

WEEKLY WRAP

30 September 2019

RBI policy and H2 borrowing to drive yields

Global manufacturing activity weakened further in Sep'19, especially in the Eurozone. In addition, US consumer confidence fell. With Mexico and Philippines reducing rates, global yields closed lower in the week. Oil prices fell by (-) 3.7% as Saudi output resumed. This supported Indian yields. Announcement of corporate tax cut helped lift Sensex and robust FII inflows supported INR. Government's H2 borrowing calendar and RBI policy meet will set the tone for the markets this week. We expect 25bps rate cut.

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Markets

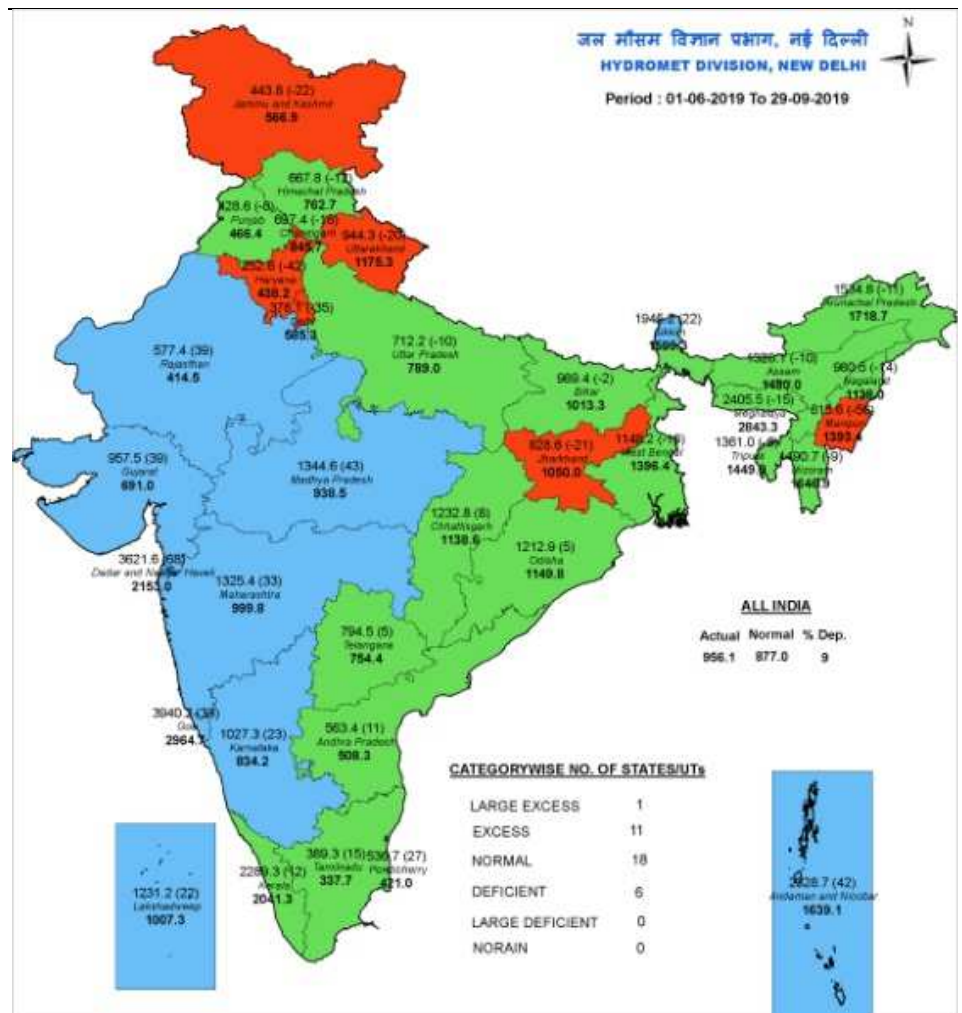
- **Bonds:** Except China, global yields closed lower amidst weaker than expected data in Eurozone, Japan and falling consumer confidence in the US. Central Banks of Mexico and Philippines did reduce policy rate. US 10Y yield fell by 4bps (1.68%). Crude prices declined by (-) 3.7% (US\$ 62/bbl) over demand concerns. India's 10Y yield also fell by 5bps (6.74%). All eyes will be on H2 borrowing calendar and RBI policy. System liquidity surplus was at Rs 1.6tn as on 27 Sep 2019 vs Rs 324bn in the previous week.
- **Currency:** Barring AUD (flat) and INR, other global currencies closed lower. DXY rose by 0.6% in the week on the back of progress in US-China trade talks. Led by weak macro data in the EU (economic sentiment, manufacturing PMI), EUR depreciated by (-) 0.7%. GBP also fell by (-) 1.5% as uncertainty over Brexit intensified. INR rose by 0.5% in the week supported by FII inflows (US\$ 1.5bn) and lower oil prices.
- **Equity:** FTSE and Sensex bucked the trend as global equity markets ended the week lower led by growth concerns. Shanghai Comp (-2.5%) declined the most, followed by Nikkei (-0.9%) and Dax (-0.7%). However Sensex (2.1%) ended in green, supported by announcement of corporate tax cuts by government in order to boost growth.
- **Upcoming key events:** In the current week, PMIs of major economies (Germany, France, US and Japan) are due to be released. Unemployment data of US will also be watched. On the domestic front, all eyes will be on H2 borrowing calendar and RBI policy meet. BoP data is also scheduled to be released.



Monsoon Tracker

- For the period 1 Jun 2019 to 29 Sep 2019, monsoon was 9% above LPA compared with (-) 9% last year. Even though the south-west monsoon draws to a close officially, rains are likely to continue in coming weeks. Rajasthan, Gujarat, Madhya Pradesh, Maharashtra continue to receive excess rains. On the other hand, J&K, Uttarkhand, Haryana and Jharkhand are still reeling with deficient rains.
- Overall kharif acreage has turned out to be same as last year as of 27 Sep 2019. Sowing area of cotton (5.5%) and oilseeds (0.1%) has seen an improvement. However, sown area of food grains and pulses has dropped by (-) 0.6% and (-) 1.7% respectively.

FIG 1 – DISTRIBUTION PATTERN OF SOUTH-WEST MONSOON



Source: IMD, Bank of Baroda Research

India macro developments

- Government has reviewed the progress in capex spending in H1FY20. Till Aug'19, 42% of total capex has been spent. As per the Union Budget, Rs 3.39tn has been allocated as GBS (vs Rs 3.17tn in FY19RE) and Rs 5.38tn as IEBR (vs Rs 6.13tn in FY19RE) for capex. Government has also asked ministries to provide their capex plans for the next 4-quarters. Further, it has said that around 90% of outstanding GST dues have been cleared.
- According to the 1st advance estimates, foodgrain production for agriculture year 2019-20 is expected to be (-) 0.7% lower at 140.57mn tonnes compared with last year. Production of pulses is also likely to be (-) 11% lower this year. This might be on the back of incessant rains. However, rice production is expected to improve moderately by 1% for the same period.
- ADB has revised its growth forecast downward for India to 6.5% from 7.2% earlier in FY20. This was in line with slowdown observed globally. However, India will continue to be one of the fastest growing economies. Recent government announcements such as corporate tax cut, bank recapitalisation and liquidity support to NBFCs will stimulate private investment including FDI and pave way for a cyclical growth recovery.
- RBI reported that currency in circulation (CIC) declined by (-) Rs 179.1bn and stood at Rs 21.8tn for the week ending 20 Sep 2019. Reserve money rose by 12.7% on a YoY basis, compared with 20% a year ago. On a FYTD basis, reserve money increased by only 1.2% as against 3% last year.
- RBI's working group on Liquidity Management Framework has suggested to continue with the corridor system (call: target rate, repo: policy rate). This would require system liquidity to be in a small deficit of 0.25-0.5% of NDTL. However, framework should be adaptable to surplus liquidity situations. It has also recommended introduction of longer-term repo operations up to one-year for durable liquidity management.
- UNCTAD estimates India's GDP growth at 6% in CY19, a 7-year low from 7.4% in CY18, led by lower tax collections and cut in public spending due to fiscal consolidation. Growth in China is also expected to be lower at 6.1% vs 6.6% in CY18. Global growth is expected to fall to 2.3% from 3% in CY18, driven by trade tensions, Brexit uncertainty and weak demand.

Global macro developments

- Central Banks of Thailand and New Zealand held their policy rates steady at 1.5% and 1% respectively. BoT also downgraded its growth forecast for CY19 to 2.8% from 3.3% earlier. Both central banks expressed concern about global slowdown and ongoing trade tensions. In CYTD19, policy rates have been reduced by 25bps (Thailand) and 75bps (New Zealand), to boost growth.
- Industrial profits in China declined by (-) 2% in Aug'19 after an increase of 2.6% in Jul'19. This was led by a drop in sales and producer prices as well as the impact of typhoons. In CYTD19, industrial profits fell by (-) 1.7% with profits in state owned enterprises falling by (-) 8.6%. Sector wise, car manufacturing industries recorded a steep decline of (-) 19% between Jan-Aug'19 amidst the US-China trade war.
- New home sales in the US jumped by 7.1% on a MoM basis vs (-) 8.6% in Jul'19, owing to lower interest rates. US 10Y yield has fallen from 2.1% in Jul'19 to 1.6% in Aug'19. The 30-year fixed mortgage rate is also down to 3.73%—a 120bps dip since the high of last year. On a YoY basis too, sales rose by 18% vs 9.4% in Jul'19, despite a 2.2% rise in median house price (-6.7% in Jul'19).
- Amidst trade war worries, US consumer confidence registered the sharpest drop in over 9 months to 125.1 in Sep'19 from 134.2 in Aug'19. The waning consumer confidence poses a serious risk to growth. The drop can also be attributed to uncertainty and volatility in the global economy. Even the present situation index took a hit, dropping to 169 in Sep'19 (176 in Aug'19).
- Germany's Ifo business climate index inched up in Sep'19 to 94.6 from 94.3 in Aug'19. This was driven by improvement in business conditions of the services sector. Manufacturing and trade companies continue to assess their current and future positions weak. As a result, Ifo expectation index deteriorated further to 90.8 vs 91.3 in Aug'19.
- Global flash PMIs indicate while manufacturing activity improved marginally in US in Sep'19, it weakened further in Japan and Eurozone (led by Germany). US registered modest improvement in output and new order growth. However, Japan and Germany continue to be hit by notable decline in new export orders. US-China trade tensions, Hong Kong protests, Brexit woes have all impacted business conditions negatively.
- Central Banks of both Mexico and Philippines reduced their policy rates by 25bps to 7.75% and 4% respectively. Both decisions were driven on account of subdued inflation, credit crunch, and faltering growth. Additionally, BSP has lowered its inflation forecast for CY19 to 2.5% from 2.6% earlier. In Q2CY19, Philippine's GDP growth had slowed to 5.5%—lowest since CY15, while Mexico's GDP rose by mere 0.1%.

FIG 2 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	1.68	(4)	19	(33)	(137)
UK	0.50	(13)	6	(33)	(110)
Japan	(0.24)	(3)	5	(8)	(36)
Germany	(0.57)	(5)	12	(25)	(110)
India	6.74	(5)	18	(14)	(129)
China	3.15	5	11	(9)	(49)
2Y yields (Δ bps)					
US	1.63	(5)	11	(12)	(120)
UK	0.40	(13)	3	(22)	(44)
Japan	(0.32)	(2)	(1)	(10)	(20)
Germany	(0.77)	(5)	14	(2)	(28)
India	5.81	0	4	(49)	(206)
China#	2.56	2	(3)	(7)	(42)
Currencies (Δ %)					
EUR	1.0940	(0.7)	(1.1)	(3.8)	(6.0)
GBP	1.2292	(1.5)	0.9	(3.2)	(6.0)
JPY	107.92	(0.3)	(1.3)	(0.1)	4.8
AUD	0.6764	(0.0)	0.5	(3.6)	(6.2)
INR	70.56	0.5	1.7	(2.2)	2.8
CNY	7.1228	(0.4)	0.3	(3.7)	(3.4)
Equity & Other indices (Δ %)					
Dow	26,820	(0.4)	1.7	0.8	1.4
FTSE	7,426	1.1	3.4	0.0	(1.6)
DAX	12,381	(0.7)	4.6	(0.1)	(0.4)
NIKKEI	21,879	(0.9)	6.9	2.8	(8.1)
Shanghai Comp	2,932	(2.5)	1.4	(1.6)	5.0
SENSEX	38,823	2.1	4.7	(1.5)	6.9
Brent (US\$/bbl)	61.91	(3.7)	1.4	(7.0)	(24.2)
Gold (US\$/oz)	1,497	(1.3)	(2.0)	6.2	26.6
CRB Index	387.5	0.5	(0.2)	(5.0)	(7.0)
Rogers Agri Index	704.2	0.8	2.7	(6.3)	(8.4)
LIBOR (3M)*	2.10	(4)	(3)	(22)	(30)
INR 5Y Swap*	6.38	3	15	(36)	(143)
India FII data (US\$ mn)					
	26 Sep	WTD	MTD	CYTD	FYTD
FII-Debt	(205.7)	(283.0)	(106.6)	4,140.6	3,596.0
FII-Equity	1,569.8	1,810.2	1,039.6	8,245.6	1,400.4

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

FIG 3 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
30-Sep	South Korea industrial production, % YoY	Aug	(0.8%)	0.6%	--
	Japan retail sales, % YoY	Aug	0.7%	(2.0%)	--
	Japan industrial production, % MoM	Aug	(0.5%)	1.3%	--
	China manufacturing PMI	Sep	49.6	49.5	--
	China non-manufacturing PMI	Sep	53.9	53.8	--
	Caixin China manufacturing PMI	Sep	50.2	50.4	--
	UK GDP, % QoQ	Q2CY19	(0.2%)	(0.2%)	--
	Germany CPI, % YoY	Sep P	1.3%	1.4%	--
	India fiscal deficit, Rs cr	Aug	--	115,550	--
	India eight infrastructure industries, % YoY	Aug	--	2.1%	--
	India current account deficit, US\$ bn	Q2FY20	(16.0)	(4.6)	--
1-Oct	South Korea exports, % YoY	Sep	(7.6%)	(13.6%)	--
	Jibun Bank Japan manufacturing PMI	Sep	--	48.9	--
	RBA policy rate, %	1-Oct	0.8%	1.0%	--
	Markit India manufacturing PMI	Sep	--	51.4	--
	Markit France manufacturing PMI	Sep	--	50.3	--
	Markit/BME Germany manufacturing PMI	Sep	41.4	41.4	--
	Markit Eurozone manufacturing PMI	Sep	45.6	45.6	--
	Markit UK PMI manufacturing SA	Sep	48.1	47.4	--
	Markit US manufacturing PMI	Sep	--	51.0	--
US ISM manufacturing	Sep	50.5	49.1	--	
2-Oct	ADP employment change	Sep	138,000	195,000	--
3-Oct	Jibun Bank Japan services PMI	Sep	--	52.8	--
	Markit Italy services PMI	Sep	--	50.6	--
	Markit France services PMI	Sep	--	51.6	--
	Markit Germany services PMI	Sep	52.5	52.5	--
	Markit Eurozone services PMI	Sep	52.0	52.0	--
	Markit/CIPS UK services PMI	Sep	50.3	50.6	--
	US initial jobless claims	28-Sep	--	213,000	--
	Markit US services PMI	Sep	--	50.9	--
	US factory orders	Aug	(0.5%)	1.4%	--
	US ISM non-manufacturing index	Sep	55.0	56.4	--
	US durable goods orders, % MoM	Aug	--	--	--
4-Oct	Markit India services PMI	Sep	--	52.4	--
	RBI policy rate, %	4-Oct	5.15%	5.40%	--
	US change in nonfarm payrolls	Sep	140,000	130,000	--
	US unemployment rate, %	Sep	3.7%	3.7%	--
	US trade balance, US\$ bn	Aug	(54.8)	(54.0)	--

Source: Bloomberg, Bank of Baroda

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