

## WEEKLY WRAP

08 February 2021

## India's fiscal impulse drive yields higher

Global equity markets rose on the back of strong corporate results and manufacturing activity. DXY index appreciated by 0.5% as US cleared US\$ 1.9tn stimulus. Global yields rose led by India and US. India's fiscal deficit is now estimated at 9.5%/6.8% for FY21/22, higher than expected. Rising oil prices and entrenched core inflation drove RBI to raise its inflation forecast for H1FY22. With inflation expected to remain above RBI's target of 4%, we don't see any rate cut. RBI will continue to buy bonds to balance the market.

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## Markets

- Bonds:** Global yields closed higher. UK 10Y yield rose by 16bps (0.48%) as BoE hinted that negative rates are not forthcoming soon. US 10Y yield rose by 10bps (1.16%) supported by fiscal stimulus. Oil prices also rose by 6.2% (US\$ 59/bbl). India's 10Y yield rose the most by 17bps (6.07%) as fiscal deficit expanded to 9.5%/ 6.8% in FY21/22. However it is trading lower today as news reports suggest RBI will conduct OMO of Rs 3tn in FY22 (Rs 2.5tn in FYTD21). System liquidity surplus was at Rs 6.2tn as on 5 Feb 2021, against Rs 5.8tn in the previous week.
- Currency:** DXY rose by 0.5% in the week driven by anticipation of stimulus led recovery. EUR depreciated by 0.7% as Germany's retail sales and factory orders were weaker than expected. GBP gained by 0.2% as BoE pushed back the possibility of negative rates till Jul'21. INR closed flat supported by FII inflows of US\$ 2.3bn even as oil prices rose by 6.2%.
- Equity:** Global indices ended higher in the week led by vaccine rollout and US stimulus. Amongst other indices, Sensex surged by 9.6% posting biggest weekly gain in over 10 months on the back of an expansionary budget. Banking, infra and real estate stocks rose the most.
- Covid-19 tracker:** Global cases rose by 3.3mn in the week ending 5 Feb 2021 compared with 3.9mn in the previous week led by dip in UK and US. India added 83k cases in the week versus 95k in the previous week.
- Upcoming key events:** Globally, CPI prints of US and China are due along with UK GDP and industrial production data. In India, CPI inflation and IIP data will be released later in the week.



## India macro developments

- The FM surprised by increasing FY21/22 fiscal deficit to 9.5%/6.8% of GDP from 4.6% in FY20. Spending in FY21 is 28.4% higher than FY20 led by subsidies, MNREGA, health and capex. Capex has got a boost even in FY22 with a 26.2% increase. Revenue estimates for FY22 look credible. However, the elevated gross and net borrowing in FY22 at Rs 12.1tn and Rs 9.2tn respectively, will put upward pressure on yields.
- India's manufacturing PMI expanded for the 6th straight month to 57.7 in Jan'21 from 56.6 in Dec'20. The uptick is led by faster expansion in total sales and new export orders. On inflation, price pressure intensified on the back of constraints in supply chains. Overall business sentiment improved with vaccine roll out, higher marketing budgets and projects in pipeline.
- MPC members unanimously voted to keep policy rate unchanged and maintain accommodative stance in the current and into next financial year. RBI did raise its growth estimate for H1FY22 up by 3%. It also raised its inflation estimate up by 0.2% and expects inflation to come down to 4.3% in Q3. We continue to believe we have come to an end to rate cycle. However, liquidity will remain accommodative. The focus will be on absorbing elevated supply of government paper through OMOs and banks (extension of HTM limit of 22% to Mar'23).
- Domestic petrol and diesel prices continued to increase in Feb'21. Base price of petrol and diesel shot up by 4.3% and 4.7% respectively on MoM basis against 2.8% and 3.1% in Jan'21. Even pump prices of petrol and diesel on an average rose to an all-time high of Rs 84.7/lt (1-4 Feb 2021) against Rs 83.3/lt in Jan'21. This was on the back of elevated crude prices (average of US\$ 58.1/bbl in Feb'21 versus US\$ 55.3/bbl in Jan'21).
- India's services activity gained pace as PMI print rose to 52.8 in Jan'21 from 52.3 in Dec'20. Both new work and business activity accelerated. Business outlook also improved due to roll out of vaccine. However, employment and export index fell sharply. Input cost was slightly weaker compared to Dec'20.
- India's trade deficit narrowed to US\$ 14.8bn in Jan'21 from US\$ 15.4bn in Dec'20 as exports bounced back by 5.4%, led by non-oil exports. Import growth however slowed to 2% from 7.6% in Dec'20 as oil imports fell. Non-oil-non-gold imports were stable.
- RBI reported that currency in circulation (CIC) declined by Rs 44.7bn and stood at Rs 28.1tn for the week ending 29 Jan 2021. Reserve money rose by 14.5% on a YoY basis, compared with 12.1% a year ago. On FYTD basis, reserve money increased by 11% as against 6% a year ago.

## Global macro developments

- BoE has kept the bank rate (0.1%) and QE program of £895bn unchanged in its latest policy meeting. Noting the impact of second lockdown in UK, the bank has revised its GDP projection for Q1CY21 downward to contraction of ~4%. MPC also discussed the possibility of deploying negative rates after 6 months, if economic situation worsens.
- US durable goods orders rose for the 8th straight month in Dec'20 at 0.2% versus an increase of 1.2% in Nov'20 on a MoM basis. This was driven by machinery (2.4% versus 1.5%). New orders for non-defence capital goods excl. aircraft (proxy for business spending) rose by 0.7% versus 0.6% in Nov'20. Separately, US jobless claims for the week ending 30 Jan 2021 declined by 33,000 to 779,000-its lowest level since Nov'20.
- US ISM non-manufacturing PMI rose to 58.7 in Jan'21 from 57.7 in Dec'20. New orders (61.8 versus 58.6) and employment index (55.2 versus 48.7) rose the most. Within new orders, domestic orders supported growth as export orders fell by 10.3 points to 47. Price pressures remained broadly stable as index eased only a tad to 64.2 from 64.4 in Dec'20.
- CPI inflation in the Euro Area rose by 0.9% in Jan'21 (YoY) basis after declining by 0.3% in Dec'20. The higher than estimated increase (est., 0.6%) was led by services (1.4% versus 0.7% in Dec'20) and food, alcohol and tobacco (1.5% versus 1.3% in Dec'20). Core CPI (excl. energy and unprocessed food) rose by 1.4% in Jan'21 versus 0.4% in Dec'20.
- Reserve Bank of Australia (RBA) in its recent policy has decided to keep the policy rate at record low level of 0.1% for "as long as necessary". It also expanded its asset purchase program by another US\$ 76bn. Further, the policy highlighted that the ultra-low rates would persist till inflation target of 2-3% is met and labour market revives (expected not before CY24).
- Euro Area's GDP contracted by 0.7% (est.: 1% drop) in Q4CY20 versus 12.4% increase in Q3. Resurgence in Covid-19 cases forced major European countries to impose strict lockdown measures in Q4. Steepest decline was seen in Austria (4.3%), Italy (2%) and France (1.3%). In CY20, Euro Area GDP fell by 6.8%, sharpest since CY95.
- US non-farm payroll additions were at 49,000 in Jan'21, lower than estimated 50,000 but showed improvement compared with 227,000 fall in Dec'20. Unemployment rate fell to 6.3% from 6.7%. However, labour force participation rate was lower at 61.4 compared with 61.5 in Dec'20. Average hourly earnings on MoM basis dropped by 0.2% from 1% increase.

FIG 1 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

| Particulars                             | Current      | 1W         | 1M         | 3M          | 12M         |
|---|--------------|------------|------------|-------------|-------------|
| <b>10Y yields (Δ bps)</b>               |              |            |            |             |             |
| US                                      | 1.16         | 10         | 21         | 35          | (42)        |
| UK                                      | 0.48         | 16         | 27         | 21          | (9)         |
| Japan                                   | 0.06         | 1          | 5          | 4           | 10          |
| Germany                                 | (0.45)       | 7          | 13         | 17          | (6)         |
| India                                   | 6.07         | 17         | 25         | 20          | (37)        |
| China                                   | 3.22         | 4          | 8          | 2           | 42          |
| <b>2Y yields (Δ bps)</b>                |              |            |            |             |             |
| US                                      | 0.10         | (1)        | (2)        | (5)         | (130)       |
| UK                                      | (0.03)       | 8          | 12         | 1           | (52)        |
| Japan                                   | (0.12)       | (1)        | 1          | 2           | 3           |
| Germany                                 | (0.71)       | 2          | 1          | 7           | (7)         |
| India                                   | 4.63         | 15         | 77         | 51          | (114)       |
| China**                                 | 2.70         | 2          | 26         | (5)         | 47          |
| <b>Currencies (Δ %)</b>                 |              |            |            |             |             |
| EUR                                     | 1.2046       | (0.7)      | (2.0)      | 1.4         | 10.0        |
| GBP                                     | 1.3735       | 0.2        | 0.8        | 4.4         | 6.5         |
| JPY                                     | 105.39       | (0.7)      | (2.6)      | (2.0)       | 4.0         |
| AUD                                     | 0.7678       | 0.4        | (1.0)      | 5.8         | 15.1        |
| INR                                     | 72.93        | 0          | 0.3        | 1.7         | (2.1)       |
| CNY                                     | 6.4656       | (0.6)      | (0.1)      | 2.2         | 7.7         |
| <b>Equity &amp; Other indices (Δ %)</b> |              |            |            |             |             |
| Dow                                     | 31,148       | 3.9        | 2.5        | 10.0        | 7.0         |
| FTSE                                    | 6,489        | 1.3        | (1.9)      | 9.8         | (13.1)      |
| DAX                                     | 14,057       | 4.6        | 3.0        | 12.6        | 4.0         |
| NIKKEI                                  | 28,779       | 4.0        | 6.0        | 18.3        | 20.8        |
| Shanghai Comp                           | 3,496        | 0.4        | (0.9)      | 5.6         | 21.6        |
| SENSEX                                  | 50,732       | 9.6        | 4.7        | 21.1        | 23.3        |
| Brent (US\$/bbl)                        | 59.34        | 6.2        | 10.7       | 50.4        | 8.9         |
| Gold (US\$/oz)                          | 1,814        | (1.8)      | (7.0)      | (7.0)       | 15.5        |
| CRB Index                               | 463.5        | 1.1        | 3.3        | 11.5        | 15.4        |
| Rogers Agri Index                       | 932.3        | 0.5        | 3.6        | 16.7        | 26.2        |
| LIBOR (3M)*                             | 0.19         | (1)        | (4)        | (1)         | (154)       |
| INR 5Y Swap*                            | 5.78         | 21         | 45         | 71          | (67)        |
| <b>India FII data (US\$ mn)</b>         |              |            |            |             |             |
|   | <b>4 Feb</b> | <b>WTD</b> | <b>MTD</b> | <b>CYTD</b> | <b>FYTD</b> |
| FII-Debt                                | 54.8         | 54.6       | 54.6       | (443.7)     | (4,537.3)   |
| FII-Equity                              | 520.9        | 2,074.6    | 2,074.6    | 4,052.9     | 34,028.6    |

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

FIG 2 – DATA RELEASE CALENDAR

| Date          | Event                                   | Period | Estimate | Previous | Actual |
|---------------|---|--------|----------|----------|--------|
| <b>8-Feb</b>  | Japan current account balance, ¥ tn     | Dec    | 1.1      | 1.9      | --     |
|               | Germany industrial production SA, % MoM | Dec    | 0.3%     | 0.9%     | --     |
|               | Taiwan exports, % YoY                   | Jan    | 23.7%    | 12.0%    | --     |
| <b>9-Feb</b>  | Japan machine tool orders, % YoY        | Jan    | --       | 9.9%     | --     |
|               | Germany exports SA, % MoM               | Dec    | (0.6%)   | 2.2%     | --     |
|               | Italy industrial production, % MoM      | Dec    | 0.3%     | (1.4%)   | --     |
| <b>10-Feb</b> | South Korea unemployment rate SA, %     | Jan    | 4.3%     | 4.6%     | --     |
|               | Japan PPI, % YoY                        | Jan    | (1.6%)   | (2.0%)   | --     |
|               | China CPI, % YoY                        | Jan    | (0.1%)   | 0.2%     | --     |
|               | China PPI, % YoY                        | Jan    | 0.3%     | (0.4%)   | --     |
|               | Germany CPI, % MoM                      | Jan    | 0.8%     | 0.8%     | --     |
|               | France industrial production, % MoM     | Dec    | 0.4%     | (0.9%)   | --     |
|               | US CPI, % MoM                           | Jan    | 0.3%     | 0.4%     | --     |
| <b>11-Feb</b> | European Commission economic forecasts  | --     | --       | --       | --     |
|               | US initial jobless claims, in thousands | 06-Feb | 760.0    | 779.0    | --     |
| <b>12-Feb</b> | UK industrial production, % MoM         | Dec    | 0.6%     | (0.1%)   | --     |
|               | UK GDP, % QoQ                           | Q4CY20 | 0.5%     | 16.0%    | --     |
|               | India IIP, % YoY                        | Dec    | (0.5%)   | (1.9%)   | --     |
|               | India CPI, % YoY                        | Jan    | 4.4%     | 4.6%     | --     |

Source: Bloomberg, Bank of Baroda

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