7.3 lakh crore in Apr-Jul 2023.

- The Government recognises the significance of private investment in driving economic growth and has been actively taking steps to promote it.

- The Production-Linked Incentive (PLI) scheme offers capital expenditure-linked incentives to 14 crucial sectors to boost private sector investments.

- The combination of the PM Gatishakti scheme and the National Infrastructure Pipeline (NIP) is set to stimulate private-sector involvement in constructing new infrastructure, attracting major private-sector infrastructure players.

- According to research by CRISIL, private-sector industrial investment recorded a CAGR of 7% between FY18 and FY22, indicating positive prospects for even higher growth in the coming years.



- According to the National Accounts Statistics for 2021-22, the private sector's Gross Fixed Capital Formation (GFCF) increased from ₹17.4 lakh crore in FY18 to ₹23.7 lakh crore in FY22.

- Multiple high-frequency indicators and industry reports indicate the emergence of positive signs suggesting a private capital expenditure upswing.

- The Index of Industrial Production (IIP) data reveals strong growth in the capital goods index (12.9%) and the infrastructure/construction goods index (8.4%) in FY23. These indices have maintained their momentum, showing growth of 6.5% and 14.5% cumulatively until May 2023 in FY24.

- A robust investment trend is also reflected in the rising imports of capital goods, which grew by 20.3% in FY23 and rose by 4.2% year-on-year in Q1 of FY24.

- Data from the CMIE Capex database reveals that new investment project announcements by the private sector in Q1 of FY24 were 11.6% higher than the same period in the previous year, marking the highest Q1 figures in 14 years.

- The transport services industry dominated the new project announcements, accounting for 72% of all new investment projects, followed by the electricity and chemicals sectors.

- According to the RBI's Order Books, Inventories, and Capacity Utilization Survey, capacity utilisation (CU) in the manufacturing sector continued to increase, reaching 76.3% in Q4 of FY23, up from the 74.3% recorded in the previous quarter.

- Bank credit to the infrastructure sector in Q1 of FY24 was 1.7% higher than the previous year, with the most substantial increase in credit availability for cargo ports and airports.

- The combination of higher capacity utilisation and double-digit growth in non-food bank credit signifies the private sector's positive intent to embark on fresh investments shortly.

Calibrated monetary policy to counter inflation while supporting growth

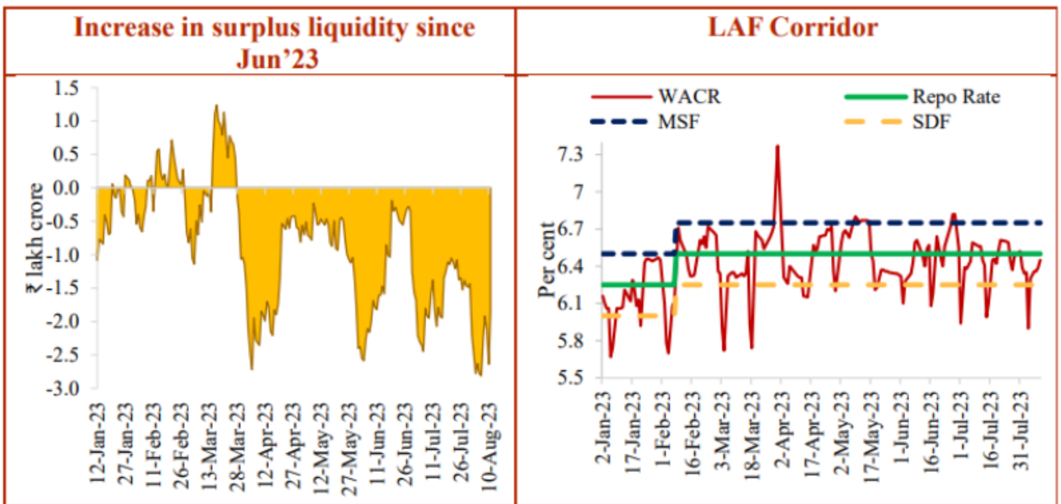
- The RBI's Monetary Policy Committee (MPC) has reacted to the changes in retail inflation and prices.

- The MPC expressed concern that the recent surge in food prices might result in a rise in retail headline inflation in the short term.

- However, the committee anticipates these price increases will rectify themselves in the months ahead.

- In light of this situation, the MPC maintained the current policy rates. Their primary focus remains on gradually withdrawing accommodation to bring inflation to the target while supporting economic growth.

- To safeguard the effectiveness of the policy rate transmission mechanism, the RBI introduced a temporary Incremental Cash Reserve Ratio (I-CRR) of 10% on banks' incremental net demand and time liabilities between May 19, 2023, and July 28, 2023.



Source: RBI

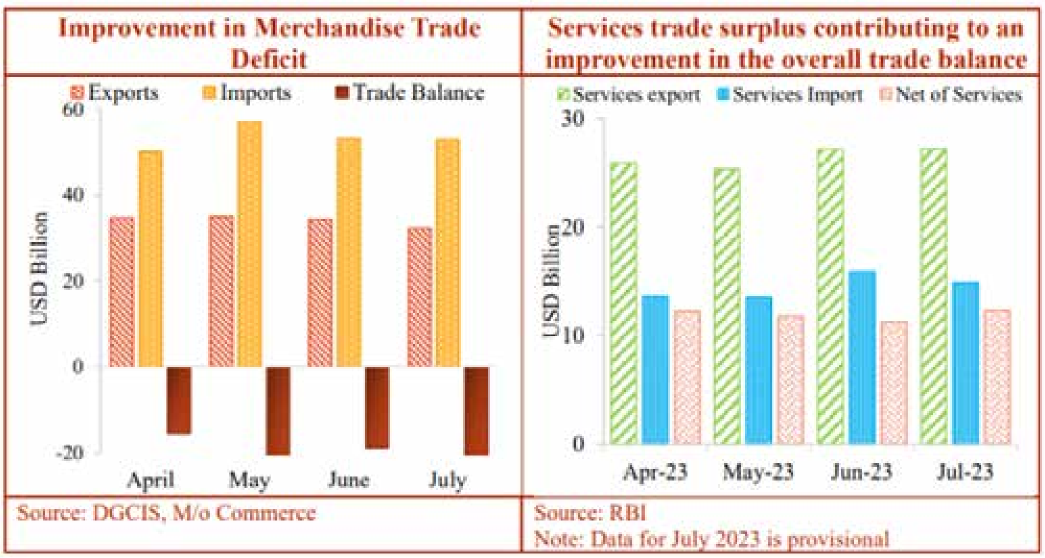
Note: Liquidity represented by Net liquidity injected (+)/ Absorbed (-) including outstanding operations

Global trade growth is slowing down.

- An examination of external stability measures highlights concerns regarding global trade due to multiple factors.
- Falling commodity prices, especially in crude oil, along with indications from major central banks about raising interest rates to control inflation, are significant factors of concern.
- Recent instances of monetary policy tightening by countries like the United States, the United Kingdom, and Russia underscore that inflation remains a challenge.
- Ongoing geopolitical events and trade restrictions, such as those related to critical minerals, are additional factors that may contribute to a trade slowdown.
- It is essential to monitor developments like the European Union's new regulations aimed at environmental protection, as they could potentially impact global trade patterns.

India's service exports remain robust.

- In July 2023, services exports demonstrated impressive growth, surging by 12% compared to July 2022. This marked a substantial improvement over the 0.7% growth experienced in June 2023 (year-on-year).
- Due to this robust performance, the services trade surplus saw a substantial increase of 20.8% in July 2023 compared to the previous year.
- In contrast, India's merchandise exports and imports experienced declines of 15.9% and 17%, respectively, year-on-year during the same month.
- A sectoral breakdown reveals that 11 out of 30 commodity groups contributed to positive export growth in July 2023 compared to the previous year. Notable contributors include iron ore (962.8%), oil meals (34.2%), oil seeds (32.8%), and ceramic products (20.8%).
- Concerning merchandise imports, several products, such as project goods, coal, coke & briquettes, fertilisers, crude & manufactured, and petroleum crude & products, saw declines in July 2023 compared to their levels in July 2022.



Foreign investors trust India's growth Potential.

- According to RBI data, India experienced a notable 4.7% increase in Foreign Direct Investment (FDI) inflow in 2022 compared to the previous year.

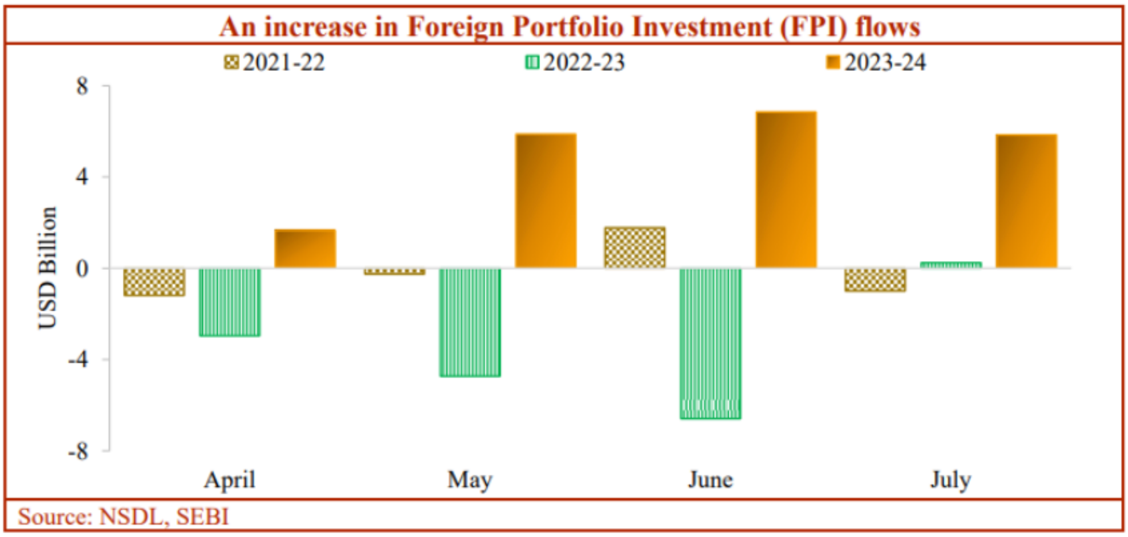
- India also displayed strong growth in project announcements during the same period, as indicated in the World Investment Report for 2023.

- This contrasts with the global FDI trend in 2022, which witnessed a 12% decline to USD 1.3 trillion. Several factors contributed to this decline, including ongoing geopolitical issues, elevated food and energy prices, reduced financial flows and transactions in developed countries, and debt pressures stemming from recessionary tendencies.

- Foreign Portfolio Investment (FPI) flows for FY24 (April 23-July 23) showed a positive trend in India, with net FPI inflows amounting to USD 20.2 billion. This is a significant turnaround from the net outflows of USD 14 billion observed during the first four months of FY23.

- India's foreign exchange reserves have increased due to robust foreign inflows and reduced imports. As of the end of July 2023, these reserves reached a substantial USD 603.9 billion, indicating a healthy financial position.

- These reserves are sufficient to provide an import cover of over ten months, underlining the country's resilience in managing external financial obligations.



Outlook

- Looking ahead, domestic consumption and investment demand are expected to remain critical drivers of economic growth.
- However, global uncertainty and domestic disruptions may continue to exert inflationary pressures in the coming months, necessitating increased vigilance from the government and the RBI.
- The government has already taken proactive measures to control food inflation, and with the arrival of fresh stock, it is anticipated that market price pressures will ease soon.
- The external sector should be closely monitored to enhance prospects amid the global pursuit of industrial policies. Services exports, particularly in Global Capability Centers, are performing well and are likely to continue doing so due to the ongoing preference for remote work.
- In the medium term, it is essential to assess the impact of emerging technologies, such as Artificial Intelligence, on the external demand for Indian services exports and their potential effects on employment.
- Risks to global stock markets, such as rising bond yields and the anticipation of further monetary tightening, also have implications for emerging economies' stock markets.
- As a result, maintaining macroeconomic stability is increasingly becoming a significant policy objective after relative respite from macroeconomic challenges.

For more information:
Ministry of Finance, Department of Economic Affairs
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