

Macro Flash

Divergence of Fed/ECB rate cuts can rekindle FX volatility while food inflation and financial expansion constraints limit expectations of India easing.

A yawning growth gap has been visible between the US and Eurozone but has not been factored into monetary policy expectations until now.

- US growth projections have been steadily increasing since Sep'23, in line with stronger realisations, while Eurozone growth expectations languish with inflation projections stable but above target.
- There was recently a scare in core inflation in both the US and Eurozone, which kept the ECB against easing rates before the Fed, but this has since faded.
- With fading of the inflation scare and the growth gap, ECB speakers have lately been emphasising independence from Fed cuts, leading to higher ECB pricing.
- Divergence in policy expectations can lead to FX volumes increasing, after these were suppressed through much of last year.
- Driving the growth gap has been a fiscal policy gap, attributable more to Germany and like-minded economies than to Southern Europe.

India high-frequency growth numbers appear to have recovered in Feb and Mar, after a post-festive soft patch.

- Improvement in Feb industrial and activity indicators is likely attributable to the leap year, but second highest GST collections on record stand out.
- Numbers for March are mixed with stronger PMI, electricity production and credit growth, but weaker auto registrations.
- High demand for credit and other financing has driven the C/D ratio of banks to a record, driving a push towards wholesale financing.
- Despite this tightness, near-term transmission of rates has been negative in some cases.

Inflation continues to show remarkable improvement in core, with food remaining bugbear.

- India's inflation has been softening at a gradual pace, showing still-high food inflation combined with series-low core inflation.
- Core inflation is likely to bottom in the current year, but food inflation will likely keep heading well-above target.
- Food inflation is often seen from the point of view of vegetables, where prices are rising early from a higher-than-usual winter base.
- Apart from this, diffusion metrics show food inflation is also broadening even with rice, pulses, and spices taken out!
- In contrast, high-quality core disinflation is seen in the monthly run-rate, as well as diffusion.
- Crude oil is a risk, with projections showing a supply deficit, and US shale limited to old wells rather than through fresh investment.

Could INR volatility also increase with global FX volatility?

- INR has been exceptionally stable owing to RBI's absorption of volatility, since Sep'23. However, recent weeks has seen an increase in volatility.
- Structural drivers of volatility: the gap between CAD and stable capital flows that historically has driven INR's beta are low, given improvement in services exports.
- However, an increase in global FX volumes and a move away from defending the INR as Q1 wears on will likely see volatility recover - in line with our latest FX views.

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