Goldman Sachs | Economics Research

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India 2024 Outlook

Port of calm in a "Higher for Longer" world

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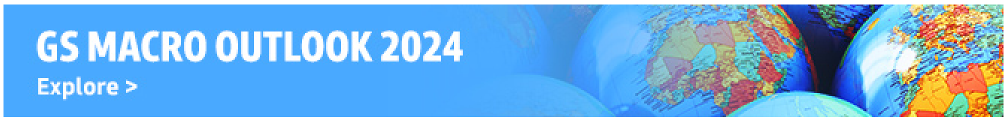


Steady growth: In 2024, we expect macro-economic resilience to continue in India amidst steady growth at 6.3% yoy. The year will likely be a tale of two halves: Pre-elections, government spending will likely be the growth driver. Post-elections, we expect investment growth to re-accelerate, especially from the private side.

A floor on core inflation: Repeated supply shocks are likely to keep headline inflation above target at 5.1% yoy (average) in 2024. We expect government intervention to keep a lid on food inflation, where possible, in an election year. We expect core inflation to only decline to 4.5% yoy (average) in 2024 from an estimated 5.1% in 2023 given food and oil supply shocks and a steady growth outlook.

A "hawkish hold" in a "higher for longer" world: Somewhat elevated inflation relative to target will limit the room for monetary easing — we forecast the RBI to stay on hold until Q4 2024 and then cut only 50bp cumulatively by early 2025. The "higher-for-longer" global scenario and elevated inflation domestically will mean continued hawkish guidance and tight banking system liquidity from the RBI.

Low external vulnerability: Higher oil prices, slower growth in trading partners, and steady domestic growth is likely to increase the current account deficit by 60bp to 1.9% of GDP in 2024. While services exports have peaked (as a share of GDP) in our view, they will continue to cushion a wide goods trade deficit in 2024. Foreign portfolio inflows from India's inclusion in a global bond index should help fund the current account deficit.

INR: A port of calm: Nearly $600bn of FX reserves should continue to allow the RBI to intervene promptly and keep the USD/INR stable. We expect the USD/INR to hover around 83.0 – 84.0 over the next 3-6 months, and expect it to appreciate slightly to 82.0 over 12 months, driven by our US economics/FX research colleagues' expectation of Fed cuts beginning in Q4 2024 and a softer broad USD by then.

Steady growth, sustained macro-economic resilience with a higher neutral rate

Over the last two years, Indian policymakers deftly managed a difficult combination of multiple commodity (food and oil) supply shocks and high Fed funds rate. They did so through a combination of monetary tightening, using fiscal policy to absorb some supply shocks, and judicious use of FX reserves to maintain a stable currency. Amidst some fiscal consolidation targeted in FY2023-24 (April 2023 to March 2024), the government re-allocated spending towards capex by cutting subsidies, and services growth in India continued to boom with services exports and remittance inflows providing cushion to the current account deficit.

We expect much of the same to continue in 2024. We expect real GDP growth in India to remain stable at 6.3% yoy (Exhibit 1), from our estimate of 6.4% growth in 2023, but it is likely to be a tale of two halves. Subsidies and transfer payments as we head into the general elections in Q2 2024 will likely be the growth driver in the first half. Post-elections, we expect investment growth to re-accelerate, especially from the private side. While we expect the government to continue its focus on capital spending, given the medium-term fiscal consolidation path, the rate of growth in capex will likely decrease from next fiscal year. Risks around the growth outlook are evenly balanced in our view with the main domestic risk emanating from political uncertainty with elections approaching in Q2 2024.

Exhibit 1: We expect the Indian economy to grow at 6.3% yoy in CY24

		Calendar Year			Fiscal Year*		
		2022	2023F	2024F	2023	2024F	2025F
Real GDP	**% yoy**	**6.7**	**6.4**	**6.3**	**7.2**	**6.2**	**6.5**
Private consumer expenditure	% yoy	8.1	5.4	6.5	7.5	7.0	5.5
Gross fixed investment	% yoy	10.3	8.2	6.2	11.4	6.4	7.5
Inflation							
CPI inflation	% yoy	6.7	5.7	5.1	6.7	5.6	4.9
Core CPI inflation^	% yoy	6.1	5.1	4.5	6.1	4.6	4.6
Core ex PDGS^^	% yoy	6.1	5.1	4.5	6.1	4.6	4.6
External							
Current account	% of GDP	-2.5	-1.3	-1.9	-2.2	-1.5	-2.1
Other							
Repo Rate^^^	end of period, %	6.25	6.50	6.25	6.50	6.50	6.00
USD/INR	end of period, level	83.0	83.0	82.0	82.2	84.0	81.9
Central Govt Fiscal Deficit	% of GDP				-6.4	-5.9	-5.4

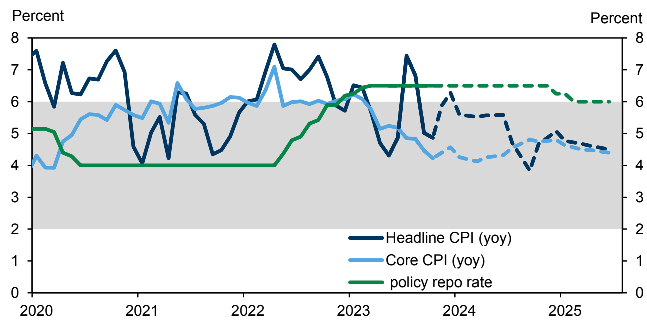
^Core CPI inflation is Headline excluding food, fuel and light inflation
^^Core ex PDGS is Core CPI inflation excluding petrol, diesel, gold and silver.
^^^We expect a 25bp cut each in Q4 CY 2024 and Q1 CY 2025 taking the repo rate to 6.0%.
**Fiscal Year 2024 refers to April 2023 to March 2024*

Source: Haver Analytics, Goldman Sachs Global Investment Research

Repeated supply shocks along with stable growth are likely to keep inflation above the central point of the RBI's target of 4.0% in 2024. We forecast headline CPI inflation to decline to 5.1% yoy (average) in 2024 (Exhibit 2), above the RBI's and consensus forecast of 4.7% yoy, from an estimated 5.7% in 2023. We expect the government to intervene through subsidies or other measures to keep a lid on food prices in an election year. While core goods inflation declined in line with our expectation in 2023, the decline in core services inflation took us by surprise, especially given resilient growth. Going forward we expect core inflation to decline to 4.5% yoy (average) in 2024 from an estimated 5.1% in 2023.

Somewhat elevated inflation relative to target will limit the room for monetary easing in our view — we forecast the RBI to cut only 50bp to 6.00% by early 2025 (25bp each in Q4 2024 and Q1 2025) (Exhibit 2). Our US economics team forecast the easing cycle to start in Q4 2024, and forecast a higher neutral rate for the Fed at 3.50 – 3.75%, above the central bank's current estimates of long-run sustainable levels. The "higher-for-longer" global scenario and elevated inflation domestically will mean continued hawkish guidance and tight banking system liquidity from the RBI until the MPC feels confident about inflation aligning with the 4.0% target.

Exhibit 2: Inflation has most likely peaked, but we forecast a long pause from the RBI



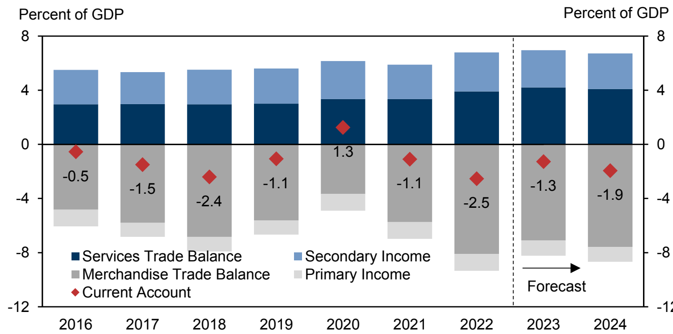
Core Inflation means headline inflation excluding Food, Fuel & Light inflation. *Shaded area denotes the official inflation target of 4%+/-2%

Source: CEIC, Goldman Sachs Global Investment Research

Our commodity strategists expect oil prices to rise to $92/bbl in 2024 vs. $83/bbl in 2023 (YTD average). This, along with a mild growth slowdown among India's export partners, and relatively resilient domestic growth is likely to increase the current account deficit to 1.9% of GDP ($ 75bn) in 2024 vs. 1.3% of GDP ($ 45bn) in 2023. While services net exports have peaked (as a share of GDP) in our view, it will continue to cushion a wide goods trade deficit in 2024 (Exhibit 3).

Macro-economic resilience in recent years aided India's inclusion in the JPM GBI-EM Global Diversified Index (beginning June 2024), and could prompt passive inflows of around USD 25-30bn over the scale-in period. With India benefiting from regional supply chain diversification, we expect continued direct investment inflows, although capital inflows will likely remain muted globally in a high interest-rate environment. Overall, we think the current account deficit should be comfortably funded next year.

Exhibit 3: We forecast current account deficit at 1.9% of GDP in 2024



NOTE:Primary income refers to receipt or payment of income from investments. Secondary income refers to remittances.

Source: CEIC, Goldman Sachs Global Investment Research

Nearly $600bn of FX reserves should continue to allow the RBI to intervene promptly on both sides in the FX market and keep the USD/INR exchange rate stable. We expect the USD/INR to hover around 83.0 – 84.0 over the next three-six months, and expect it to appreciate slightly to 82.0 over a 12-month horizon. This is driven by our global FX team's expectation of a softer broad USD by then, should the Fed start the easing cycle by Q4 2024, as our US economics team expects.

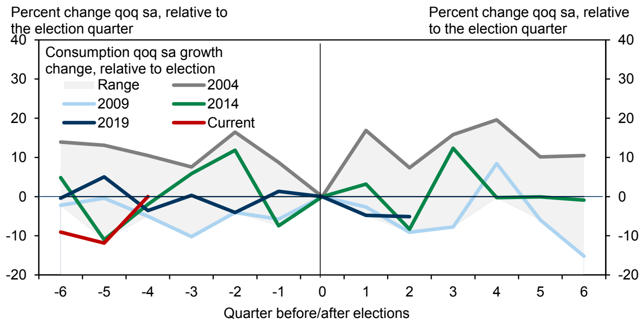
Growth: From government to private sector

Consumption: Driven by subsidies around elections

Real private consumption growth going into the general elections has been mixed (Exhibit 4), with the growth rate generally rising a year before elections but falling subsequently as we approached the election date. Post the general elections, consumption growth declined on balance except in 2004.

With the general elections approaching in Q2 2024, we have already seen increased allocation towards the rural employment program, higher cooking gas subsidies and an extension of the food subsidy program from the central government, apart from a spate of fiscal outlays from state governments before the state elections in Nov-Dec 2023. Going forward in 1H-2024, we expect consumption growth to be driven by subsidies and transfer payments. Our analysis of spending patterns of the government going into the last three election cycles are consistent with this view - subsidies increased from around three quarters before the elections as compared to the expenditure in the same period in the previous 3 years (Exhibit 5).

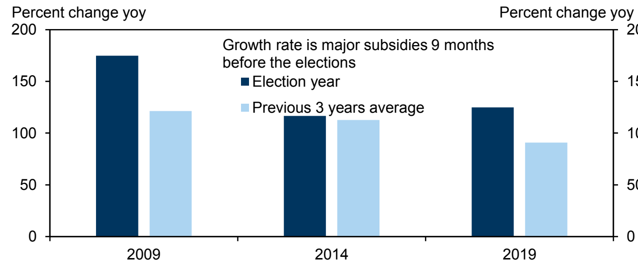
Exhibit 4: Consumption growth on balance declined after the elections except in 2004



Note: i) Covid-19 related outliers are removed from the 2019 line, ii) Current line is rebased to 0 in the current quarter, i.e. June 2023

Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 5: We have typically seen an increase in subsidy spending going into the elections



Note: i) For the election in 2009, the growth in the election year spend has been compared with the growth in spend in 2008 only due to unavailability of past data. ii) For example in 2019, we have taken the growth in the total subsidy spend from October 2018-March 2019 vs October 2017-March 2018.

Source: CEIC, Goldman Sachs Global Investment Research

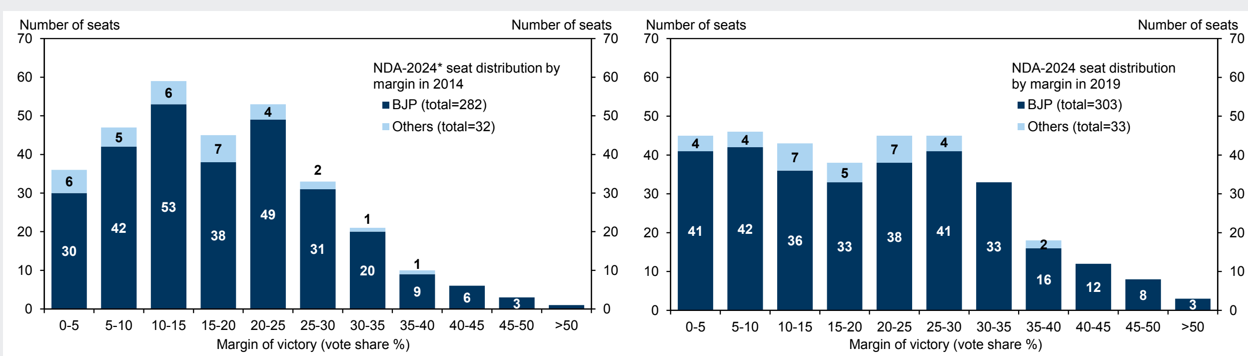
Election season gets underway in India

The election season in India has kicked-off this month with five sub-national elections, culminating with the national (general) elections scheduled for April-May 2024. The outcomes of these elections will be keenly watched by investors from the standpoint of economic reforms and/or policy continuity.

Earlier this year, 28 opposition parties came together to form the Indian National Developmental Inclusive Alliance (I.N.D.I.A.) to contest the 2024 elections against the ruling NDA, led by the BJP. Polls suggest that I.N.D.I.A.'s position has improved materially over the last year, although the NDA has maintained a comfortable lead.

Our analysis of margins of victory in the previous two elections reveal that the BJP won more seats with a closer margin (as calculated by vote share) in 2019 than in 2014 (Exhibit 6), while the INC won a greater share of the seats with a higher margin in 2019 vs. 2014.

Exhibit 6: The BJP won more seats with a thin margin of 0-5% vote share in 2019 than in 2014



*Note: The NDA alliance in 2024 comprises of 35 parties currently holding 334 seats in the Lok Sabha

Source: CEIC, Goldman Sachs Global Investment Research

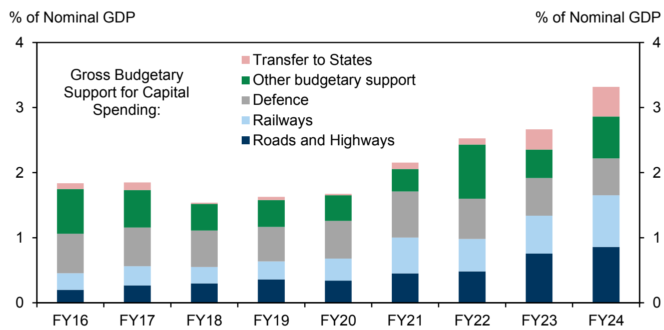
Overall, we expect real consumption growth to average around 9% yoy in 1H 2024 driven by increased subsidies ahead of the elections. In 2H 2024, we expect consumption growth to slow as the boost from subsidies wanes post general elections and forecast consumption growth to reduce to around half of 1H growth.

Investment cycle: From government to private

In our earlier analysis we have shown that over the last 25 years, in real terms, households and private corporations were the main drivers of investment in India and together accounted for around 75% of overall investment. Public sector investment accounted for about 25% of GDP as of 2022.

The real investment trend growth uptick in recent years was likely due to an increase in public capex. The central government increased capex by 33% CAGR over the last three years to 3.3% of GDP in FY24 (18-year high) from around 1.5% of GDP on average between FY18 to FY20 (Exhibit 7). Given the fiscal consolidation targets of the central government we think this growth rate will come off to average around nominal GDP growth rates or lower going forward.

Exhibit 7: Central government has increased capex in recent years



NOTE: Years are in fiscal years. FY2024 runs from April 2023 to March 2024. Before FY16, transfer to states is captured in other budgetary support.

Source: CEIC

We have maintained since last year that the supply side conditions look conducive for an investment cycle recovery. We remain optimistic that the private investment cycle may see renewed vigor in 2H-2024 after the election related uncertainty. Separately, as MNCs re-draw their supply chains for more reliable sourcing and manufacturing, India presents an attractive opportunity. Over the long term, a large consumer market also presents a favorable backdrop for the "Make in India" initiative.

Strong private sector balance sheets

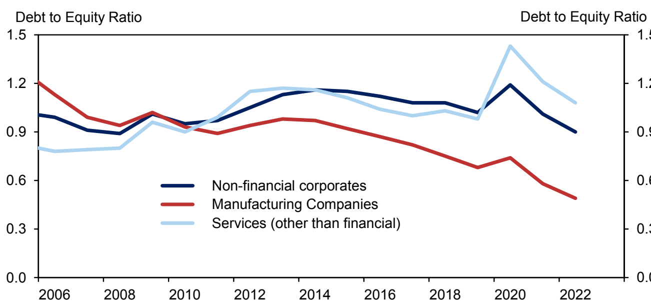
Balance sheet stress of Indian corporates has reduced materially, and should set them up for a capital expenditure cycle going forward. Manufacturing companies have deleveraged (Exhibit 8) with leverage ratios at a 16-year low, while services companies have also reduced leverage after a sharp increase post-pandemic. For the overall corporate sector, leverage is now at a sixteen-year low[1].

Large private and public sector banks have their Tier 1 capital adequacy ratio (Tier 1 ratio)

[1] We saw a further deveraging in the overall non-financial sector in FY 2023, but did not show it in the chart as the sample is restricted to 5296 non-financial sector companies.

well in excess of the 9.5% regulatory norms which has enabled banks to grow balance sheets as credit demand revived post pandemic (Exhibit 9). We see adequate capital buffer and enough headroom to start a lending cycle in 2024, as industrial credit demand grows.

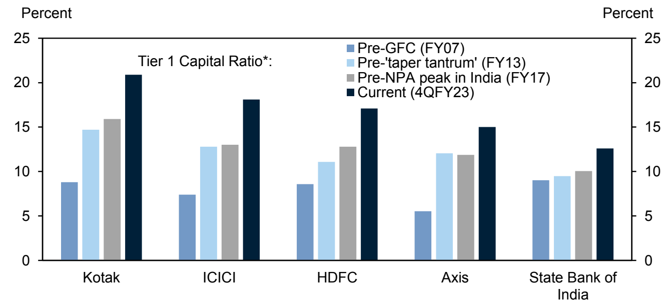
Exhibit 8: Manufacturing companies have de-leveraged



NOTE: *Years are in Fiscal year. Fiscal year 2022 refers to April 2021 to March 2022. Debt to equity ratio is calculated by dividing aggregate debt of companies in the sample by aggregate shareholder's equity of these companies.

Source: CMIE, Goldman Sachs Global Investment Research

Exhibit 9: Major bank balance sheets are well capitalized

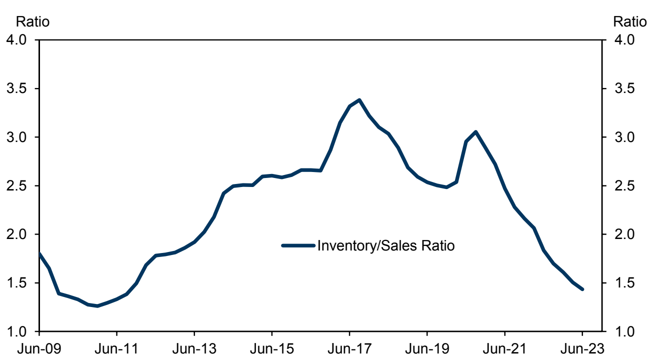


NOTE: Years are in Fiscal year. Fiscal year 2023 refers to April 2022 to March 2023. NPA stands for non-performing assets. *Tier 1 capital ratio refers to share capital and other core reserves as a proportion of the risk-weighted assets of a bank, and is used as a fair representation of balance sheet strength and the ability to cover loan losses.

Source: Goldman Sachs Global Investment Research

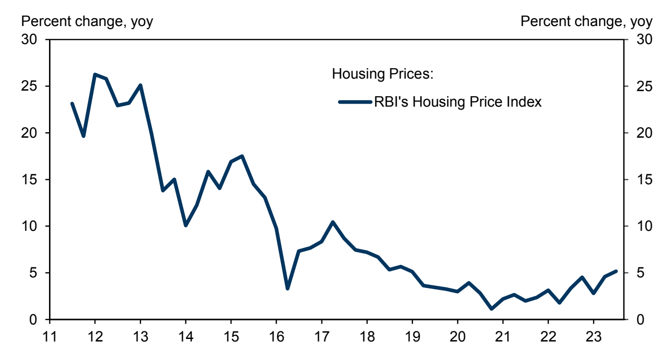
In household investments, real estate constitutes the largest share and a decline in household investments since 2012 was mainly due to a decline in real estate investment, which was likely the result of a decline in house price inflation and tighter credit conditions due to the NBFC crisis[2] during that period. With inventory-sales ratio at the lowest in 13-years (Exhibit 10) and house price inflation starting to increase after a long period of softness (Exhibit 11), we expect household investments to remain buoyant over 2024.

Exhibit 10: Inventory to sales ratio the lowest in the last 13 years



Source: PropEquity, Goldman Sachs Global Investment Research

Exhibit 11: Housing price inflation has bottomed out



Source: Haver Analytics, Goldman Sachs Global Investment Research

Overall, the favorable supply side conditions are likely to aid investment growth over the next several years. Clearly, the 'Make in India' policy if successful provides upside risk to investment outlook over the medium term. In 1H 2024 we expect investment growth to slow down to 5.5% of GDP driven by a slowdown in growth in public capex and subsequently rebound to 7.2% yoy in 2H 2024 with the election related uncertainty

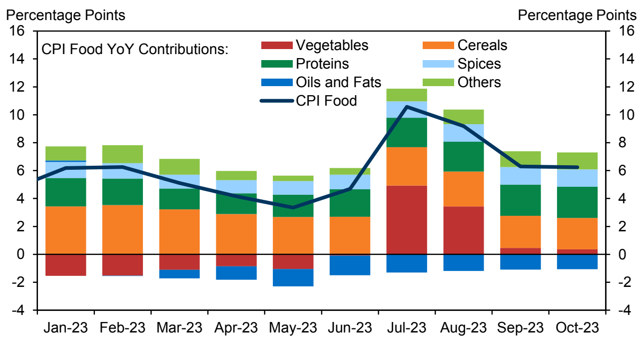
[2] Non-banking financial companies (NBFC). In June 2018, IL&FS defaulted for the first time on repayment of commercial paper and inter-corporate deposits which led to a series of defaults by other NBFCs.

behind us.

Inflation: Supply shocks put a floor on core

Headline inflation declined to average 5.7% yoy (GSe) in 2023 from 6.7% in 2022, aided by lower oil prices and monetary tightening by the RBI. Food inflation remained relatively muted in the first half of 2023 but witnessed a steep increase in Q3 (Exhibit 12) on the back of uneven monsoons and supply side bottlenecks. This caused headline inflation to exceed the upper end of the RBI's target in Q3, even as core inflation declined, led by core goods inflation as WPI manufacturing inflation declined and core services inflation also declined led by a decline in housing rent inflation (Exhibit 13).

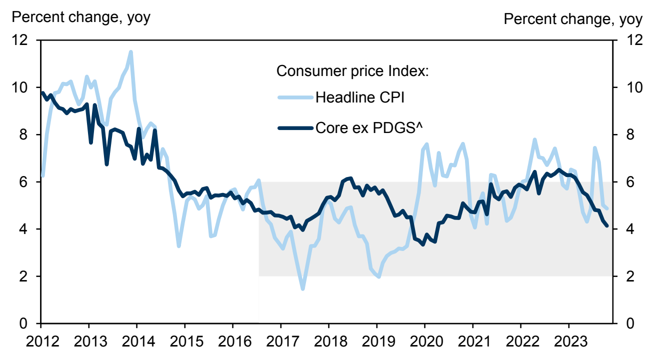
Exhibit 12: Food inflation spiked in Q3 2023 driven by vegetable prices



NOTE: Proteins include meat and fish, eggs, milk and pulses.

Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 13: Core ex PDGS inflation steadily declined in 2023



^Core ex PDGS inflation is headline inflation excluding food, fuel, petrol, diesel, gold and silver inflation. *Shaded area denotes the official inflation target of 4%+/-2%

Source: Haver Analytics, Goldman Sachs Global Investment Research

The government actively intervened (Exhibit 14) with fiscal, tariff and non-tariff measures to mitigate the impact of high inflation on the consumer:

a) The government amended the export policy to prohibit exports of rice, and stopped releasing subsidized rice for ethanol production after retail prices increased in June-July.

b) Announced two additional cooking gas subsidies: i) INR 200/cylinder for all users, and ii) INR 300/cylinder for all users under the existing government cooking gas scheme for poor women (Ujjwala[3] users).

c) The government extended its food subsidy scheme to 813mn beneficiaries beyond its deadline of 31st December 2022, for five years.

[3] Pradhan Mantri Ujjwala Yojana (PMUY) is a scheme from the Ministry of Petroleum & Natural Gas for providing LPG connections to women from Below Poverty Line (BPL) households. The scheme was launched on 1st May 2016 in Uttar Pradesh and as of 1st March 2023 there are around 96mn PMUY beneficiaries

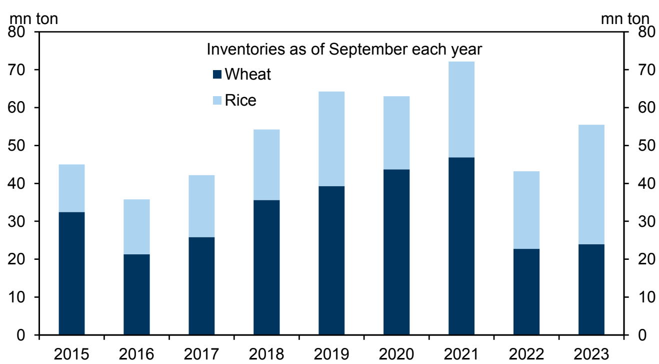
Exhibit 14: Measures taken by government to tackle inflation

Item	Weight in CPI (%)	Date	Measures
Food			
Cereals & products	9.7	November 5, 2023	Extended the food subsidy scheme to 813mn beneficiaries□beyond its deadline of 31st December 2022, for five years.
Rice	4.4	August 9, 2023	Offloaded an additional 2.5mn tons of rice from its stocks to contain prices
		August 26, 2023	Imposed 20% export duty on parboiled rice effective till October 15, 2023
		August 27, 2023	Restricted exports of certain kind of rice (Basmati) valued below $1200/MT. The government had earlier also banned export of another variety of rice in July
		October 6, 2023	Extended the 20% export duty on parboiled rice to March 31, 2024
		October 24, 2023	Lowered the minimum export price for a certain kind of rice (basmati) to USD 950/tonne
Edible Oil	2.9	June 2, 2023	Directed the industry to cut edible oils MRP by INR 8-12 per litre as global prices drop
Tomato	0.6	July 20, 2023	Reduced price of subsidised tomato to INR 70 per kg
Wheat	2.6	August 9, 2023	Offloaded an additional 5mn tons of wheat from its stocks to contain price increases
		September 14, 2023	Sets 2000 tonnes as the quantity of wheat that traders, wholesalers and supermarkets can store to boost supplies in the retail markets
		November 9, 2023	Allocated 0.25mn ton of wheat for providing subsidised wheat at INR 21.5/kg
Sugar	1.1	October, 18 2023	Extended sugar export restrictions beyond October 2023
Others			
Cooking Gas	1.3	August 29, 2023	Announced a subsidy of INR 200/cylinder of cooking gas to eligible benficiaries under the government's affordable cooking fuel program for poor women (Ujjwala Yojna)
		October 4, 2023	Announced an additional subsidy of INR 100 taking the total subsidy to INR 300 for the eligible benficiaries under the government's affordable cooking fuel program for poor women (Ujjwala Yojna)

Source: News Articles, Goldman Sachs Global Investment Research

The export ban on rice helped cool prices and improve inventories (Exhibit 15). Going forward, we see some upside risk to cereals inflation, given the deficient monsoons this year may impact the winter (Rabi) crop harvest, because of water reservoir levels being 21% lower in 2023 vs. 2022 and water from reservoirs is used for cultivation of the winter crop.

Exhibit 15: Rice stocks have improved in 2023



Source: CEIC, Goldman Sachs Global Investment Research

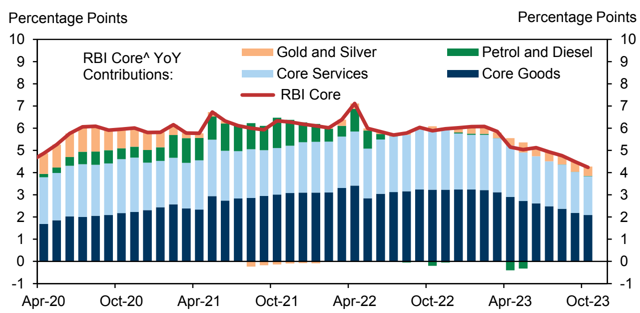
Similarly, pulses (legumes) sowing in the summer (Kharif) season was 8% less compared to last year and is likely to affect production and keep prices elevated. Further, uneven monsoon distribution has already impacted the arrivals of stocks of onions in September and October which has led to an increase in onion prices. Putting all this together we forecast food inflation at 7.0% yoy in 1H 2024 and expect it to decline to

4.2% yoy in 2H 2024. Overall, we forecast food inflation to be at 5.6% yoy in 2024.

Core inflation to decline to 4.5% in 2024

The RBI's measure of core inflation[4] has averaged around 6% yoy (Exhibit 16) in 2022, and declined to 4.7% yoy in Q3 2023 driven by a decline in both core goods and services inflation from 7.2% yoy (2022 average) and 5.1% yoy (2022 average) respectively to 5.3% yoy and 4.0% yoy in Q3 2023. We expect core goods inflation to bottom out at 4.5% yoy in Q1 CY24 and increase towards 5.0% yoy by Q4 as WPI manufacturing inflation has bottomed out (Exhibit 17).

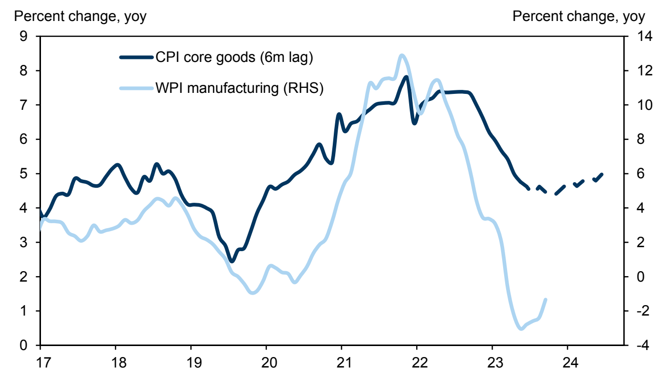
Exhibit 16: RBI core inflation has declined to around 4.2%



NOTE: ^ RBI core inflation refers to headline inflation excluding food, fuel and light, but includes petrol and diesel (under transportation inflation). Fuel inflation refers to cooking fuel, gas and kerosene.

Source: Goldman Sachs Global Investment Research

Exhibit 17: We expect core goods inflation to inch higher to 5.0% by the end of CY24 as WPI manufacturing inflation has bottomed out



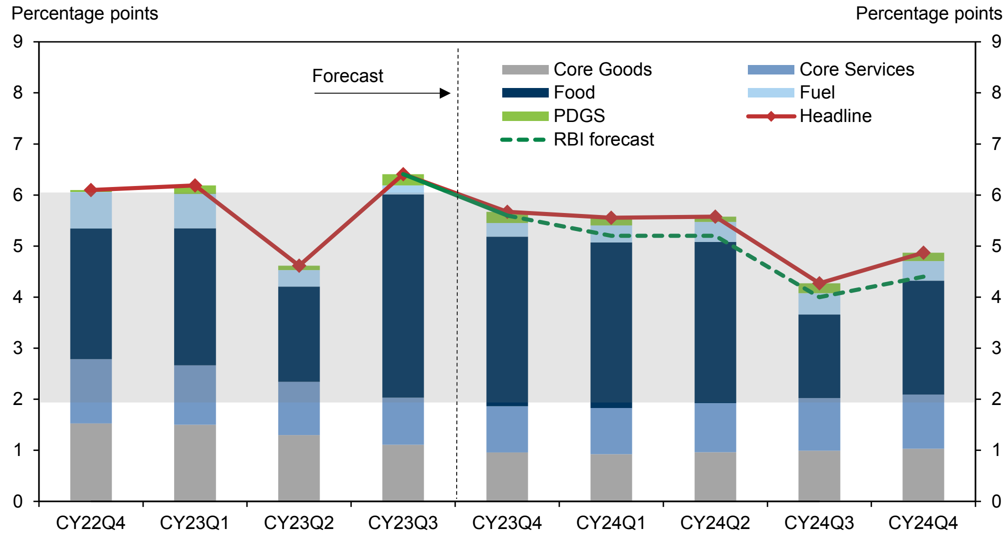
Source: CEIC, Goldman Sachs Global Investment Research

While core goods inflation declined in line with our expectation 2023, the decline in core services inflation took us by surprise, driven by an unexpected decline in housing inflation. Going forward we expect core services inflation to inch higher from its current levels of 3.6% yoy to around 4.5% yoy in 2H 2024.

Putting this together, we forecast overall headline inflation at 5.1% yoy (average) in CY24 with food inflation at 5.6% yoy, RBI core inflation at 4.5% yoy, and fuel inflation at 5.6% yoy (Exhibit 18).

[4] RBI Core inflation: Headline inflation excluding food, fuel and light. Fuel inflation: cooking fuel, gas and kerosene. RBI core inflation includes petrol and diesel (under transportation inflation).

Exhibit 18: We forecast headline CPI inflation at 5.1% yoy (average) in CY24



NOTE: Shaded area denotes the official inflation target of 4%+/-2%. PDGS refers to petrol, diesel, gold and silver.

Source: Goldman Sachs Global Investment Research

Monetary policy: "Hawkish Hold" in a "Higher for Longer" world

Somewhat elevated inflation relative to target will limit the room for monetary easing from the RBI, in our view. Our US economics team forecast the easing cycle to start in Q4 2024, and forecast a higher neutral rate for the Fed at 3.50 – 3.75%, above the Fed's current estimates of long-run sustainable levels. The "higher-for-longer" global scenario and elevated inflation domestically will mean continued "hawkish guidance" and tight banking system liquidity from the RBI until the MPC feels confident about inflation aligning with the 4.0% target. In our base case we don't see the RBI hiking either - low external vulnerability and our global view of a dollar peak by 2H 2024 will give the RBI more degrees of freedom to operate monetary policy without aggravating external risks.

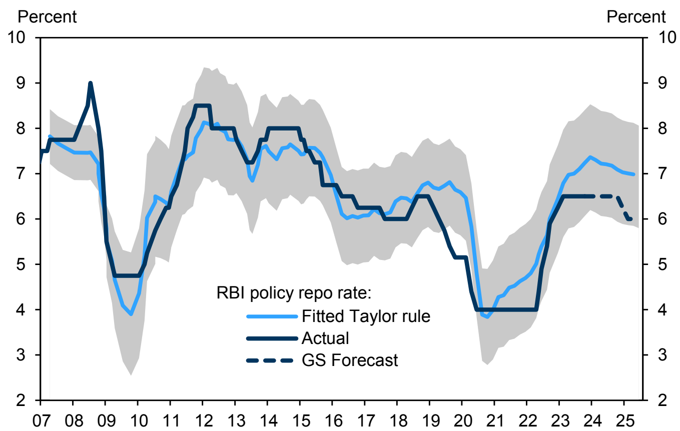
We forecast the easing cycle in India to be in three stages: 1) verbal guidance that inflation is aligning to the RBI's target of 4.0% on a sustainable basis, 2) change policy stance from 'Removal of Accommodation' to 'Neutral' or 'Accommodative' and 3) cut policy rate from the current level of 6.50% by 25bp. We think that steps 1 and 2 can happen together or in either order in Q3 or Q4 CY24, and step 3 will likely happen only by Q4 CY24. Overall we forecast the RBI to cut repo rates by only 50bp to 6.00% by early 2025 (25bp each in Q4 2024 and Q1 2025). This would leave the real policy rate at 1.3% by Q1 2025[5] (Exhibit 20).

[5] real policy rate here equals central bank's nominal policy rate-headline CPI inflation

Exhibit 19: Stages of monetary policy easing by the RBI

Stage	Expected action	Likely Timeline
1	Verbal guidance - dovish commentary in policy statement and/or minutes	Start from Q3/Q4 CY24
2	Liquidity easing	Start from Q3/Q4 CY24
3	Policy repo rate cut	Q4 CY24

Exhibit 20: We expect the RBI to cut the repo rate by 25bp in December 2024 policy meeting, followed by 25bp in February 2025



Shaded area denotes +/- 1 standard deviation bands

Source: Goldman Sachs Global Investment Research

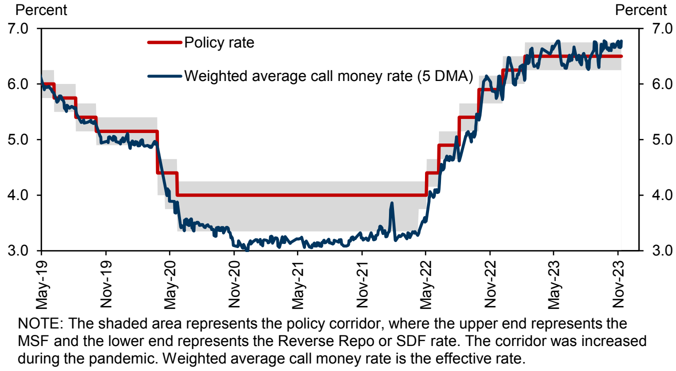
Banking system liquidity is a monetary policy tool

Short-end rates have remained tight with the weighted average call rate (WACR) trading near the marginal standing facility (MSF) rate which is the upper end of the liquidity adjustment facility corridor (Exhibit 21). We expect the RBI to keep liquidity tight in-line with their monetary policy stance of "removal of accommodation" in a world of "Higher for Longer" rates.

Liquidity distribution in the system has been recently skewed as indicated by elevated borrowings by some banks from the RBI at the MSF (which is the upper end of the liquidity adjustment corridor, 25bp above the policy repo rate) while other banks are parking substantial amounts with the RBI under the standing deposit facility (or SDF, which is the lower end of the liquidity adjustment corridor, 25bp below the policy repo rate).

The RBI has been conducting open market operation (OMO) sales, where the RBI sells government bonds in the secondary market to manage liquidity. We expect this policy to continue and this, in our view, will partly offset the incremental demand for bonds from FIIs due to India's index inclusion next year.

Exhibit 21: Overnight rates are tight in the banking system



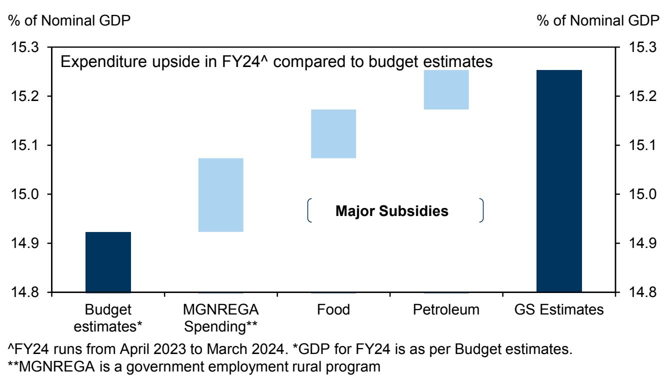
Source: Haver Analytics, Goldman Sachs Global Investment Research

In the monetary policy easing cycle, as the RBI eases liquidity overnight rates would first come back from MSF to the policy repo rate, and decline further to the SDF depending on the quantum of liquidity easing by the RBI. Thus even with only 50bp repo rate cuts, the RBI would have the option to effectively deliver 100bp of easing (50bp from repo + 50bp from liquidity easing) if required.

Fiscal policy: Trade-offs and Constraints

As detailed earlier, the government has played an active role in absorbing the food price shocks on the consumer and at the same time has also been able to sustain capital expenditure growth at higher levels until now. In addition to the incremental subsidy costs undertaken by the government this year to help control inflation, the government in FY24 has already spent around INR 636bn on the rural employment guarantee program of the available INR 600bn until September. As per our estimates, going by historical trends, spending on the rural employment guarantee program could cost the government an additional INR 450bn, taking the total spend on the program to around 0.4% of GDP (Exhibit 22).

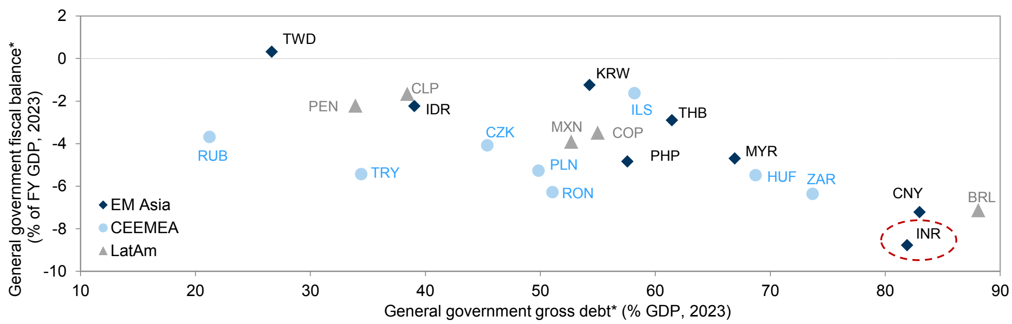
Exhibit 22: We estimate spend on subsidies and rural employment program to increase in FY24 compared to budget estimates



Source: CEIC, Goldman Sachs Global Investment Research

The pivot towards subsidies and welfare spending going into the elections is likely to continue, though given the fiscal constraints (Exhibit 23) from the stock of debt (India's public debt to GDP ratio is above 80%, one of the largest in EM), we don't expect the government to increase the fiscal deficit. Thus, we think that a decline in public capital expenditure (as a % of GDP) will have to share the burden of fiscal consolidation, among a reduction in other current expenditure. In other words, the growth in government capex seen in the past few years cannot be sustained going forward, in our view, as we detailed in our earlier analysis.

Exhibit 23: India a regional and EM outlier on general government deficit



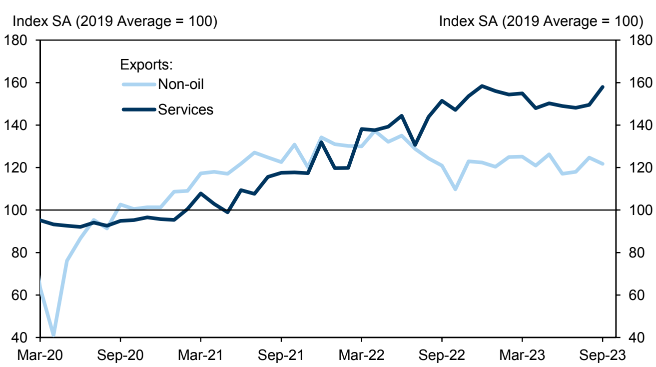
*General government fiscal balance and general government debt based on October IMF estimations;
China general government balance based on GS estimates of China effective on-budget fiscal balance and government special bond issuance in 2023

Source: Haver Analytics, Goldman Sachs Global Investment Research

External: Low external vulnerability to continue

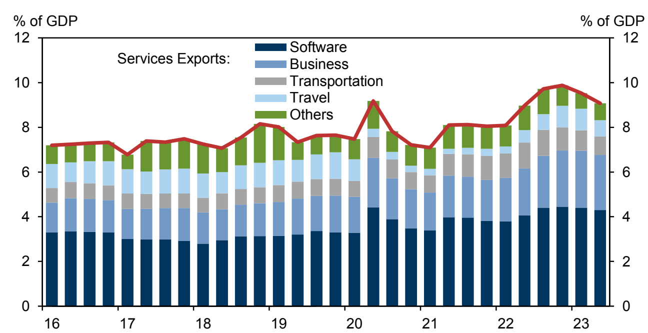
On the external balances front, slower global economic growth among trading partners has impacted India's goods export growth (Exhibit 24) in 2023. The current account deficit, though, has been cushioned by strong services export growth (Exhibit 25) which has held up despite weak demand in western economies.

Exhibit 24: Merchandise exports are weaker than services exports



Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 25: Services exports have significantly increased over the last few years



NOTE: The spike in Q2 CY20 is due to Covid-19 induced contraction in GDP. Break-up of services exports is available up to Jun 2023.

Source: CEIC, Goldman Sachs Global Investment Research

Our commodity strategists expect oil prices to rise to $92/bbl in 2024 vs. $83/bbl in 2023 (YTD average). This, along with a mild growth slowdown among India's export partners, and relatively resilient domestic growth, is likely to increase the current account deficit to 1.9% of GDP ($ 75bn) in 2024 vs. 1.3% of GDP ($ 45bn) in 2023. While services net exports have peaked (as % of GDP) (Exhibit 25) in our view, they will continue to cushion a wide goods trade deficit in 2024.

Exhibit 26: We forecast India's current account deficit at 1.9% of GDP in CY24

Amount ($ bn)	2021	2022	2023F	2024F
Current Account	**-34**	**-86**	**-45**	**-75**
(as % of GDP)	-1.1	-2.5	-1.3	-1.9
Goods Trade Balance	**-177**	**-274**	**-249**	**-294**
Oil Trade Balance	**-87**	**-113**	**-104**	**-135**
Non-Oil Trade Balance	**-90**	**-161**	**-145**	**-159**
Goods Exports	402	458	428	442
Oil Exports	54	95	87	96
Non-Oil Exports	348	358	339	346
Goods Imports	579	732	677	736
Oil Imports	141	208	191	231
Gold Imports	56	37	42	40
Non-Oil Non-Gold Imports	382	476	440	465
Services Trade Balance	**103**	**133**	**148**	**158**
Services Exports	241	309	331	354
Services Imports	138	177	183	195
Primary Income	**-38**	**-42**	**-40**	**-42**
Secondary Income	**78**	**97**	**96**	**102**

Source: Goldman Sachs Global Investment Research

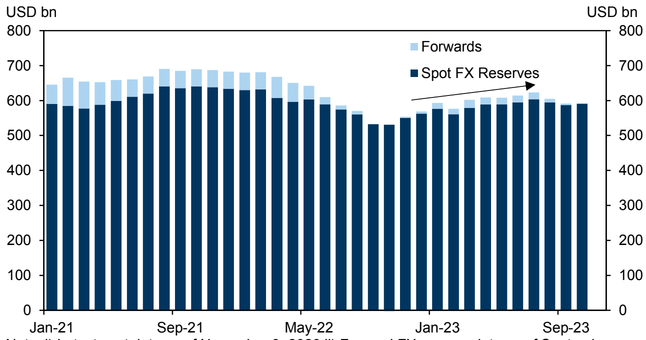
Exhibit 27: We estimate capital account surplus to more than offset the current account deficit

Amount ($ bn)	2021	2022	2023F	2024F
Current Account	**-34**	**-86**	**-45**	**-75**
(as % of GDP)	-1.1	-2.5	-1.3	-1.9
Goods Trade Balance	**-177**	**-274**	**-249**	**-294**
Services Trade Balance	**103**	**133**	**148**	**158**
Primary Income	**-38**	**-42**	**-40**	**-42**
Secondary Income	**78**	**97**	**96**	**102**
Capital Account	**100**	**57**	**61**	**79**
Foreign direct investment	**27**	**36**	**19**	**36**
Foreign portfolio flows	**6**	**-19**	**24**	**33**
Others (incl. Loans, banking capital etc)	**67**	**40**	**17**	**10**
Overall BoP deficit / surplus	**66**	**-29**	**16**	**4**

Source: Goldman Sachs Global Investment Research

The RBI has not been shy to use the FX reserves that India accumulated during the pandemic to carry out FX interventions on both sides and arresting volatility in the INR (Exhibit 28). It replenished part of the reserves it had lost through most of 2022 by accumulating reserves from November 2022 to July 2023. India's spot FX reserves are currently at $590bn (including SDR and Gold) for the week ending November 3. In our view, the RBI's FX market intervention is likely to continue going forward as we expect it to mop up any balance of payment surpluses and not let the INR materially appreciate against the dollar.

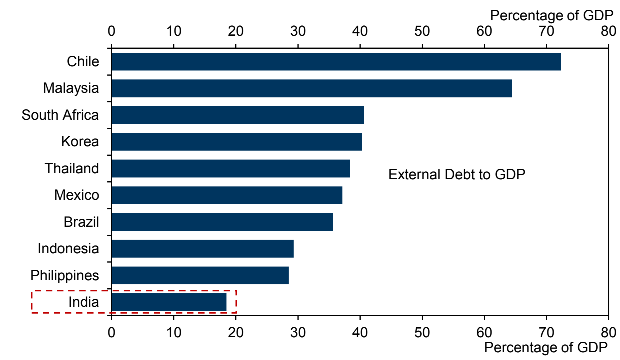
Exhibit 28: Forex reserves improved after declining sharply since last year



Note: i) Latest spot data as of November 3, 2023 ii) Forward FX reserve data as of September 2023.

Source: Haver Analytics

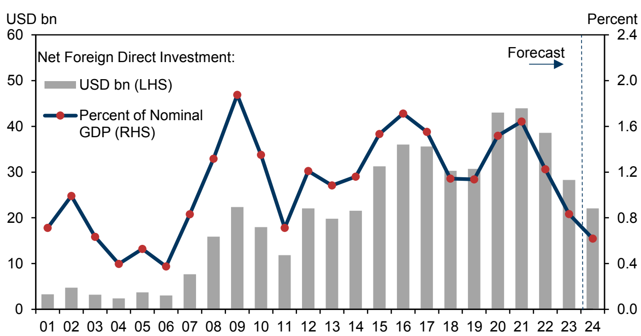
Exhibit 29: India has the lowest external debt to GDP among its EM peers



Source: Haver Analytics, Goldman Sachs Global Investment Research

Macro-economic resilience in recent years aided India's inclusion in the JPM GBIM global bond index (beginning June 2024), and could prompt passive inflows of around USD 25-30bn over the scale-in period. With India benefiting from regional supply chain diversification, we expect continued direct investment inflows, although capital inflows will likely remain muted globally in a high interest-rate environment (Exhibit 30). Higher US interest rates may also mean less dollar funding by Indian corporates (Exhibit 31). Despite these headwinds, we think the current account deficit should be comfortably funded next year given bond inflows.

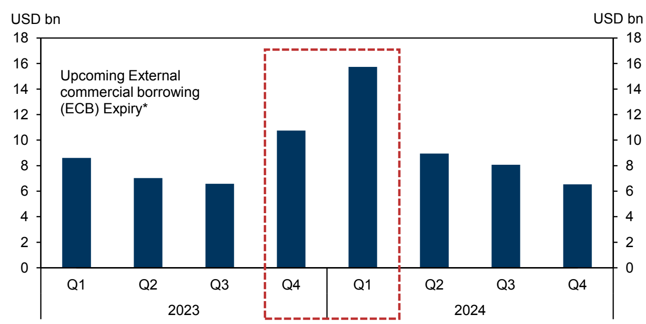
Exhibit 30: Net FDI has fallen sharply from its 2021 highs



Note: i) Years are in Fiscal year. Fiscal year 2024 refers to April 2023 to March 2024. ii) FY24

Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 31: External commercial borrowings (ECB) maturities are skewed heavily in Q4 CY23 and Q1 CY24



*Based on monthly data on External commercial borrowing (ECB) applications released by RBI.

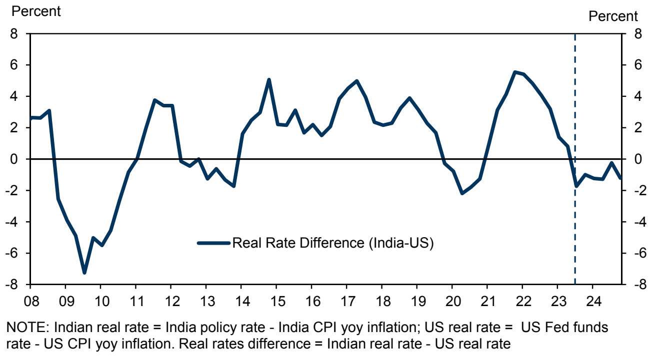
Source: RBI

Forex outlook: USD/INR to stay range bound

Nearly $600bn of FX reserves should continue to allow the RBI to intervene promptly on both sides in the FX market and keep the USD/INR stable. We expect the USD/INR to hover around 83.0 – 84.0 over the next three-six months, and expect it to appreciate slightly to 82.0 over a 12-month horizon. The INR appreciation view over the 12-month horizon is driven by our global FX team's expectation of a softer broad USD by then, should the Fed start the easing cycle by Q4 2024, as our US economics team expects.

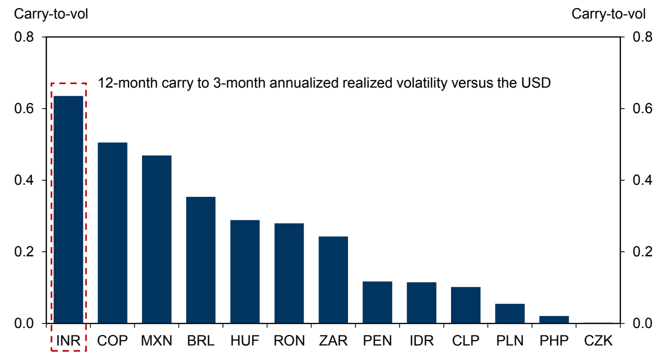
We note that for the INR, although real rate differentials[6] (Exhibit 32) are the narrowest in many years (leaving aside the start of the pandemic period), INR offers the best carry-to-vol among large EMs (Exhibit 33).

Exhibit 32: Real rate differential with the US has declined



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 33: The INR offers the best carry-to-vol versus the USD among its EM peers



Source: Goldman Sachs Global Investment Research

6 Difference between real rates in India and in US, where real rate is the difference between central bank policy rate and CPI inflation.

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Reg AC

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