WEEKLY WRAP

22 October 2018

Asia slowing, US on firmer footing

Chinese equity markets fell as economy is slowing down and trade spat with US is likely to hurt its economy. However, US yields, equity markets and US$ strengthened as US economy continues to strengthen. Indian equity markets fell as liquidity issues are impacting NBFCs. However, yields eased and INR appreciated. MPC minutes suggest members are concerned about upside risks to inflation. However, members are optimistic on growth. Liquidity issues with NBFCs and higher oil prices will be a drag on growth, in our view.

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Markets

- **Bonds:** Except US and Japan, global yields declined. This was led by 0.8% drop in crude prices (US$ 80/bbl) following rising US inventories. US yields went up on the back of strong labour market and Fed minutes reiterating rate hikes. Indian 10Y yield declined by 6bps supported by strengthening INR and RBI's liquidity infusion measures (OMO purchase of Rs 759bn in CYTD18). The system liquidity was in deficit of Rs 1.3tn versus Rs 215bn in the previous week.

- **Currency:** Except INR and AUD, other global currencies ended lower against US$. Even as China is slowing down, economic momentum in US is likely to sustain. In addition, uncertainty around Brexit and concerns over Italy's budget deficit lifted the dollar (DXY: +0.5%). INR posted its second weekly gain on the back of lower oil prices (down 0.8% in the week). FPI outflows during the week were also lower at US$ 370mn.

- **Equity:** Global indices closed mixed. Dow gained by 0.4% in a strong start to corporate earnings season. European markets remained volatile throughout the week, but gained despite an impasse over Brexit. Shanghai Comp (2.2%) lost the most as China is slowing (imports and industrial production data suggests so). Sensex ended the week in red (-1.2%) on concern over liquidity crunch in NBFCs.

- **Upcoming key events:** Globally, US Q3CY18 GDP data, ECB's monetary policy decision, and flash manufacturing PMIs will be closely watched. US new home sales, Taiwan's exports and Germany's IFO business climate index will also be released. On domestic front, oil price movement and INR will impact the markets.

India macro developments

- India's trade deficit declined to US$ 13.9bn in Sep'18 from US$ 17.4bn in Aug'18, but compared to year ago it has risen by US$ 4bn. Exports declined unexpectedly by (-) 2.2% in Sep'18, mainly due to adverse base effect and were led by gems & jewellery and textiles. Imports on the other hand rose by 10.5%, lower than 25.4% in Aug'18. Owing to higher crude prices, oil imports rose by 26.8% in Sep'18 (+40% in FYTD19 vs 25% in FYTD18).
- WPI inflation increased from 4.5% in Aug'18 to 5.1% in Sep'18 led by higher food inflation which increased to 0.1% in Sep'18 from (-) 2.3% in Aug'18. Fuel & power inflation also remained elevated at 16.6% in Sep'18 (17.7% in Aug'18). INR depreciation of 3.7% in Sep'18 added to upward pressure.
- India jumped five places to rank 58th in WEF's global competitiveness ranking for 2018. This was the largest gain amongst G20 economies. As per the WEF, India's greatest competitive advantages include its huge market size, innovation and entrepreneurship. On the other hand, trade openness, human capital and investments in innovations require attention.
- RBI reported that currency in circulation (CIC) increased by Rs 203bn (on a weekly basis) and stood at Rs 19.5tn as on 12 Oct 2018. Overall, reserve money rose by 18% on a YoY basis because of increased currency demand compared with a fall of (-) 5.2% a year ago. On FYTD basis, reserve money rose by 2.9% as against 10.8% in the previous year.
- RBI released minutes of its meeting held between 3 and 5 Oct, voicing its concerns on upside risks to inflation. The persistent undershoot of actual inflation prints versus RBI's forecasts seems to have made MPC members evaluate the impact of MSP hikes and imported inflation on actual prints. On the growth front, MPC members remained buoyant even as Q1FY20 estimate has been revised marginally lower.
- India's FX reserves for the week ending 12 Oct 2018 declined steeply to US$ 394bn. On a weekly basis, forex reserves declined by US$ 5bn, registering the sharpest weekly decline since Nov'11, compared with a decline of US$ 1bn last week. On CYTD basis, reserves are down by US$ 14.9bn, compared with an accretion of US$ 40bn in the same period last year. Pressure on forex reserves is in line with INR depreciation (13% in CYTD18).

Global macro developments

- US retail sales grew by 0.1% in Sep'18 (est.: 0.7%) unchanged from Aug'18 and lower than expectation .This was led by drop in restaurant receipts which reflected temporary impact of Hurricane.
- Industrial production in the US rose for 4th consecutive month on a MoM basis, by 0.3% vs 0.4% in Aug'18. This was driven by higher manufacturing and mining output. However, in Q3CY18, industrial output grew by 3.3% at an annualised rate; lower than 5.3% growth seen in Q2CY18. Capacity utilisation of the industrial sector remained unchanged at 78.1% which was 1.7% below its long period average.
- China's CPI rose by 2.5% in Sep'18 vs 2.3% in Aug'18, led by increase in prices of non-food items (2.2%), most notably medical products & services (2.7%) and transport & communication (2.8%). On the other hand, wholesale inflation (PPI) cooled off to 3.6% in Sep'18 vs 4.1% in Aug'18. This is worrisome as it impacts profit margins of the firms and thereby growth momentum.
- Fed minutes highlighted that gradual increases in fund rate would be warranted in line with economic expansion and robust labour market conditions. Some FOMC members also said Fed might even go beyond normalization of rates and adopt a more restrictive stance. Elsewhere, US jobless claims fell to 210,000 for the week ending 13 Oct 2018 compared to 215,000 seen in the previous week.
- China's Q3CY18 GDP growth slipped to 6.5% on a YoY basis (est.: 6.6%), down from 6.7% in Q2. Separate data showed that industrial output growth slipped to 5.8% in Sep'18 vs est. 6%, while infrastructure investment growth fell to 3.3% (4.2% in Jan-Aug'18). Higher (9.2%) than expected (9%) retail sales growth provides hope that China's domestic demand will compensate for external headwinds and meet GDP target of 6.5% for CY18.
- Retail inflation in Japan edged up by 1% in Sep'18 on YoY basis, compared to its estimate and previous month's rate of 1.3%. Inflation was driven by higher energy prices. Core remained stable at 0.4% in Sep'18.

FIG 1 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	3.19	3	13	30	87
UK	1.58	(6)	(3)	34	30
Japan	0.15	0	3	11	8
Germany	0.46	(4)	(3)	9	7
India	7.92	(6)	(15)	14	116
China	3.58	(1)	(11)	6	(14)
2Y yields (Δ bps)					
US	2.90	5	11	31	137
UK	0.81	(3)	(4)	7	39
Japan	(0.12)	0	(2)	0	3
Germany	(0.58)	(2)	(5)	4	15
India	7.64	(2)	(32)	10	134
China	2.87	1	(8)	(26)	(68)
Currencies (Δ %)					
EUR	1.1514	(0.4)	(1.4)	(1.8)	(2.9)
GBP	1.3076	(0.6)	(0.5)	(0.5)	(0.6)
JPY	112.55	(0.3)	(0.2)	(1.0)	(0.0)
AUD	0.7119	0.1	(2.0)	(4.0)	(9.6)
INR	73.33	0.3	(1.3)	(6.5)	(12.7)
CNY	6.9290	(0.1)	(1.2)	(2.4)	(4.8)
Equity & Other indices (Δ %)					
Dow	25,444	0.4	(3.6)	1.5	9.8
FTSE	7,050	0.8	(3.8)	(8.2)	(6.3)
DAX	11,554	0.3	(5.4)	(8.0)	(11.1)
NIKKEI	22,532	(0.7)	(4.8)	(0.7)	5.1
Shanghai Comp	2,550	(2.2)	(6.6)	(9.9)	(24.3)
SENSEX	34,316	(1.2)	(7.6)	(6.0)	5.9
Brent (US$/bbl)	79.78	(0.8)	0.5	9.2	39.4
Gold (US$/oz)	1,226	0.8	1.9	(0.2)	(4.9)
CRB Index	416.7	(0.2)	1.1	(3.6)	(2.8)
Rogers Agri Index	787.8	(0.4)	3.3	(1.1)	(2.9)
LIBOR (3M)*	2.47	3	13	13	111
INR 5Y Swap*	7.70	(9)	3	0	162
India FII data (US$ mn)	**17 Oct**	**WTD**	**MTD**	**CYTD**	**FYTD**
FII-Debt	(55.1)	(266.3)	(1,555.5)	(8,665.1)	(8,911.1)
FII-Equity	42.9	(103.7)	(2,456.9)	(4,462.5)	(6,588.0)

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

FIG 2 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
22-Oct	Thailand trade balance, US$ mn	Sep	1,832.0	(588.0)	--
	Japan industry activity index, % MoM	Aug	0.4%	0.0%	--
	Taiwan export orders, % YoY	Sep	5.6%	7.1%	--
	Taiwan unemployment rate, %	Sep	3.7%	3.7%	--
	Euro Area govt debt/GDP ratio	Q2CY18	--	86.7%	--
23-Oct	South Korea PPI, % YoY	Sep	--	3.0%	--
	Japan machine tool orders, % YoY	Sep F	--	2.8%	--
	Germany PPI, % YoY	Sep	3.0%	3.1%	--
	Taiwan industrial production, % YoY	Sep	1.6%	1.3%	--
	Euro area consumer confidence	Oct	(3.2)	(2.9)	--
24-Oct	Japan manufacturing PMI	Oct	--	52.5	--
	France manufacturing confidence	Oct	107.0	107.0	--
	France manufacturing PMI	Oct	52.4	52.5	--
	France services PMI	Oct	54.7	54.8	--
	Germany manufacturing PMI	Oct	53.4	53.7	--
	Germany services PMI	Oct	55.5	55.9	--
	Eurozone manufacturing PMI	Oct	53.0	53.2	--
	Eurozone services PMI	Oct	54.5	54.7	--
	US manufacturing PMI	Oct	55.5	55.6	--
	US services PMI	Oct	54.0	53.5	--
	US new home sales (in thousand)	Sep	625	629	--
25-Oct	South Korea GDP, % YoY	Q3CY18	2.2%	2.8%	--
	Japan PPI services, % YoY	Sep	1.2%	1.3%	--
	Germany GfK consumer confidence	Nov	10.5	10.6	--
	Germany IFO business climate	Oct	103.1	103.7	--
	ECB Main Refinancing Rate	25-Oct	0.0%	0.0%	--
	ECB Marginal Lending Facility	25-Oct	0.3%	0.3%	--
	ECB Deposit Facility Rate	25-Oct	(0.4%)	(0.4%)	--
	US advance goods trade balance, US$ bn	Sep	(75.1)	(75.8)	--
	US durable goods orders	Sep P	(1.5%)	4.4%	--
	US initial jobless claims	20-Oct	213,000	210,000	--
26-Oct	US GDP annualized, % QoQ	Q3CY18	3.4%	4.2%	--
	France consumer confidence	Oct	94.0	94.0	--
	France PPI, % YoY	Sep	--	3.7%	--

Source: Bloomberg, Bank of Baroda Research

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