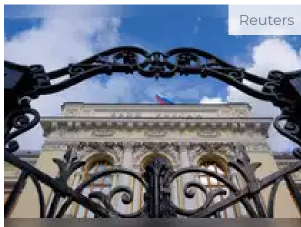
BENCHMARKS LIVE
Nifty 18,600.40 37.00
FEATURED FUNDS ★★★★★ 5Y RETURN
ICICI Prudential Large & ... 15.07 % INVEST NOW
Search Stock Quotes, News, Mutual Funds and more

Path Towards Economic Normalcy: Assessing the impact of inflation, central bank policies

By Kaustubh Gupta, ET CONTRIBUTORS

Last Updated: Jun 09, 2023, 08:06 PM IST

Synopsis
Despite global economic activity slowing down, the absence of any significant financial accidents, robust employment conditions, and stronger balance sheets have aided in withstanding the normalisation cycle better than expected. However, the pressure on demand conditions may continue to rise due to higher nominal yield curves and tightened lending standards. Although corporate earnings have surpassed expectations, inflation will likely remain elevated compared to pre-Covid levels. The worst of the inflation scare may be over, but central banks are unlikely to resort to rate cuts unless there is a threat to financial stability. RBI's proactive stance has supported India's growth momentum, but fiscal deficit run rate is 6%, and pre-emptive loosening can backfire, resulting in higher inflation. Thus, rates may remain higher for longer, and short-term funds may provide healthier accruals without taking significant duration risk.


Reuters

In the last six months, while global nominal economic activity has decelerated meaningfully, real growth has remained positive despite the aggressive pace of rate hikes.

Stronger balance sheets, robust employment conditions, and the absence of any large financial accidents have helped economic agents withstand this normalisation cycle better than counterfactuals would suggest.

ABSL AMC NSE LIVE - 11:05 AM | 12 Jun 2023
375.05 INVEST NOW
2.00 (0.54%) 1D

Is this the right time to buy ABSL AMC?
Talk directly with India's top stock market experts.
Explore More
MORE ON ABSL AMC

Market Dashboard NSE BSE
TOP GAINERS TOP LOSERS
IndusInd Bank 1,331.05
03:58 PM | 09 Jun 2023 27.20 (2.09%)
Power Grid 244.90
03:59 PM | 09 Jun 2023 3.25 (1.34%)
Axis Bank 974.75
03:56 PM | 09 Jun 2023 12.65 (1.31%)
L&T 2,363.00
03:58 PM | 09 Jun 2023 22.70 (0.97%)
View All Top Gainers ››

The higher nominal yield curve, tightening lending standards, and the lagged

effect of policy hikes indicate that the pressure on demand conditions will continue ahead. However, corporate earnings have broadly beaten expectations and risk markets have rallied from February lows indicating peak stress on margins may be behind us and that corporates retain pricing power.

Given this, one can make the case that the worst of the inflation scare is now over and the path towards normalcy has begun. However, inflation is likely to remain elevated compared to pre-Covid levels.

Over the last year and a half, central banks have been behind the curve on the assessment of inflation and are likely to seek assurance on that front before indicating any rate easing move.

In fact, central banks are unlikely to come to the rescue with rate cuts as demand slowdown is engineered to bring down inflation closer to policy targets unless there is a threat to financial stability.

TAP TO WATCH

Any pre-emptive easing could reverse the orderly disinflation process as goods prices stop declining and services inflation remains sticky.

Recently, two large central bankers (Australia & Canada) resumed their rate hikes after a brief pause as disinflationary tendencies aren't widespread enough to reach their policy goals.

Thus, we believe global policy response is likely to be highly uncertain & delayed and needs to be priced in while investing

RBI has been very proactive and has proven to be a prudent central banker given the uncertain macro environment we are living in.

Last year, RBI raised the operative rate in line with developed market central banks despite our inflation is closer to the target band and no large fiscal stimulus being released to stimulate demand.

Slowing inflation readings and improving the external situation gave the confidence that financial stability is secured, and rates are near to peak in this cycle. Probably, that’s the reason RBI paused in April against the consensus expectations of a hike.

Assurance of reasonable liquidity from RBI, a cleaner balance sheet of banks and corporates, improving capacity utilization, and investment push by central government have helped local growth momentum to gain traction

SUBSCRIBE TO:
ETTECH TOP 5
A closer look at today's biggest tech and startup news and why they matter
Enter your email id
SUBSCRIBE
Sample Newsletter

Mid-cap Growth Stocks

NLC India	99.95	0.10%
Mahanagar Gas	1025.25	-0.44%
JK Paper	325.30	-1.24%
Esab India	3862.00	0.91%

Why follow tips? Choose your winners rationally in 3 simple steps!
START NOW

TRENDING IN MARKETS

Stock Screener Stock Market IPO Gold Rate

Latest from ET

despite the global slowdown we are in.

The policy decision was an acknowledgement of these strengths and the MPC kept rates and stance unchanged.

On the growth outlook, the MPC appeared comfortable with Q4 FY23 numbers surprising to the upside and high-frequency indicators supporting continued expansion.

On inflation, there was a subtle change in communication with the Governor stressing that inflation needs to align towards the 4% target on a durable basis. He pointed out that the MPC used the flexibility provided by the tolerance band to weather the pandemic and war-induced shocks and that as uncertainty has reduced, it was time to focus back on the target.

Another reason to be cautious is that the fiscal deficit run rate now is 6% compared to 4.5% pre-covid. With growth normalising to pre-Covid levels, any pre-emptive loosening can backfire and result in higher inflation.

With robust credit growth & leaner balance sheets, lower rates may not be necessary at this stage to support the economy.

Going ahead, growth momentum will drive the monetary policy response rather than inflation readings and policy stance will only be reviewed if there is a threat to growth conditions.

To summarise, India's growth is relatively resilient, and thus in our assessment rate cuts will be delayed. If anything, policy rates may stay higher for longer than the market is expecting.

We do not expect any rate cuts in FY24. We think that most positives are already in the price and duration plays carry higher risks at this point.
We expect the 10Y to trade in the range of 6.95-7.20% in the near term. We are positive on the growth outlook and upgrade our estimate for FY24 GDP growth to 6.25-6.5% which is slightly above consensus forecasts. The near-term risks arise from global spillovers, El Nino, and its impact on the spatial and temporal distribution of monsoons in India.

Fixed income is finally offering reasonable "real yields" after yields have surged globally. This has boosted the allure of fixed-income investment.

We like the short end of the yield curve which allows us to earn healthy accruals without taking significant duration risk. Policy makers' response has turned asymmetric with growth as the preferred variable, and we expect rates to remain higher for longer. Thus, short-term funds may be a better play for accrual compared to long-duration exposure.

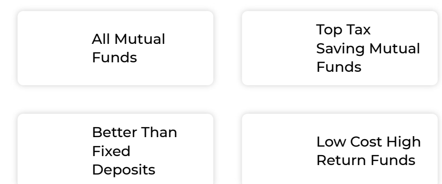
(Kaustubh Gupta is co-head of fixed income at Aditya Birla Sun Life AMC)

1. Rise of 5G makes it hard for retailers to sell 4G mobile handsets

2. FinMin to pitch for rating upgrade to Moody's

3. RBI's liquidity absorption toolkit comes to the fore

DISCOVER MUTUAL FUNDS



Popular in Markets

1. Canara Bank among top 8 stks below the industry PE levels

2. Day Trading Guide: BHEL among 7 stock ideas for the upcoming session

3. How are IEX, Sonata Software, & Just Dial looking on charts for next trade

4. IKIO listing-Wipro buyback: Corporate actions this week

5. 3 Tata group stocks set to trade ex-dividend this week