Mizuho Chart Speak: India's Oil Risks

Economics & Strategy | Asia ex-Japan

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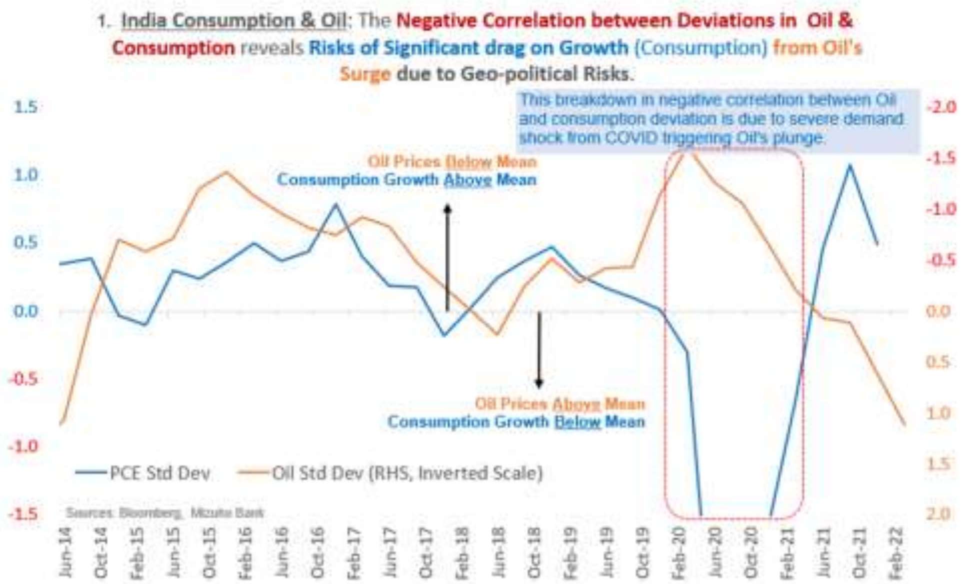
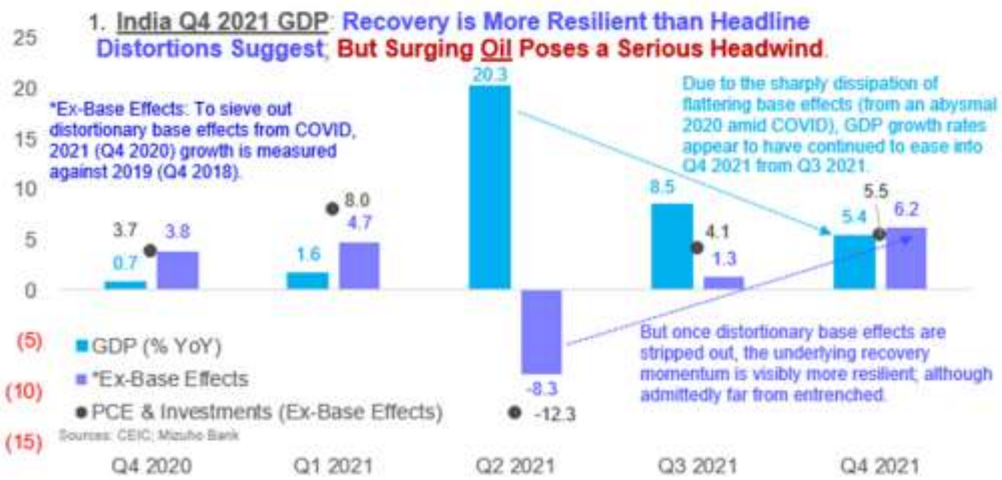
India's Shifting Growth Risks

Wrong (Worry) Tree



Admittedly, at **5.4% YoY, India's Q4 2021 GDP** disappointed markets expectations of ~6%. But **fretting this miss is barking up the wrong tree**. Especially given *removing exceptional base effect distortions reveals resilient recovery intact.* The big picture being, **escalating in geo-political risks and attendant Oil price surge** are rapidly **displacing pandemic risks**. And arguably **threaten to be more diabolical** insofar that **stagflation-type pressures that inflame price pressures yet depress demand sharpen policy trade-offs** and **intensify dangers of macro-instability**. All said, rear-view mirror nit-picking on uneven and deficit recovery, while not entirely unjustified, pale in comparison to the **dangers of Oil exacerbating imbalances as well retarding progress**. The **RBI**'s task at hand is daunting. But **stoic initiation of tightening is perhaps the course of least destruction**.

Recovery Intact



Admittedly, Q4 GDP for 2021 fell short of expectations with a 5.4% YoY print, where markets were expecting a more buoyant ~6% (albeit more in-line with our 5.2% estimate). But that's **no reason to lose sight of a fairly resilient recovery intact**, which is evident **once exceptional base effect distortions are backed out** (see Chart 2).

In fact, the underlying (ex-base effects) growth is **consistent with sustained recovery from H2 2021**, **in sharp contrast to the headline** (distorted) **deceleration** in growth. Which is to say, the **Indian economy has not been derailed from continued improvement since the worst of the "delta wave"** (May 2021), and has managed to mitigate adverse "Omicron" impact.

Albeit Uneven

That said, there is **no ignoring the fact that the recovery, despite encouraging resilience, remains woefully uneven**; with low-income households and smaller business with limited access to financing struggling to make back ground. Meanwhile, *rolling global supply-chain snarls amplify vulnerabilities to, and inequalities from,* **adverse cost shocks** and **negative demand impulses**.

Oil Fuels Headwinds …

And **surging Oil prices amid geo-political risks threaten to impose daunting headwinds to the recovery via stagflation-type shock**. This sets the stage to exacerbate the inequality and potential instability associated with a 'K-shaped' recovery, and worryingly, may setback a recovery altogether in worse-case iterations.

… as Diabolical Geo-Political Threats Overtake Pandemic Risks

Upshot being, forward-looking assessments to India's growth ought to recognize that **escalating geo-political threats have displaced fading pandemic risks**. And this is *a diabolical risk that sharpens trade-offs* to the extreme as it is **simultaneously an accelerant of destabilizing inflation** (as well as "twin deficits") **and a demand depressant**. In fact, the negative impact of surging oil prices on consumption (Chart 1), with notable feed-through to growth is widely recognized.

Trade-Offs & Tyrannies Imposed by Oil

So, with **surging Oil prices** lighting up inflation on one hand, but suppressing demand (by eroding disposable real household incomes and eroding corporate profit margins) on the other, the **RBI will be faced with a "devil and deep blue sea" trade-off**. Specifically, the risk is that maintaining monetary accommodation to ease growth pains could come at (a **potentially exorbitant**) **cost of abrupt macro- and rupee instability**; should an aggressively hawkish Fed and global risk sentiments conspire to brew the perfect storm that dispatches disorderly capital outflows.

The **tyranny** of inconveniently and insidiously elevated Oil prices being that in one fell swoop, **India's investment fundamentals are undermined** by *plunging real returns* (from surging inflation), *sharply wider current account deficit* (from high-cost Oil imports) that flash red on the country's operating "cash burn" and *fiscal consolidation knocked off-course* by wider deficit and higher debt financing costs reinforcing one another. Coming out of the pandemic with pre-existing fragilities only amplifies the threats from Oil.

Demands a Stoic RBI

While the RBI's reservations about downside risks to growth may be validated, its sanguine view of inflation moderation into H2 now looks more precarious. As we stated in our last RBI commentary (Mizuho Chart Speak – the RBI's Leveraged Bet, 11th Feb 2022), the RBI may have to step up on policy tightening to respond to macro-stability risks; with 100bps of tightening this year. **Better stoic macro risk mitigation** than a more costly scramble to salvage after the fact.