Research

CRISIL

An S&P Global Company

India macroeconomic outlook, fiscal 2023

Cloudy, with some sunshine

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Highlights

- **The growth forecast:** CRISIL retains its fiscal 2023 real gross domestic product (GDP) growth forecast for India at 7.3%, with downside risks
- **Why are risks tilted to the downside?** Higher oil prices, slowing global demand for India's exports, and higher inflation are acting as the major drag factors. Inflation reduces purchasing power and would weigh on revival of consumption — the largest component of GDP which has been backsliding for a while. However, a normal monsoon forecast and rebound in contact-intensive services are expected to bring some succour
- **Inflation at 6.8%:** We foresee the consumer price index (CPI)-based, or retail inflation rising to 6.8% on average this fiscal, compared with 5.5% last year. The impact of this year's heatwave on domestic food production, coupled with persisting high international commodity prices and input costs, will cause a broad-based rise
- **Current account deficit at 3%:** Elevated commodity prices, slowing global growth, and supply chain snarls do not augur well for India's current account balance. We expect the current account deficit (CAD) to widen to 3% of GDP this fiscal, up from 1.2% in fiscal 2022
- **Rupee at 78/$:** The rupee-dollar exchange rate will remain volatile with a depreciation bias in the near term due to a widening trade deficit, foreign portfolio investment (FPI) outflows and strengthening of the US dollar index (owing to rate hikes by the US Federal Reserve, or Fed, and safe-haven demand for the dollar amid geopolitical risks). We expect the exchange rate to settle at 78/$ by March 2023, compared with 76.2/$ in March 2022

Our rationale for the growth outlook

The economy was just moving past the impact of the pandemic, when it was confronted with newer risks.

The seemingly unending Russia-Ukraine war has wreaked havoc in commodity markets. While freight costs have moderated of late[1], they are still elevated when compared with the beginning of this year (pre-war). This seems to suggest that a continuing war will prevent any meaningful correction. For India, this translates to higher import bills and higher inflation.

At the same time, global growth projections have been lowered[2], signalling a drag on India's exports.

Then, there is spectre of 'stagflation' looming large, as systemically important global central banks use the sledgehammer of rate hikes to tame inflation.

Domestically, revival in private consumption, the largest demand-side driver, remains weak. Though investments have shown some pick up, it will remain closely tied to consumption momentum.

The only bright spots are the uptick in contact-intensive services and forecast of a normal and well-distributed monsoon.

Hence, we retain our real GDP growth forecast at 7.3%, with downside risks.

[1] For instance, the Baltic Dry Index has descended from its recent peak of 3369 on May 23 to 2204 on June 28
[2] See box on Global Outlook

What’s getting growth down?

The commodity price shock is continuing well into this fiscal

The Russia-Ukraine war has dealt a severe blow to energy and food supplies. Energy prices are projected to rise over 50% this year, and non-energy by ~20%, according to the World Bank’s latest commodity outlook.

Crude oil, of which India is a major importer, is expected to average $105-110/bbl[3] this fiscal, up 35% over last fiscal, and the highest since 2013. According to the World Bank, “the increase in energy prices over the past two years has been the largest since the 1973 oil crisis and price increase for fertilizers, which rely on natural gas as a production input, have been the largest since 2008.”

High commodity prices have a domino effect on India. As the terms of trade worsen with a rising import bill, imported inflation surges.

For instance, between April and January in fiscal 2022, we assess that imported inflation accounted for as much as 60.9% of the wholesale price index (WPI)-based inflation[4]. Such pressures are likely to play out this fiscal as well. Some commodity prices have moderated, and others are expected to soften going ahead, but even with moderation, many commodity prices will be above fiscal 2022 levels.

Global outlook for 2022

The global economy continues to face an unusually large number of shocks.

Beginning 2022, the effects of the pandemic were in retreat in most geographies and S&P Global had forecast a robust but uneven rebound, with above-trend growth in most countries and moderately high but transitory inflation.

However, even that cautious optimism has given way to worries of a sharply weakened global economy ahead, on account of a longer-than-expected Russia-Ukraine conflict, higher energy and commodity prices, economic damage from pandemic lockdowns and restrictions in China, and faster-than-anticipated monetary policy normalisation by major central banks such as in the United States (US) and European Union.

Clubbed with weak first quarter growth, the above scenario has forced a paring of growth forecasts for all major global economies *(see table below).*

Moreover, the balance of risks to the baseline forecast has deteriorated and remains on the downside.

[3] CRISIL Research forecast
[4] Refer to CRISIL insight, ‘The burden of price’, May 12, 2022

Global growth forecasts pared, %

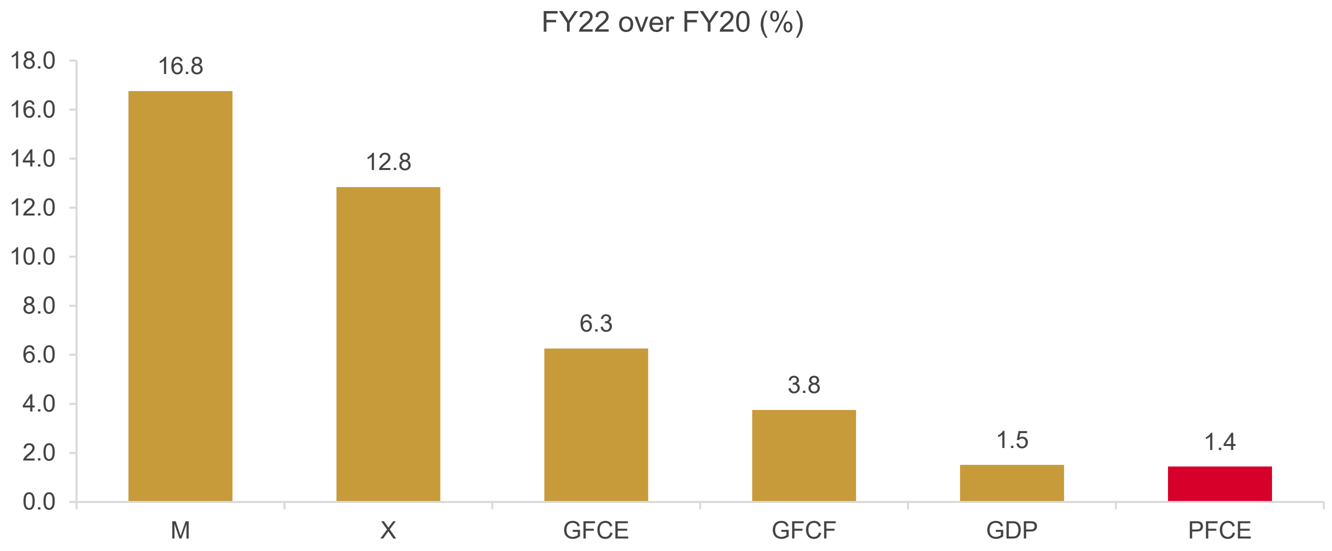
	2021	2022F (March)	2022F (June)
US	5.7	3.2	2.4
Eurozone	5.2	3.3	2.6
UK	7.3	3.5	3.2
China	8.1	4.9	3.3
Japan	1.7	2.4	2.0
World	6.0	3.6	-

Source: S&P Global

Private consumption remains a weak link

The recently released GDP data confirmed that private consumption, represented by private final consumption expenditure (PFCE) data, remains weak. While all other components have been staging a livelier comeback, PFCE has been the slowest to recover from the pandemic's impact — it was just 1.4% above its pre-pandemic (fiscal 2020) level in fiscal 2022. In fact, PFCE growth slowed sharply to 1.8% on-year in the fourth quarter of fiscal 2022, from 7.4% in the third quarter, reflecting the mixed impact of the omicron-led third wave and higher inflation.

Private consumption is the slowest GDP component to recover



Note: M = Imports, X = Exports, GFCE = Government final consumption expenditure, GFCF = Gross fixed capital formation, GDP = Gross domestic product, PFCE = Private final consumption expenditure; data is in real terms

Source: NSO, CRISIL

Three trends are noteworthy here.

One, a higher and broader-based inflation this fiscal will create a further drag on the private consumption revival. Higher food and fuel prices (more details in the inflation section) would shrink the budget for discretionary spending in the low- and mid-income categories since food and fuel form a greater part of their consumption basket[5]. This is at a time when higher core inflation is already creating headwinds for discretionary spending. This is in sync with RBI's consumer confidence survey which found that households "expected higher essential spending whereas the sentiments on non-essential spending remained downbeat."

Two, is the divergence in consumption. While recovery in low-priced items remains weak, high-ticket items are seeing a much better uptick (for e.g., see table below). This reflects the K-shaped nature of economic recovery.

Premium vehicle segments have recovered relatively faster whereas low-priced variants underperform

Volume growth (%, y-o-y)	Price range	FY20	FY21	FY22	2MFY23*
Passenger vehicles	Up to Rs 10 lakh	-16%	-2%	4%	17%
	More than Rs 10 lakh	-17%	0%	38%	62%
Motorcycles	Up to Rs 70,000	-19%	-16%	-11%	66%
	More than Rs 70,000	-15%	-1%	-10%	55%
Scooters	Up to Rs 70,000	-26%	-27%	-33%	84%
	More than Rs 70,000	-15%	-18%	-8%	118%

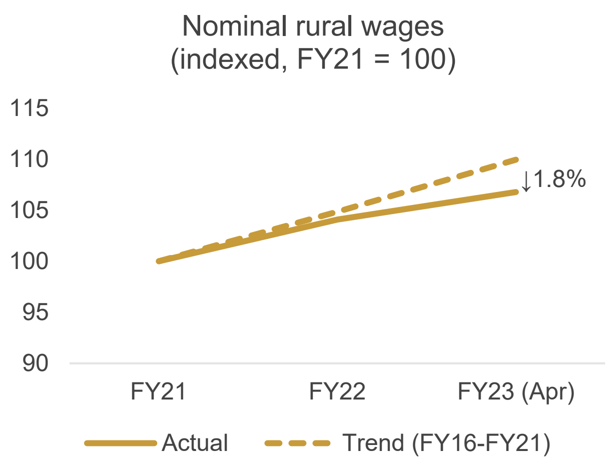
*April-May 2022

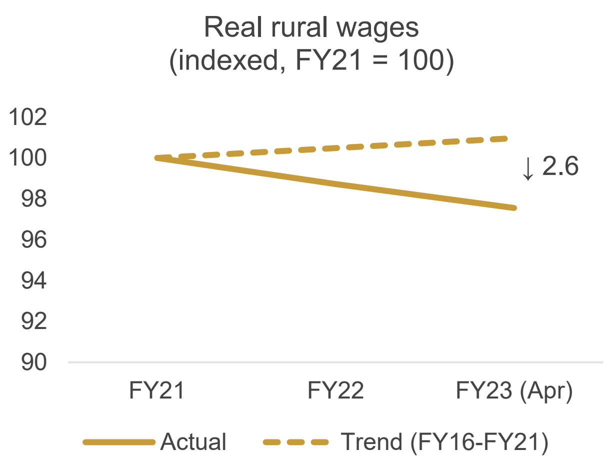
Source: SIAM, company reports, industry estimates, CRISIL Research

It follows that revenue growth in many of the low-ticket consumption items is being driven more by price growth and less by volume growth. For instance, in automobiles, CRISIL Research projects revenue growth for two-wheelers (a low-ticket item vis-à-vis cars) at 8-13% this fiscal, but volume growth at a much lower 3-8%. On the other hand, cars are likely to see 12-16% and 10-15% growth, respectively.

Three, rural distress could be on the rise. Slower wage growth coupled with high inflation is denting rural purchasing power. Not only has rural income growth slowed in nominal terms - from an average of 6.1% in fiscal 2021 to 4.1% in fiscal 2022, but real incomes have been declining, led by rising consumer price inflation. In fact, both nominal and real rural wages remain below trend (*see charts below*).

Rural wages remain below trend





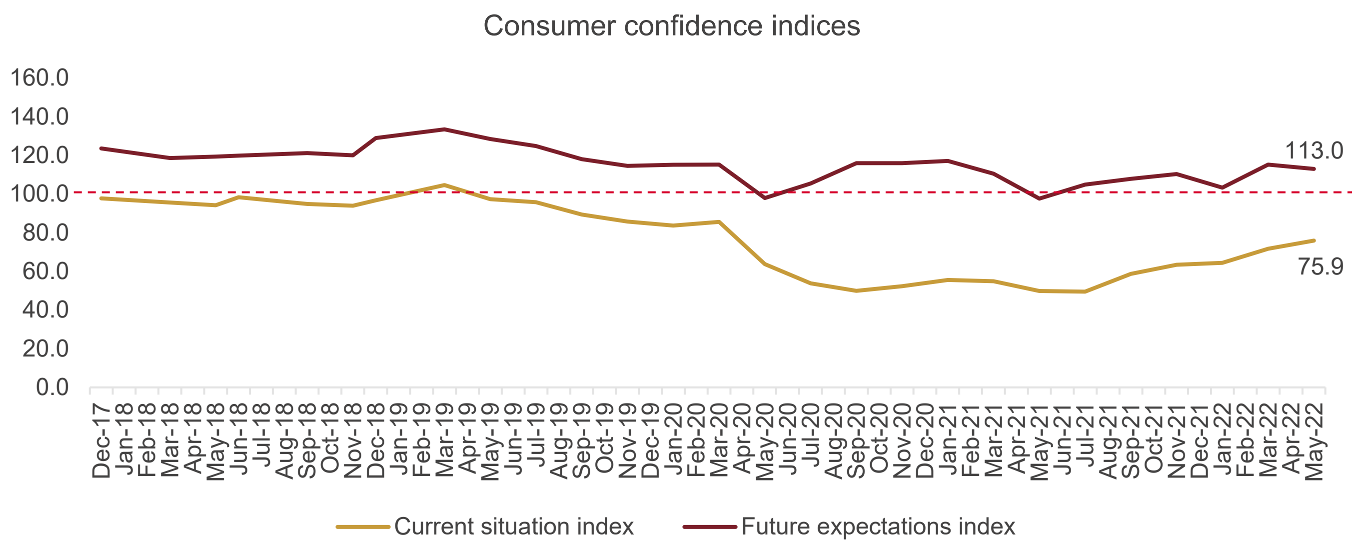
Source: Labour Bureau, India, CRISIL

[5] Refer to CRISIL Insight, 'The burden of price', May 12, 2022, for more details

Also, the number of persons demanding work under the Mahatma Gandhi Rural Employment Guarantee Act (MGNREGA) remains high, showing distress in the countryside. In May 2022, for instance, around 31 million households demanded work under MGNREGA, which is almost 16% higher on-year and much higher than the corresponding pre-Covid period.

To be sure, consumer confidence has improved over the past few quarters. However, both the current situation and future expectation indices continued to trail the pre-pandemic levels in May 2022 (*see chart below*).

Consumer confidence still below pre-pandemic levels



Source: RBI, June 2022

Investments seeing an uptick, but muted consumption preventing lift-off

The share of gross fixed capital formation, or investments, in the economy rose to 32.5% of GDP in fiscal 2022, from 30.5% in fiscal 2021. This has largely been government-led, through a focus on infrastructure-led capital expenditure (capex).

In fiscal 2022 for instance, the central government undertook capex of Rs 5.93 lakh crore, up 39.2% on-year. This is budgeted to rise 26.5% to Rs. 7.5 lakh crore this fiscal. Despite some pressure on fiscal math due to the recent petrol and diesel excise cuts to curb inflation and the increased subsidy burden on account of higher food and fertiliser prices, the government has reiterated its resolve to stick to its capex programme. But it is noteworthy that even if government spends the budgeted amount, the quantum of infrastructure and associated work generated could be lower, thanks to increased costs due to higher raw material/input prices.

At the same time, private sector investment, which have been declining in the past few years, is expected to gain some traction since: a) corporates have been deleveraging and thus have appetite for undertaking fresh investment, and b) capacity utilisation (CU) in the economy has been inching up, which could necessitate more investments. According to the Reserve Bank of India's (RBI) latest OBICUS[6] survey, CU for the manufacturing sector at the aggregate level rose to 74.5% in the fourth quarter of fiscal 2022, from 72.4% in the third quarter.

However, dichotomies in sectoral CU rates prevail. CRISIL Research finds different recovery trends between infrastructure-linked and industrial sectors. While utilisation levels in infra-linked sectors such as steel and cement

[6] Order Books, Inventories and Capacity Utilisation Survey

have rebounded strongly, in line with economic recovery, that of key auto verticals are still lower than the long-term average.

- For steel and cement sectors, CU is estimated at 75-80% and 65-70%, respectively, in fiscal 2022
- On the other hand, passenger vehicles, two-wheelers, and commercial vehicle segments continue to operate below 60% utilisation due to supply-chain constraints and muted recovery
- A stark difference is also observed between utilisation of top 2-3 players in each of these segments vis-à-vis rest of the market, with large players continuing to push the pedal on capex. This is also in line with consolidation observed across most sectors in revenue performance

The production-linked incentive scheme is expected to support private capex. It is likely to generate Rs 2.5-3.0 lakh crore of capex spread across 14 manufacturing sectors over the medium run. Given that approvals for many companies were granted in the third quarter of fiscal 2022, a part of that is likely to start showing up this fiscal.

All that said, the subdued consumption revival, coupled with an uncertain global environment, could limit the extent and pace of overall investment recovery. Hence, we expect only a marginal uptick in the share of investment in GDP this fiscal.

What's getting growth up?

Broad-basing of domestic economic activity

Not all is gloom and doom though. The latest tax collection data is encouraging and points to continued economic recovery.

According to the Ministry of Finance, gross and net tax revenues were up 40% and 45% on-year, respectively, as of mid-June 2022. Similar buoyancy is visible in Goods and Services Tax (GST) collections, which rose 30% on-year during April-May 2022.

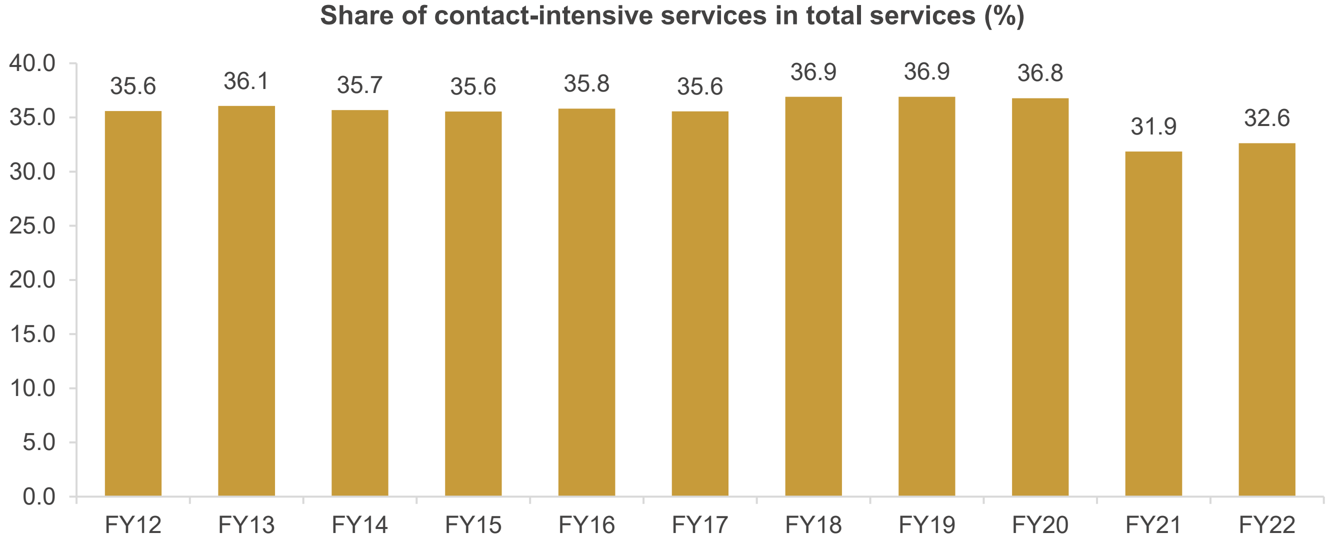
While higher tax collections are partly a result of higher inflation leading to higher nominal growth, they also reflect the healthy momentum observed in the first quarter of the current fiscal.

Take for instance, the contact-intensive services sector. In fiscal 2022, gross value added (GVA) in trade, hotels, transportation, etc., was still 11.3% below its pre-pandemic levels. But with the pandemic's impact ebbing and large-scale vaccination coverage[7], this segment is recovering. Real GVA of the segment clawed back to Rs 7.42 lakh crore in the fourth quarter of last fiscal, above the pre-pandemic level (fourth quarter of fiscal 2020) of Rs 7.30 lakh crore.

This is significant because contact-intensive services form a substantial part of overall services GVA (see chart below). In the three years before the pandemic, it averaged ~37%, but lost steam in fiscal 2021 when Covid hit. If these services fully recover the lost ground this fiscal, they could grow ~20% on-year, crossing the pre-pandemic level of fiscal 2020 and thereby contributing ~200 basis points (bps) to GVA growth this fiscal. This rebound is expected to support urban consumption demand.

[7] 65% of India's population is now fully vaccinated, compared with the world average of 60.7% (as on June 20, 2022)

Contact-intensive services lost ground during the pandemic



Note: Contact-intensive services refer to the trade, hotels, transport, communication and services related to broadcasting; data is in real terms

Source: NSO, CRISIL

Forecast of a normal monsoon, albeit distribution remains monitorable

The India Meteorological Department (IMD) has forecast normal rains (103% of the long-period average) during the south-west monsoon this year, making it the fourth consecutive year of normal/above normal rainfall.

Though this augurs well for the agriculture sector and, thereby, rural demand, the spatial and temporal distribution of rainfall is a monitorable. For instance, as of June 30, 2022, while overall rainfall remained normal (8% below LPA[8]), it was deficient in central India (30% below LPA), an important crop-growing region.

Moreover, as many as 14 states still have deficient rainfall (-59% to -20% of LPA) and two have large deficiencies (-99% to -60% of LPA), as shown in the Annexure.

Deficient rainfall in many parts of the country has meant lower kharif sowing so far this year, over last year (see annexure). However, it is worth highlighting that June marks only the beginning of the kharif sowing, which gathers pace in July. Hence the rainfall in July will remain a crucial monitorable.

Increasing extreme weather conditions are posing risks to agricultural output

According to the IMD, March 2022 was India's hottest March in recorded history (1901-2022). The temperatures were high all over India, especially in the northwest that scorched under a heat wave. The average maximum temperature over northwest and central India in April this year has also been the highest in 122 years. The IMD declares a heatwave if at least two weather stations experience a maximum temperature of 45 degrees Celsius or above, or the temperature is 4.5- 6.4 degrees Celsius above normal for two consecutive days.

A recent research study by Grantham Institute – Climate Change and the Environment, Imperial College London suggests that while such heatwave events are rare, "climate change caused by greenhouse gases from burning fossil fuels has made it about 30 times more likely to happen." The study also showed, if the average global

[8] Long period average

temperature rise reaches 2°C, such heatwaves could be expected as often as once every five years. It is worth noting that in India, 11 of the 15 warmest years since 1901 were during the past fifteen years (2007-2021).

To be sure, heavy rainfall-led floods, cold waves and cyclones are also extreme weather events — India experienced five cyclones last year, three of which were severe and above.

According to the Germanwatch Global Climate Risk Index (CRI), which is based on extreme weather events such as storms, floods and heatwaves in a particular year, India is one of the most vulnerable countries for the extreme weather events. Compared with 31 in 2010, India ranked 7 on CRI in 2019.

CRISIL Research studied the impact of the February-April heatwave this year on agriculture and found it had affected several field and horticultural crops:

- Yield decline in wheat due to heatwaves was evident across all the major wheat-producing states. In Punjab, which contributes ~15-16% to total wheat production, yields are estimated to have declined ~15% on year. At a pan-India level, wheat yield for marketing year 2022 is estimated to decline 5-6%
- The seed setting of mustard and cumin has also been affected, resulting in estimated lower yields on-year. Ultra-high temperatures in March have also impacted summer crops such as groundnut and bajra, leading to poor germination and vegetative growth
- Overall mango yield from the northern states of Uttar Pradesh and Bihar is estimated to have declined a significant 15-20% on-year in 2022

Inflation

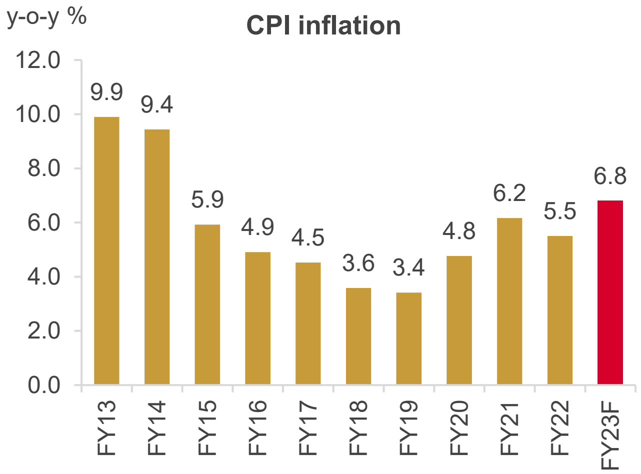
Compounding shocks worsen outlook

We expect CPI inflation to rise to 6.8% on average this fiscal, from 5.5% previous fiscal.

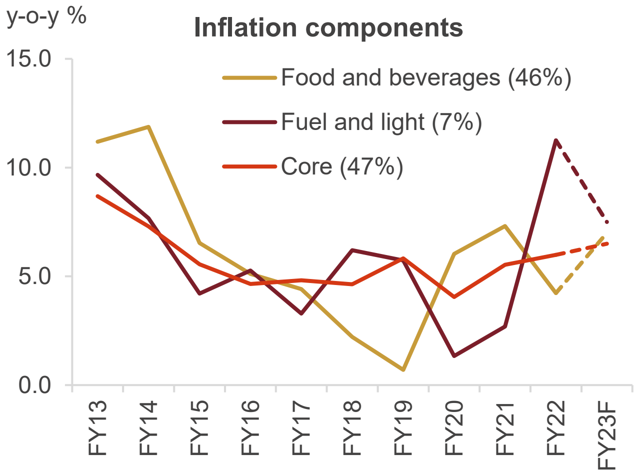
This would be the highest level in 9 years, and above the RBI's target range of 2-6%.

Domestic climate-related shocks affecting food supply, even as the Russia-Ukraine war continues to put pressure on commodities worldwide, has led to a deteriorating outlook.

Poised to reach a 9-year high



Food to drive the rise, non-food elevated too



Note: F refers to CRISIL forecast; figures in brackets in RHS chart refer to respective category's weight in CPI

Source: NSO, CEIC, CRISIL

The heatwave's impact on food production

The outlook on food inflation has worsened considerably after the unnatural heatwave impacted production of several foodgrains, vegetables and spices this year, including major ones such as wheat and tomatoes.

Wheat supply is particularly tight. The third advance estimate for the year revised down wheat production by 4.4%, pegging it at 106.4 million tonne (MT) in fiscal 2022, the lowest since fiscal 2019. Low production has hit the Food Corporation of India's procurement and buffer stocks. As of June 1, 2022, wheat buffer stocks fell to 31.1 MT, 48.3% lower on-year, reaching the lowest level since June 2008. It is only slightly above the operational and strategic norms set for July (*see table below*).

Rice stocks, however, are more comfortably placed so far.

The easing of food prices hereon will, among other aspects, depend on the quantum and spread of the monsoon. A normal monsoon could help ease prices in the second half. However, its intensity and distribution will have an important bearing on production.

Some relief is also expected from easing edible oil prices with the lifting of Indonesia's export ban and import duty relief provided by Indian government.

Wheat buffer stocks stand precariously close to minimum requirements

In million metric tonnes	Norms for July 1		Stock on June 1, 2022
	Operational	Strategic	
Rice	11.5	2.0	33.1
Wheat	24.6	3.0	31.1

Source: FCI, CRISIL

Persistently high international commodity prices

The sharp rise in commodity prices post the Russia-Ukraine war is unrelenting.

Crude oil outlook has worsened as the European Union announced in May that it would ban 90% of Russian crude oil by end-2022. CRISIL Research expects Brent crude to average $105-110/barrel in this fiscal compared with $80 per barrel in fiscal 2022.

Commodities such as metals have begun seeing price corrections as global demand softens. CRISIL Research projects prices to trend lower sequentially in the second half of this fiscal for several energy, agriculture and metal commodities (see table below). Yet, on average prices are expected to remain higher on-year for most agriculture and energy commodities this fiscal.

Overall, the broad-based surge in global commodity prices will put pressure on food, fuel and core[9] inflation in India:

- Food inflation faces pressure from rising prices of fuel, fertiliser, pesticides, and animal feed
- Elevated prices of crude and other energy products will put pressure on fuel inflation, which comes on top of the pass-through of prices pending from the previous fiscal

[9] CPI excluding food and beverages and fuel and light

- Delayed pass-through from fiscal 2022, coupled with the surge in prices in this fiscal, will also lead to higher core inflation. Producers have consistently faced double-digit WPI inflation since April 2022 till date. Despite the recent moderation in some commodity prices, the wedge between WPI and CPI remains high. Producers are expected to pass on the persistently elevated cost pressures to consumers to a greater extent this fiscal. RBI surveys of the manufacturing, services and infrastructure sectors corroborate expectations of a further rise in input and output prices going forward
- The rise in core inflation is also expected to get broad-based, as services inflation rises along with goods inflation. Services inflation had been subdued so far as demand was severely hit by pandemic-induced restrictions. However, in our recent analysis[10], we find that inflation has begun rising fast in discretionary and transportation-linked services in the past six months, as pandemic restrictions eased.

Commodity prices to ease sequentially in second half, yet remain higher on-year for many items

Commodity		Sequential price growth (%)		Annual price growth (%)
		H1FY23/ H2FY22	H2FY23/ H1FY23	FY23/FY22
Energy	Brent crude - international	↑	↓	↑
	Coal - Indonesian non-coking	↓	↓	↑
	Natural gas - international spot	↓	↑	↑
Agriculture	Wheat - domestic	↑	↑	↑
	Edible oils - domestic	↑	↓	↑
	Sugar - domestic	↑	↓	↑
	Corn - domestic	↑	↓	↑
	Cotton - domestic	↑	↓	↑
Metals	Steel - domestic	↓	↓	↓
	Aluminium - domestic	↑	↓	↑
	Zinc - international	↑	↓	↑
	Copper - international	↓	↓	↓
Precious metals	Gold - international	↑	↓	↑

Source: CRISIL Research

[10] *The turn of services inflation*, CRISIL Quickonomics, May 2022

More policy rate hikes ahead, but growth impact to be mild this fiscal

The RBI is expected to aggressively tighten monetary policy in the next few months, to tackle surging inflation and the tight global financial conditions. After hiking repo rate by 90 bps so far, we expect at least another 75 bps hike in the remainder of fiscal. These hikes are expected to be frontloaded in first half of the fiscal, given that inflationary pressures remain high at present. The further pace of hikes however, will depend on the inflation trajectory in second half, and how the US Fed calibrates its moves.

Prolonged high levels of oil and commodity prices can keep upside risks to inflation high. Rate hikes beyond 75 bps cannot be ruled out if inflation overshoots RBI's projected trajectory.

It is expected that the RBI will continue monitoring surprises on global monetary policy actions. Compared with the RBI's 90 bps hike, the US Fed has raised its policy rate by 150 bps so far. For now, S&P Global to accelerate monetary tightening and raise rate by another 200 bps (cumulatively, 350 bps) to 3.50-3.75% by mid-2023. However, downsides to US growth are emerging and the Fed will watch for any signs of sharp slowdown in growth.

The RBI there is dilemma on two fronts. First, the inflation problem is largely supply driven but there are pockets where demand-side pressures play a role. Second, growth is sluggish given weak consumption growth and domestic financial conditions are already tightening.

Hiking repo rate by another 75 bps, will take the repo rate to 50 bps above the pre-pandemic level and push real repo rate into the positive territory by the last quarter of the current fiscal.

We believe that RBI will 'cross the river by feeling the stones' after 75 bps of hikes.

Why rising interest rates may not dent growth prospects in a big way

That said, we believe India's GDP growth does not face significant downside risks from rising rates this fiscal due to the following reasons:

- **Real interest rates likely to remain lower than pre-pandemic levels:** Though the repo rate is rising, it is unlikely to catch up with inflation for most of this fiscal. Our base case assumes repo rate to reach 5.65% by March 2023. Meanwhile, CPI inflation is expected to average 6.8% this fiscal, and at 5.8% in the final quarter as per our assessment. Thus, real policy rate is expected to turn weakly positive by fiscal-end, which will still be lower than pre-pandemic (0.60% in fiscal 2020 and 2.92% in fiscal 2019).
- **Monetary policy actions get transmitted to the broader economy with a lag**: Monetary tightening typically impacts growth with a lag of at least 3-4 quarters; hence, the peak impact of rate hikes will be felt towards the last quarter of this fiscal and the first quarter of the next. Even as bank lending rates have begun rising, they remain lower compared with pre-pandemic levels as well as relative to the past decade.

Current account balance

Terms of trade shock to widen CAD

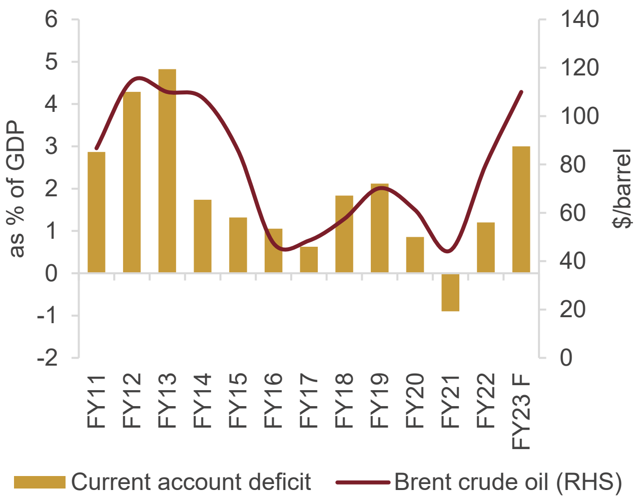
We expect the CAD to widen to 3% of GDP this fiscal, with imports becoming costlier owing to higher commodity prices, while exports face slowing external demand. The Russia-Ukraine conflict and China's slow easing of restrictions from its zero-Covid strategy has strained supply chains, further slowing merchandise trade and increasing logistic costs. The steep widening of the CAD will contrast with the past two years: the first year of the pandemic saw current account turning surplus (at 0.9% of GDP) in fiscal 2021, owing to sharp contraction in imports. Fiscal 2022 saw recovery in merchandise trade and domestic demand, leading to the CAD moving into deficit zone, but remaining comfortable at 1.2% of GDP in fiscal 2022.

CAD to widen as merchandise trade deficit worsens. India's CAD is largely influenced by the merchandise trade deficit. This is expected to widen, as imports increase more than exports. Elevated commodity prices will have the largest bearing on import values particularly, crude oil. Crude and petroleum products are India's largest import items, accounting for ~27% of total imports.

Further, import demand is sticky, with its income elasticity at 0.9[11]. Thus, imports are expected to remain steady, despite high international prices and slowing domestic growth this fiscal.

Exports, on the other hand, are highly sensitive to global demand — income elasticity of exports is high at 3.9. Since global demand is expected to soften this year (as recovery moderates, pandemic-induced policy support is withdrawn and monetary policy is tightened), India's exports may not find much support. Further, we estimate the price elasticity of exports (i.e., responsiveness to prices; here, the real exchange rate) is low, at 0.8. Hence, a depreciation of the exchange rate may not provide much impulse to exports as global growth is the dominant driver.

Current account balance closely tracks crude oil price trajectory



India's merchandise exports closely tracks global GDP

Source: RBI, Ministry of Commerce and Industry, IMF

But expect some support from services trade surplus. The rebalancing of global demand from goods to services this year, with the pandemic easing further, is expected to provide an impetus to services exports. Already, growth in information technology (IT)/IT-enabled services, and telecom services exports supported overall services exports to a record high in fiscal 2022. However, the support will be limited to an extent: as services exports account for about 38% of total exports, and hence, will not alter the overall trade (merchandise+ services) balance significantly.

[11] Absolute values of elasticity more than one are interpreted as high sensitivity, elasticity less than one has the opposite interpretation. All figures are from OLS estimation of import and export demand functions for the period 2004Q2-2020Q4.

The rupee

Depreciation bias intensifies

The rupee-dollar exchange rate will remain volatile with depreciation bias in the near term due to widening of the trade deficit, FPI outflows, and strengthening of the US dollar index (owing to rate hikes by the US Fed and safe-haven demand for the dollar amid geopolitical risks).

The rupee has slipped ~4.6% so far this fiscal (as of June 29, 2022). It has remained relatively stable though, compared with past crises (e.g., Taper Tantrum 2013, Global Financial Crisis 2008), since external vulnerability remains relatively low (read relatively high import cover and low external debt). The RBI, too, has stepped in via forex market interventions to manage volatility, but at the cost of forex reserves going down (*see box below).*

Though India is less vulnerable to external shocks now compared with 2013, the shocks this time are much bigger with the Fed on an aggressive rate hike path amid escalating geopolitical tensions.

We thus expect the rupee to be under pressure in the near term. The exchange rate had already touched new lows, at 79/$ as on June 29. However, the pressure may ease towards the end of the fiscal, as crude oil prices are expected to come down, and the Fed slows its rate hike spree. Hence, we expect the exchange rate to settle to 78/$ by March 2023, compared with 76.2/$ in March 2022, with a lot of volatility thrown in between now and then.

Persistent FPI outflows and RBI's interventions dent forex reserves

Widening CAD, persistent risk-off sentiment owing to geopolitical tensions, strengthening dollar index, and continuous sell-off by foreign portfolio investors has put depreciating pressure on the rupee. The foreign portfolio investors have remained net sellers in Indian markets since October 2021. Since the start of calendar 2022, they net-sold more than $23 billion, higher than the net purchase of $21 billion in the two years of the pandemic. Net foreign direct investment (FDI) inflows were robust in the March-ending quarter, providing some cushion to the currency, but were still dwarfed by the FPI outflows. At the same time, the US dollar index has appreciated more than 4% in 2022 so far.

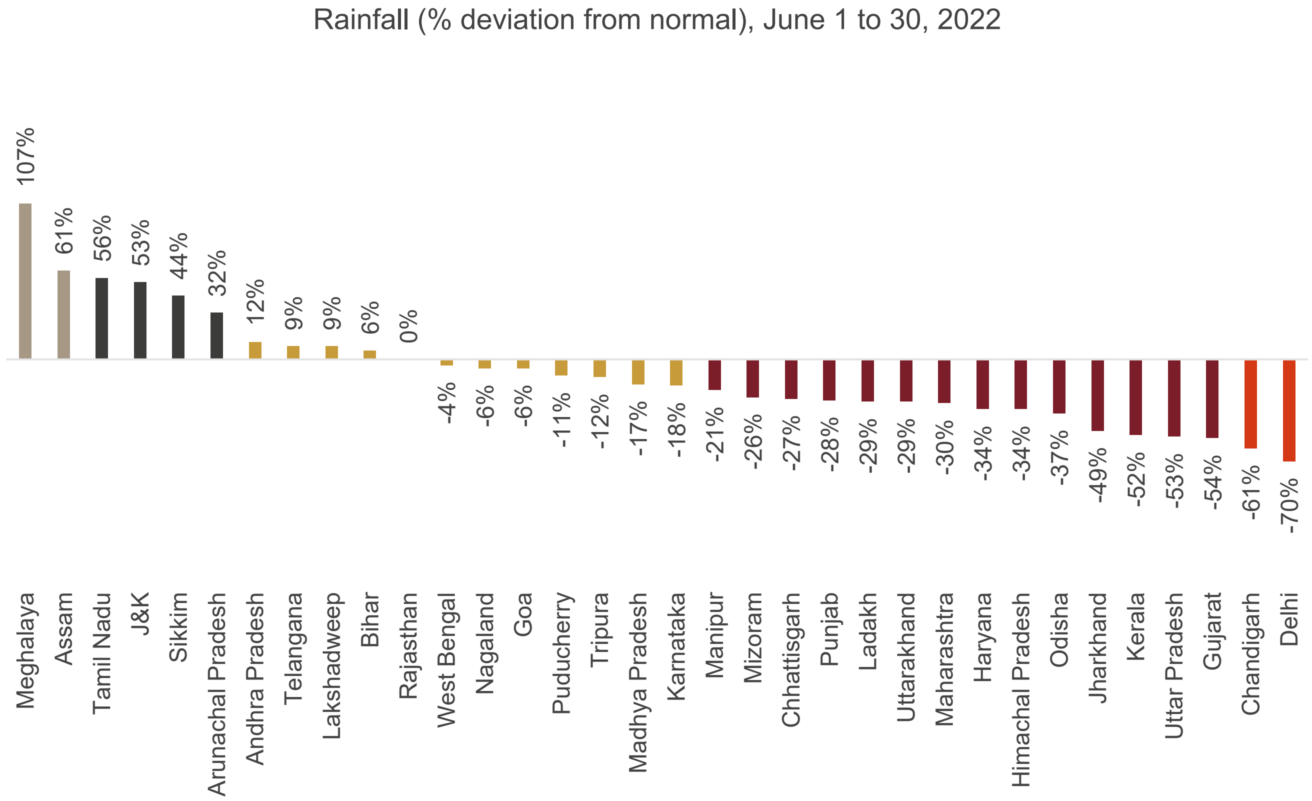
The RBI has stepped in to arrest a large depreciation in the currency, with interventions in the spot and forward forex markets. The RBI governor has stated that they would not "allow a runaway depreciation" further signalling the central bank's intent. In the first month after the Russia-Ukraine conflict erupted, the RBI net-sold $20 billion in the spot market (March 2022), its highest ever in the past decade.

The interventions in the spot market have shaved off part of the RBI's sizeable forex buffers: at the start of the crisis, RBI forex reserves totalled $631 billion (as on February 25). This has since come down to $590.6 billion (as on June 17). Of course, part of the decline may be attributed to valuation loss, as the US dollar index has appreciated in the interim.

The drawdown of forex reserves in the past few months has led the central bank to intervene in the forex market through alternative means, without depleting its reserves. It is doing so via operations in derivative markets (in forwards), and with banks selling dollars on behalf of the RBI. Latest data available for April shows the RBI's net forward assets (receivable) stood at $63.8 billion, up from $49.1 billion in February.

Annexure

State-wise rainfall situation



Colour	Status	Criteria (% deviation from LPA)
	Large excess	≥ 60%
	Excess	20% to 59%
	Normal	-19% to 19%
	Deficient	-59% to -20%
	Large deficient	-99% to -60%

Source: IMD, CRISIL

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Weekly area coverage under kharif crops as on June 24, 2022 (lakh ha)

Sr no	Crops	Area sown (lakh ha)		Difference in area coverage over	% of increase (+)/ decrease (-) over
		2022	2021	2021	2021
1	Rice	19.59	36.03	-16.44	-45.62
2	Total pulses	8.7	13.62	-4.91	-36.08
(i)	Arhar	2.35	5.21	-2.86	-54.87
(ii)	Kulthi	0.02	0.02	0	-0.13
(iii)	Urad	0.93	1.94	-1.01	-52.03
(iv)	Moong	3.38	5.13	-1.75	-34.08
(v)	Other pulses	2.02	1.32	0.7	53.06
3	Total coarse cereals	11.08	18.06	-6.98	-38.65
(i)	Jowar	0.6	1.01	-0.41	-40.76
(ii)	Bajra	1.27	3.99	-2.72	-68.12
(iii)	Ragi	0.03	0.07	-0.04	-53.94
(iv)	Maize	8.13	11.98	-3.85	-32.15
(v)	Small millets	1.05	1.01	0.04	4.01
4	Total oilseeds	11.78	22.41	-10.63	-47.45
(i)	Groundnut	7.62	8.72	-1.1	-12.62
(ii)	Sunflower	0.75	0.47	0.29	61.13
(iii)	Sesamum	0.57	0.65	-0.08	-12.26
(iv)	Niger	0	0.01	-0.01	-91.05
(v)	Castor	0.02	0.04	-0.01	-33.36
(vi)	Soyabean	2.78	12.5	-9.72	-77.74
(vii)	Other oilseeds	0.03	0.03	0	-3.9
5	Sugarcane	50.74	50.16	0.58	1.16
6	Total jute and mesta	6.8	6.82	-0.02	-0.28
7	Cotton	31.83	37.34	-5.51	-14.76
	Grand total	**140.52**	**184.44**	**-43.91**	**-23.81**

Source: Department of Agriculture & Farmers' Welfare

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