

## Review Article

### What's In Store For The Economy On Second Half?

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#### **ABSTRACT:**

The recent escalation of the Israel-Palestine conflict and geopolitical tensions in West Asia pose significant risks to global oil prices and supply chains, potentially impacting India's economy. The Indian economy, which saw robust growth of 7.8% in the first quarter of 2024, faces new uncertainties with rising crude oil prices and potential disruptions in food and fertilizer supplies. Although the Reserve Bank of India (RBI) anticipates a slight moderation in GDP growth to 6.5%, the conflict could exacerbate inflationary pressures and increase transportation costs. Finance Minister Nirmala Sitharaman has highlighted concerns about how these disruptions might affect inflation and supply chains. The RBI's Governor, Shaktikanta Das, has underscored the added risks from volatile markets and high U.S. bond yields, suggesting that interest rates will remain elevated. Despite domestic inflation easing to 5% in September, it remains above desired levels, and future trends indicate potential challenges for consumption and investment. The International Monetary Fund (IMF) has slightly revised India's GDP growth forecast to 6.3%, reflecting the impact of these global and domestic uncertainties. The article examines how these factors might influence India's economic trajectory and the balance of domestic and international risks.

**KEYWORDS:** Crude Oil, Economic Growth, Inflation, Interest Rates, Supply Chains.

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## INTRODUCTION

Could the West Asia flare-up push oil prices further up and disrupt food and fertilizer supply lines? How may fraught geopolitical events, rising risk aversion, higher interest rates and volatile markets impact India? How domestic concerns about inflation faded?

**The story so far:** The Indian economy, measured in terms of the Gross Domestic Product (GDP) as well as Gross Value-Added (GVA), grew 7.8% between April and June (first quarter or Q1) this year, a four quarter-high. The Finance Ministry believes the momentum of economic activity was carried forward in the July- September quarter, despite retail inflation hardening to 6.4% from 4.7% in Q1 thanks to a spike in food prices. Growth estimates for Q2 will come in next month, but the Reserve Bank of India (RBI) expects GDP growth to moderate to 6.5%. A week into the second half of the year, the Israel-Palestine conflict erupted and a spate of fresh dark clouds now hover over the economy.<sup>1</sup>

### How have experts reacted to recent events?

Economists feel a prolonged conflict in West Asia could push crude oil prices beyond India's comfort zone and if other countries join the fray, critical sea routes could face disruptions and spike transport and insurance costs. The government may not pass on higher petroleum prices to consumers ahead of critical elections, but producers' costs may still rise. Airlines, for instance, have been hiking fares in line with aviation turbine fuel costs.<sup>2</sup> Moreover, higher fuel import bills could pose implications on the exchequer as oil marketing companies may need support for under-recoveries. Finance Minister Nirmala Sitharaman, in her first remarks since the strife in Gaza, said it has brought concerns about fuel, food security and supply chains back to the forefront. She flagged concerns about the impact of any disruptions on inflation in the near future. In subsequent comments, she has also emphasised the need to ensure that global food, fertilizer and fuel supplies did not become an "instrument of war and disruption". in West Asia could push crude oil prices beyond India's comfort zone.<sup>4</sup>

The RBI Governor Shaktikanta Das, who chaired a monetary policy review hours before Hamas launched the first salvo in the conflict, summed up the emerging situation eloquently. "We all thought that the period of uncertainties is over, but as you would have seen in the last fortnight, new

uncertainties have been thrown up while some that already existed, like oil prices and volatility in financial markets, have got more pronounced," he said last Friday. Among the new uncertainties, he listed the spurt in U.S. bond yields that hit a 16-year high this month and mixed global data points amid fears of "higher for longer" interest rates. A cut in India's interest rate is not on the cards, he emphasised. "Interest rates will remain high... how long... only time and the way the world is evolving, will tell." Higher interest rates can impact investment flows in markets like India.<sup>3</sup>

### Is there a shift in the assessment of risks for the economy?

The International Monetary Fund (IMF) raised its 2023-24 GDP growth estimate for India to 6.3% this month from 6.1% estimated earlier. This is just slightly below the 6.5% GDP uptick the Finance Ministry and the RBI have penned in for this year, following last year's 7.2% growth. In its monthly economic review report released last month, the Department of Economic Affairs (DEA) in the Finance Ministry said it was comfortable with the 6.5% hopes "with symmetric risks". Bright spots of corporate profitability, private sector capital formation, bank credit growth and construction sector activity offset the risks at the time. These included steadily climbing crude oil prices ("but no alarms yet") and an overdue global stock market correction, which it termed "an ever-present risk". The RBI, this month, also asserted that risks from the uneven monsoon, geopolitical tensions, global market volatility and economic slowdown, were "evenly balanced". The RBI expects GDP growth to slow to 6% in the current quarter, and further to 5.7% in January to March 2024 before picking up to 6.6% in Q1 of 2024-25. Governor Das has since exuded confidence in the overall macro fundamentals of the Indian economy, despite the uncertainties that have emerged this month. Last Monday, in its latest economy review, the DEA noted that though domestic fundamentals are strong and improving, downside risks arise from global headwinds that have been compounded by recent developments in the Persian Gulf, and uncertainties in weather conditions due to El Niño effects. "Depending on how the situation develops, crude oil prices may push higher. Further, the relentless supply of U.S. Treasuries and continued restrictive monetary policy in the U.S. (with further monetary policy

tightening not ruled out) could cause financial conditions to be restrictive,” it said. It was also prescient about the U.S. stock markets having a greater correction risk, which would have spillover effects on other markets. India’s stock markets clocked six straight days of sharp declines before a marginal recovery was seen this Friday. The DEA has flagged a broader worry about fraught geopolitical conditions triggering a surge in risk aversion. “If these risks worsen and are sustained, they can affect economic activity in other countries, including India,” it noted, even as it averred that India’s growth story remained on track.<sup>5</sup>

Inflation had eased to 5% in September from a 15-month high of 7.4% in July and the department highlighted higher upticks in industrial capacity utilisation levels, private consumption and investment, retail loans extended for vehicles and housing as bright spots in its economic outlook. The report also cited ‘optimistic’ findings from RBI’s forwarding-looking surveys on manufacturing, consumer confidence, employment and inflation expectations to stress all is well.

What are domestic factors to watch out for? Inflation may have subsided last month, but could creep back up. The RBI, which expects average inflation of 5.4% through 2023-24, has penned in a 5.6% average uptick in prices for the October to December quarter and 5.2% for the first six months of 2024. While some vegetable prices have corrected, inflation in onions has shot up while for pulses and some cereals, prices are likely to

stay high for a while.

average even higher at 5.5% and 5.9%, respectively. The RBI’s preferred 4% inflation mark remains elusive as do prospects of interest rate cuts. This doesn’t bode well for a sustained rise in consumption demand that is vital to revive private investments. A Bank of Baroda study on consumption trends shows that production of readymade garments, mobile phones, hair dye, shampoo, cookers and even ice cream, had declined between 12% to 20% in the first five months of this year. “Normally when inflation is high households tend to cut back on discretionary spending which is what is being seen today,” it noted.

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