

WEEKLY WRAP

26 August 2019

Global uncertainty increases

Amidst weak global macro indicators (PMI and US new home sales), China announced new set of tariffs on US goods. This will lead to demand for safe haven assets such as JPY and Gold. Global yields, in particular US, are likely to ease further and EM currencies may come under pressure. On the domestic front, government announced Rs 700bn recap into PSBs and additional liquidity to HFCs along with other measures. This should insulate the Indian economy but markets will be impacted by global events.

Sameer Narang | Dipanwita Mazumdar
 chief.economist@bankofbaroda.com

Markets

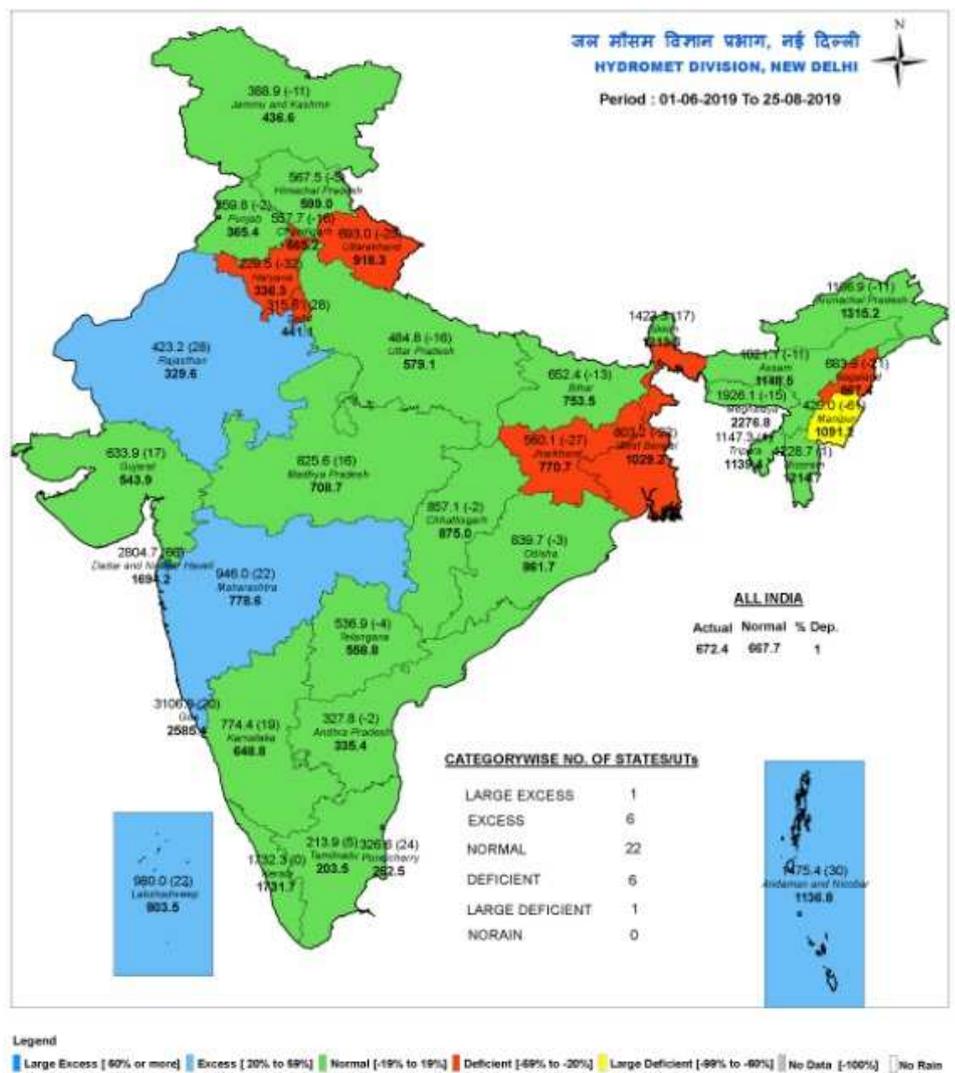
- **Bonds:** Global yields closed mixed as global manufacturing activity remained weak, US-China tensions escalated and uncertainty on US rate trajectory. US 10Y yield fell by 2bps (1.54%). Crude prices inched by 1.2% (US\$ 59/bbl) driven by drawdown of US inventories. India's 10Y yield rose by 3bps (6.57%). However it is trading lower today (6.52%) supported by government's reforms and commitment to fiscal prudence. System liquidity is in surplus of Rs 1tn as on 23 Aug 2019 vs Rs 1.3tn in the previous week.
- **Currency:** Asian currencies closed lower against the dollar on the back of escalation of US-China tariff war. CNY depreciated by (-) 0.7% to near an 11-year low. On the other hand, JPY rose by 0.9% driven by safe-haven demand. EUR too appreciated. DXY fell by (-) 0.5%. In line with other EM currencies (down by -0.2%), INR also depreciated by (-) 0.7%.
- **Equity:** Global indices closed the week mixed with Dow (-1%), FTSE (-0.3%) and Sensex (-1.7%) ending lower. Escalations in US-China trade tensions, uncertainty around 'no-deal Brexit' dragged the markets down. Domestic traders were cautious ahead of stimulus package announced by the government. Indian equity markets have opened higher despite China announcing new tariffs on US goods.
- **Upcoming key events:** In the current week, markets await GDP prints for US, India and Brazil and Bank of Korea's policy rate decision. Apart from this, Germany's IFO business climate index, Euro Area CPI and Japan industrial production data are also due for release this week.



Monsoon Tracker

- For the period 1 Jun 2019 to 25 Aug 2019, monsoon was 1% above LPA compared with (-) 7% last year. The south-west monsoon has now turned into surplus mode as Rajasthan and Maharashtra continue to receive incessant rains with other part of country receiving normal rains. However, Uttarakhand, Haryana, Jharkhand and West Bengal are still receiving deficient rains.
- Overall kharif sowing declined by (-) 2.3% as on 23 Aug 2019 compared with last year. The decline is led by lower sown area of rice (-) 6.4% and pulses (-3.1%). Major decline is also visible in sugarcane (-5.6%). However, sown area of cotton has improved by 5.7%.

FIG 1 – DISTRIBUTION PATTERN OF SOUTH-WEST MONSOON



India macro developments

- In an effort to boost domestic economy, FM has announced a host of reforms. Enhanced surcharge on long/short term capital gains has been rolled back. Upfront release of Rs 700bn capital to PSBs has been announced which will enhance liquidity of ~Rs 5tn. In a relief to MSMEs, all pending GST returns will be paid within 30days and future refund to be sorted within 60days. HFCs will also get liquidity support of Rs 200bn in addition to Rs 100bn announced earlier by NHB.
- RBI minutes revealed that MPC has kept room open for further reduction in rates as economic activity continues to decelerate. A benign inflation outlook favours lower real rates. We believe there is room for another 40bps cut in policy rates (110bps in CYTD19). However, focus will be on transmission, particularly, for new loans linked to external benchmark to ensure lower lending rates which will incentivize consumers/ firms to invest.
- According to fourth advance estimates, while food grain output at 285mn ton missed its target for 2018-19, it was still higher than the last 5-year average. Rice, wheat and sugarcane output touched a record high in 2018-19, rising by 3%, 2% and 5.3% respectively from last year. Even oilseeds production increased by 3% in 2018-19 vs last year. Pulses and cotton output turned out to be lower than last year; still above its 5-year average.
- According to news reports, 15th Finance Commission (FC) is expected to discontinue the revenue deficit grants given to states. 14th FC had set out “post-devolution” grants of Rs 1.9tn for 11 states for the period FY16-20. For FY20, 8 states have estimated revenue deficits, between 0.2% (A.P.) to 2.6% (Rajasthan). This move may push these states towards higher market borrowings in order to meet their expenditure targets.
- RBI reported that currency in circulation increased by Rs 46bn (on a weekly basis) and stood at Rs 21.9tn as on 16 Aug 2019. Overall reserve money increased by 13.6% on a YoY basis vs 19.4% a year ago. On FYTD basis, reserve money has risen by 1% against 1.9% in the previous year.
- As per news reports, domestic air passenger traffic rose by 3.1% between Jan-Jul'19; slowest pace in 5 years. This is in comparison to 22% growth between Jan-Jul'18 and 17.2% between Jan-Jul'17. The sharp decline is on account of weak demand and less supply (due to grounding of Jet airways).

Global macro developments

- US FOMC minutes highlighted that the current 25bps reduction in policy rate was a part of “recalibration of the stance of policy”. The mid-cycle adjustment was guided by muted growth outlook (especially business investment and manufacturing) and ongoing trade tensions. Few of the FOMC members also preferred a 50bps cut at the current juncture when inflation is also softening and global central banks are on a path of easing.
- US new home sales growth fell by (-) 12.8% in Jul’19 vs 20.9% in Jun’19 on a MoM basis-sharpest monthly decline in 6 years. On YoY basis too, growth eased to 4.3% from 17.8% in Jun’19, despite 3rd consecutive decline in house price in Jul’19 (-4.5%). However, as borrowing costs continue to decline, analysts believe sales may stabilize in coming months.
- Inflation in both the Euro Area and EU moderated to 1% and 1.4% in Jul’19 vs 1.3% & 1.6% respectively, in Jun’19 on YoY basis. There has been broad based moderation, especially in energy prices (0.5% in Jul’19 vs 1.7% in Jun’19). Core CPI also edged down by 0.9% vs 1.1% in Jun’19. Muted inflation coupled with subdued growth might prompt ECB to cut rates.
- Flash PMI data reflected that while services activity remained buoyant, manufacturing continued to falter. Eurozone manufacturing PMI was still below the 50 mark at 47 in Aug’19 vs 46.5 in Jul’19. Services PMI however, rose to 53.4 vs 53.2 in Jul’19. In Japan as well, similar trend was visible (manufacturing PMI: 49.5 and services PMI: 53.4 in Aug’19). All indices-new order inflows, employment and input prices remained subdued.
- Japan’s exports fell by (-) 1.6% in Jul’19 vs (-) 6.6% in Jun’19, declining for 8 straight months as global outlook continues to worsen. Exports to China fell for the 5th straight month, by (-) 9.3% in Jul’19, led by decline in exports of equipment used to manufacture semi-conductors (-31.5%) and electrical machinery (-14.1%). Along with the intensifying trade war between US and China, Japan’s own trade dispute with South Korea have hurt exports.
- Bank of Indonesia (BI) has reduced its policy rate by another 25bps in Aug’19 to 5.5%, after delivering its first rate cut (25bps) in Jul’19. This was led by benign inflation (3.3% in Jul’19) and subdued growth. BI expects CY19 GDP to be lower than government’s target of 5.2%. Further, to push growth beyond 5.3% next year, government in its budget last week announced spending of US\$ 178bn and tax incentives for businesses.

FIG 2 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	1.54	(2)	(51)	(79)	(127)
UK	0.48	2	(20)	(48)	(80)
Japan	(0.23)	0	(8)	(16)	(33)
Germany	(0.68)	1	(30)	(56)	(102)
India	6.57	3	14	(65)	(130)
China	3.07	5	(10)	(24)	(56)
2Y yields (Δ bps)					
US	1.53	6	(28)	(63)	(109)
UK	0.45	(7)	(3)	(19)	(27)
Japan	(0.29)	(2)	(9)	(14)	(18)
Germany	(0.89)	2	(11)	(26)	(30)
India	5.81	(6)	(29)	(75)	(176)
China	2.60	8	1	0	(25)
Currencies (Δ %)					
EUR	1.1144	0.5	0	(0.5)	(4.1)
GBP	1.2266	1.0	(1.7)	(3.5)	(4.5)
JPY	105.39	0.9	2.6	3.6	5.3
AUD	0.6756	(0.3)	(3.2)	(2.5)	(7.8)
INR	71.66	(0.7)	(3.9)	(3.1)	(2.5)
CNY	7.0955	(0.7)	(3.3)	(2.8)	(4.2)
Equity & Other indices (Δ %)					
Dow	25,629	(1.0)	(6.0)	0.2	(0.6)
FTSE	7,095	(0.3)	(5.4)	(2.5)	(6.4)
DAX	11,612	0.4	(7.3)	(3.3)	(6.3)
NIKKEI	20,711	1.4	(4.6)	(1.9)	(8.4)
Shanghai Comp	2,897	2.6	(0.9)	1.6	6.2
SENSEX	36,701	(1.7)	(3.0)	(6.9)	(4.1)
Brent (US\$/bbl)	59.34	1.2	(6.1)	(13.6)	(21.7)
Gold (US\$/oz)	1,527	0.9	7.1	18.8	26.7
CRB Index	392.4	(1.5)	(3.7)	(5.4)	(4.8)
Rogers Agri Index	680.9	(1.9)	(7.8)	(7.0)	(13.0)
LIBOR (3M)*	2.14	1	(12)	(38)	(17)
INR 5Y Swap*	6.27	(3)	(25)	(55)	(126)
India FII data (US\$ mn)					
	22 Aug	WTD	MTD	CYTD	FYTD
FII-Debt	363.0	897.9	1,151.8	3,805.8	3,261.1
FII-Equity	(179.9)	(420.0)	(1,514.7)	7,889.9	1,044.7

Source: Bloomberg, Bank of Baroda | *Indicates change in bps

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For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com