WEEKLY WRAP

11 November 2019

India's inflation to rise above 4%

Global sentiment improved as US and China are near to a trade deal. Global equity markets and yields rose in response. Growth remains lacklustre because of which China and Thailand eased policy rates. China may look at another rate cut as Yuan has regained ground. On the domestic front, Moody's downgraded India's outlook to negative on growth and fiscal concerns and India opted out of RCEP. With muted growth, RBI may ignore an inflation print above 4% and reduce rates in Dec'19.

Sameer Narang | Jahnavi
chief.economist@bankofbaroda.com

Markets

- **Bonds:** Except China, global yields closed higher over developments on US-China trade deal. US 10Y yield rose the most by 23bps (1.94%). However, global growth indicators remained muted. Bank of Thailand reduced policy rate to its lowest since CY09. Crude prices rose by 1.3% (US$ 63/bbl). India's 10Y yield rose by 9bps (6.75%) as fiscal concerns aggravated over lacklustre direct tax collection and Moody's downgrade of India's sovereign credit rating. System liquidity surplus was at Rs 2.4tn as on 08 Nov 2019 vs Rs 2.7tn in the previous week.

- **Currency:** Barring CNY, other global currencies ended lower this week as developments over US-China trade deal weighed. DXY rose by 1.1% in the week. CNY rose by 0.6% to its highest level since Aug'19 on hopes of finalisation of a trade deal. EUR fell by (-) 1.3% as European Commission cut the growth forecast for the region by 10bps to 1.1% in CY19. INR depreciated by (-) 0.7% as Moody's downgraded India's outlook to negative. FII inflows were US$ 790mn in the week.

- **Equity:** Driven by optimism around US-China trade deal and better than expected corporate earnings, global indices ended higher this week. Nikkei surged by 2.4%, followed by Dax (2.1%) and Dow (1.2%) which continued its winning streak. Following positive global cues, Sensex too ended the week (0.4%) in green pushed up by real estate and metal stocks.

- **Upcoming key events:** In the current week, markets await industrial production data for China, US, Euro Area and Japan. Q3 GDP print of Japan's and Euro Area is also awaited. On the domestic front, industrial production, WPI, CPI, and trade data is scheduled for release.

India macro developments

- As per news reports, government revenue receipts might see a turnaround with implementation of Direct Tax Code. The report suggests a shift away from prosecution of assessment for people paying higher income tax for upto six years. This could boost revenues by Rs 550bn. In FYTD20, direct tax collection have risen by 3% as of Oct'19 vs BE of 18.6% in FY20 (Income tax: 5% vs BE of 22.4%, corporate tax: 0.5% vs BE of 15.4%).
- Government has approved Rs 250bn special window as a Category-2 Alternate Investment Fund (AIF) to boost real estate sector. Out of this, Rs 100bn will be provided by the government and remaining will be raised from LIC, SBI, sovereign wealth and pension funds. Any RERA registered project with positive net worth will be eligible for this fund, irrespective of stage of completion. Around 1,600 projects will be covered.
- Moody's downgraded India's credit rating outlook to negative from stable. This was on the back of slowdown in domestic growth, rising debt burden, fiscal concerns and ongoing financial stress. Moody's believes fiscal deficit will be higher at 3.8% of GDP in FY20 vs BE of 3.3%. As a result INR has opened weaker and yields are higher. We believe continued reforms (privatisation, cut in corporate tax, measures to boost FDI) should support domestic growth and contain fiscal deficit in the near-term.
- India's services PMI fell to 49.2 in Oct'19 vs 48.7 in Sep'19. The slower pace of reduction was led by increase in new export orders. However, domestic demand remains muted, with competitive pressures and higher input prices building stress on profit margins. Employment growth too remains subdued. The 12-month outlook fell to its 14-year low in Oct'19.
- RBI reported that currency in circulation (CIC) increased by Rs 5.8bn and stood at Rs 22tn for the week ending 1 Nov 2019. Reserve money rose by 13.5% on a YoY basis, compared with 17.3% a year ago. On a FYTD basis, reserve money increased by 3.5% as against 4.4% last year.
- India has decided to not join RCEP citing concerns over India's economic interests particularly for farmers, MSMEs and consumers. India had raised concerns over rules of origin, trade deficit, protection against cheaper imports and better market access for exports. A total of 15 countries, including 10 ASEAN members along with China, S.Korea, Japan, NZ and Australia agreed to sign the agreement next year.

Global macro developments

- China's PPI fell by (-) 1.6% in Oct'19 vs (-) 1.2% in Sep'19. The steepest decline since Jul'16 was driven by oil & natural gas extraction (-17.9%) and ferrous metal mining (-6.1%). On the other hand, CPI soared to ~8 year high of 3.8% in Oct'19 vs 3% in Sep'19, on the back of doubling of pork price (101.3%). In CYTD19, CPI is up by 2.6% vs PBOC's target of 3%, implying that if food inflation continues to inch up, PBOC may restrain monetary policy easing measures in the coming months.
- Bank of England (BoE) kept the key policy rate unchanged with a vote of 7-2. However, it signalled chances of future rate cut to support growth amidst gloomier global growth outlook and entrenching Brexit uncertainties. Growth is also expected to bottom out to 1% in CY19. Inflation will be at 1.25% in the spring, below the 2% target.
- In line with market expectations, central banks of both, Australia (RBA) and Malaysia (BNM), held policy rates unchanged at 0.75% and 3% respectively. RBA and BNM also clarified that future course of policy will be data driven and dependent on US-China trade deal. RBA trimmed its growth forecast for CY19 to 2.25% from 2.5% earlier. Both banks are expected to deliver at least one more rate cut in early CY20.
- US ISM non-manufacturing PMI rose to 54.7 in Oct'19 after falling to a 3-year low at 52.6 in Sep'19. Amongst the sub-indices, employment index rose the most to 53.7 (+3.3) followed by new orders at 55.6 (+1.9). Separate data showed that US trade deficit narrowed to US$ 52.7bn in Sep'19 vs US$ 55bn in Aug'19.
- China's PBOC has reduced its medium-term lending facility (MLF) rate by 5bps, a first since CY16, to 3.25% from 3.3% earlier. The rate cut comes in the wake of slowing growth and tight liquidity conditions. Since the new Loan Prime Rate (LPR) is now linked to MLF, the overall lending rates are also expected to come down from 20 Nov 2019 onwards. Analysts are expecting one more 5bps cut in MLF and RRR in CY20.
- China's exports fell by (-) 0.9% in Oct'19 vs (-) 3.2% in Sep'19. The ease in contraction was driven by postponement of tariffs on Chinese goods by the US. China's imports too declined, by (-) 6.4% vs (-) 8.5% in Sep'19 due to weak domestic demand. Analysts expect decline in exports to bottom out in coming months if US-China reach a trade deal before 15 Dec 2019.

FIG 1 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	1.94	23	36	20	(124)
UK	0.79	13	33	31	(70)
Japan	(0.05)	13	15	17	(17)
Germany	(0.26)	12	29	31	(67)
India	6.75	9	9	25	(101)
China**	3.27	0	15	24	(22)
2Y yields (Δ bps)					
US	1.67	12	21	3	(129)
UK	0.55	3	18	11	(29)
Japan	(0.17)	10	14	10	(3)
Germany	(0.62)	4	14	25	(4)
India	5.56	7	(9)	(29)	(192)
China#	2.69	0	11	17	(1)
Currencies (Δ %)					
EUR	1.1018	(1.3)	0.4	(1.6)	(2.8)
GBP	1.2774	(1.3)	4.7	6.2	(1.5)
JPY	109.26	(1.0)	(1.7)	(3.4)	4.0
AUD	0.6863	(0.6)	2.1	1.1	(5.0)
INR	71.29	(0.7)	(0.3)	(0.7)	1.7
CNY	6.9959	0.6	1.9	0.9	(0.6)
Equity & Other indices (Δ %)					
Dow	27,681	1.2	5.1	5.3	6.5
FTSE	7,359	0.8	2.7	1.5	3.6
DAX	13,229	2.1	9.4	13.1	14.7
NIKKEI	23,392	2.4	9.0	13.1	5.1
Shanghai Comp	2,964	0.2	1.3	6.8	14.1
SENSEX	40,324	0.4	5.6	7.3	14.7
Brent (US$/bbl)	62.51	1.3	7.2	6.8	(10.9)
Gold (US$/oz)	1,459	(3.7)	(3.1)	(2.5)	20.6
CRB Index	390.7	0.2	0.9	(2.5)	(5.7)
Rogers Agri Index	730.6	(0.2)	1.8	2.4	(5.8)
LIBOR (3M)*	1.90	1	(8)	(28)	(72)
INR 5Y Swap*	6.50	(1)	23	17	(119)
India FII data (US$ mn)	**7 Nov**	**WTD**	**MTD**	**CYTD**	**FYTD**
FII-Debt	(146.7)	418.6	652.1	5,339.0	4,794.3
FII-Equity	126.0	371.9	626.9	10,849.7	4,004.5

Source: Bloomberg, Bank of Baroda | *Indicates change in bps, #1Y yield

FIG 2 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
11-Nov	China CPI, % YoY	Oct	3.4%	3.0%	--
	China PPI, % YoY	Oct	(1.5%)	(1.2%)	--
	Japan core machine orders, % MoM	Sep	0.90%	(2.40%)	--
	Japan current account balance, ¥ tn	Sep	1.7	2.2	--
	Italy industrial production, % MoM	Sep	(0.4%)	0.3%	--
	UK GDP, % QoQ	3Q P	0.4%	(0.2%)	--
	UK industrial production, % MoM	Sep	(0.1%)	(0.6%)	--
	India industrial production, % YoY	Sep	(2.3%)	(1.1%)	--
12-Nov	Singapore retail sales SA, % MoM	Sep	0.9%	(1.3%)	--
	UK jobless claims change	Oct	--	21,100	--
	UK ILO unemployment rate 3mths, %	Sep	3.9%	3.9%	--
	Germany ZEW survey expectations	Nov	(15.0)	(22.8)	--
13-Nov	Japan PPI, % MoM	Oct	1.2%	0.0%	--
	New Zealand policy rate, %	13-Nov	0.75%	1.00%	--
	Germany CPI, % MoM	Oct F	0.1%	0.1%	--
	UK CPI, % YoY	Oct	1.7%	1.7%	--
	Euro Area industrial production SA, % MoM	Sep	(0.3%)	0.4%	--
	India CPI, % YoY	Oct	4.3%	4.0%	--
	US CPI, % MoM	Oct	0.3%	0.0%	--
14-Nov	Japan GDP SA, % QoQ	Q3CY19	0.2%	0.3%	--
	Australia unemployment rate, %	Oct	5.2%	5.2%	--
	China fixed assets ex rural YTD, % YoY	Oct	5.4%	5.4%	--
	China industrial production, % YoY	Oct	5.4%	5.8%	--
	China retail sales, % YoY	Oct	7.8%	7.8%	--
	India WPI, % YoY	Oct	(0.22%)	0.33%	--
	Germany GDP SA, % QoQ	Q3CY19	(0.1%)	(0.1%)	--
	France CPI, % YoY	Oct	0.7%	0.7%	--
	Philippines policy rate, %	14-Nov	4.0%	4.0%	--
	Euro Area GDP SA, % QoQ	Q3CY19	0.2%	0.2%	--
	US PPI final demand, % YoY	Oct	0.9%	1.4%	--
	US initial jobless claims	9-Nov	--	211,000	--
15-Nov	China new home prices, % MoM	Oct	--	0.53%	--
	Japan industrial production, % MoM	Sep	--	1.4%	--
	Hong Kong GDP, % YoY	Q3CY19	(2.9%)	(2.9%)	--
	Euro Area CPI, % YoY	Oct	0.7%	0.7%	--
	US retail sales advance, % MoM	Oct	0.2%	(0.3%)	--
	US industrial production, % MoM	Oct	(0.3%)	(0.4%)	--
	India exports, % YoY	Oct	--	(6.6%)	--

Source: Bloomberg, Bank of Baroda

Disclaimer

Visit us at **www.bankofbaroda.com**

For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com