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INDIA'S GROWING GLOBAL ECONOMIC ASCENDANCE: CONTINUED POLICY STABILITY IS NEEDED

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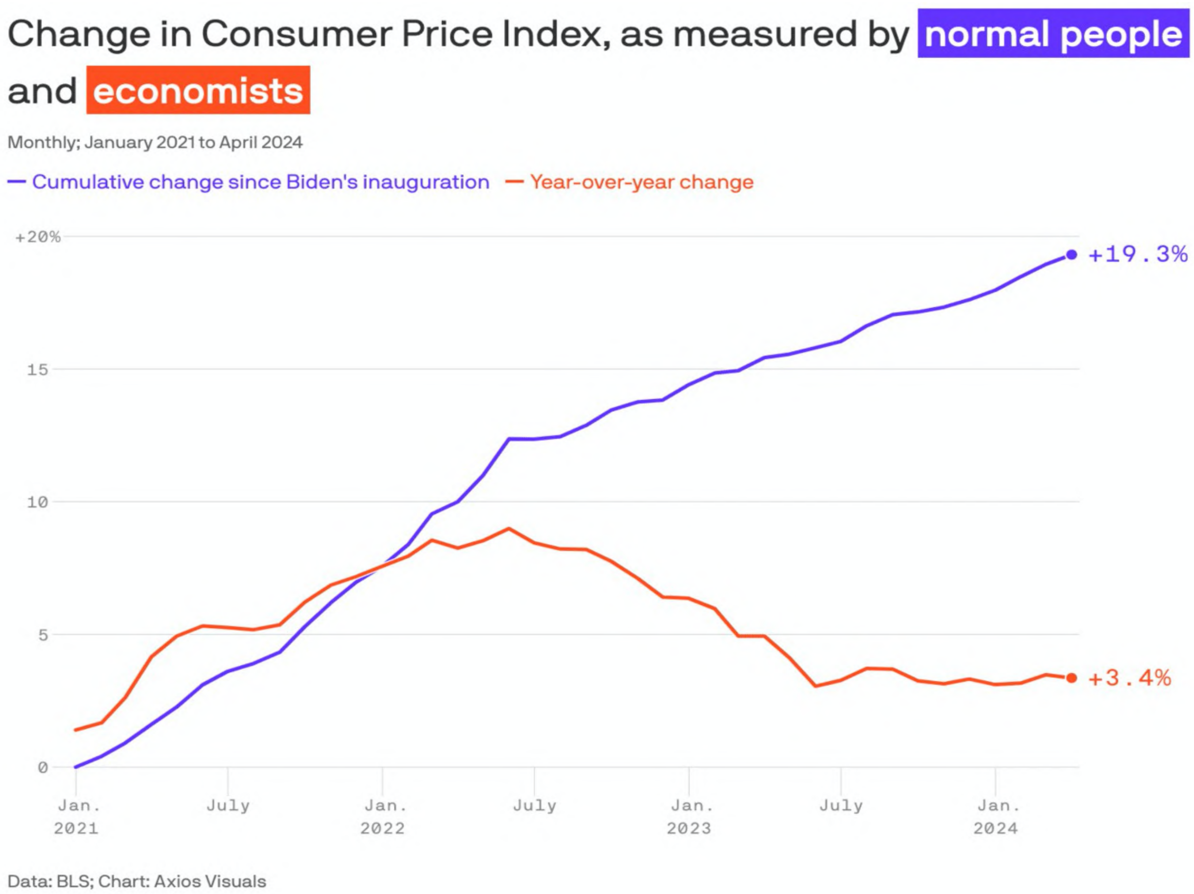
The US 10-year Treasury note yield has firmed up to 4.57 per cent (29 May'24) and the 2-year note reached almost 5 per cent (28 May'24). The labour costs in the United States increased to 121.23 points in the first quarter of 2024 from 119.86 points in the fourth quarter of 2023. Compensation costs increased 1.2 per cent for civilian workers, seasonally adjusted, from December 2023 to March 2024. Over the year, total compensation rose 4.2 per cent, wages and salaries rose 4.4 per cent, and benefit costs rose 3.7 per cent.

The market anticipation of any possible rate cut has shifted from June'24 to Sept'24, as the minutes of the May'24 Federal Open Market Committee (FOMC) reflected that there is a need to gain greater confidence that inflation would move sustainably towards 2 per cent target rate. The important question, in this context is - to contain an apparent inflation era, are we creating inflation story for petty and small-scale producers/manufacturers/households by sustaining high borrowing costs?

The Fed's Beige Book survey of regional business contacts released on May 29, 2024 revealed the dichotomy in the Fed's perception of inflation as against the view of the reality of most people. This anomalous situation is starkly reflected in the fact that as per government data, inflation fell steeply from its 40-year peak of 9.1 per cent two years ago to 3.4 per cent now. But the man on the street faced with still rising costs of eggs, coffee, meat, and orange juice finds this concept of "cooling inflation" difficult to reconcile with.



Rising prices together with Federal Reserve's high interest rates led to higher use of credit card and higher delinquency rates and drove sentiment lower. Hence this issue needs to be looked at against the backdrop of rising total household debt by $184 billion in the first quarter of the year, 1.1 per cent more than the end of 2023. Clearly, then, as William Shakespeare wrote powerfully in his classic work *Hamlet (*Act 1, Scene 2*)* centuries ago, "*all is not well; I doubt some foul play*".

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Emerging Contours of the Indian Economy

In the context of the Indian economy, there are some positive developments. Prior to the declaration of the election results, the global credit rating agency S&P has revised its outlook from stable to positive. This revision is based on India's continued policy stability, deepening economic reforms, and high infrastructure investment. The rating agency has stressed that going forward, the rating could be upgraded provided India's fiscal deficits narrow meaningfully such that the net change in general government debt falls below 7 per cent of GDP on a structural basis. Global rating agencies have highlighted that sustained deficit reduction, especially if underpinned by durable revenue-raising reforms, would be positive for India's sovereign rating fundamentals over the medium-term. The GoI aimed to narrow the fiscal deficit gradually towards 4.5 per cent of GDP by FY26.

The RBI, at the 608th meeting of the Central Board of Directors of Reserve Bank of India, on 22 May 2024, approved the transfer of ₹2,10,874 crore as surplus to the Central Government for the accounting year 2023-24, which surpassed the 0.3 per cent of GDP expected in the FY25 budget from Feb'24. The higher global yields, revaluation of reserves, and ever-increasing gold prices and reserves helped the central bank to garner much larger profits.

This much larger transfer from the RBI is a huge positive for the GOI in containing its fiscal deficit as well as prioritise its policies. For instance, a cautious saving of the windfall transfer could lead to a reduction of the fiscal deficit below 5.1 per cent of GDP in FY25. The clarity would be reflected after the formation of the new government post-election period, in its medium-term fiscal priorities. A deficit reduction would enhance its sovereign rating, cheer the bond market by softening the yields further.

Nevertheless, it seems that the capex plan of the GoI would be sustained as the GoI has announced plans to increase its capital expenditure on infrastructure projects to ₹ 11.1trn ($134bn) in its interim budget for 2024-2025, 11 per cent higher from the previous fiscal year.

Roads & Highways account for the highest share, followed by Railways and Urban Public Transport. The government has set ambitious targets for the transport sector, including development of two lakh-km national highway network by 2025 and expanding airports to 220. Furthermore, plans include operationalizing 23 waterways by 2030 and developing 35 Multi-Modal Logistics Parks (MMLPs). The total budgetary outlay for infrastructure-related ministries increased from around ₹ 3.7 lakh crore in FY23 to ₹ 5 lakh crore in FY24.

Projects in India, particularly government projects, have historically been beleaguered by time and cost overruns with a deleterious impact on the viability and the surplus generation of the project. The ratio of cost overruns in central government projects increased to a 12-month high of 20.1 per cent in April 2024 compared to 18.7 per cent in March 2024 (CMIE data, MOSPI). A cautious approach is needed to save precious resources spent on legal cases and avoidable issues. A balanced approach is needed to expend judiciously on health, education and to boost small enterprises to sustain the demographic dividend.

According to the Reserve Bank of India's (RBI's) latest annual report released on May 30, 2024, the Indian economy is projected to grow at 7 per cent — the fastest among major economies across the world — in the current fiscal year, because of solid investment demand which is supported by healthy balance sheets of banks and corporates, the government's focus on capital expenditure and prudent monetary, regulatory, and fiscal policies.

The RBI also justifiably maintained that the external sector's strength and buffers in the form of foreign exchange reserves will insulate domestic economic activity from global spillovers. The report, however, added that geopolitical tensions, geo-economic fragmentation, global financial market volatility, international commodity price movements and erratic weather developments pose downside risks to the growth outlook and upside risks to the inflation outlook. Hence, despite some concerns, India's macroeconomic landscape seems to be robust and resilient.