WEEKLY WRAP

01 October 2018

Another rate hike to begin with

US data suggests growth is likely to pick-up in the near-term thus driving US yields and currency higher. Fed's assessment of US economy is also upbeat. Oil prices gained 5% this week (24% CYTD18). For India, this implies higher CAD and inflation. While yields fell because of reduction in government borrowing (Rs 200bn below est.) in H2 and OMOs of Rs 360bn for Oct'18, the macro backdrop suggests yields are likely to move higher than lower. With INR falling by 5.6% and oil up by 14% since last policy, we expect RBI to hike rate by 25bps on 5 Oct 2018.

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Markets

- **Bonds:** Global yields closed mixed. 10Y US treasury yield rose to 3.06% as Fed indicated 3 more hikes in 2019. Crude prices soared by 5% (now at US$ 83.2/bbl) driven by supply side concerns. Indian 10Y closed lower by 6bps supported by RBI's liquidity measure both directly (through OMOs of Rs 500bn in CYTD18 and announcement of another Rs 360bn in Oct'18) and indirectly (additional carve out from SLR). The overall system level liquidity deficit stood at Rs405bn vs Rs 1.3tn in the previous week.

- **Currency:** Major global currencies closed lower as dollar strengthened. DXY ended higher by 1% to near two-week highs supported by robust US GDP data and Fed's rate hike. EUR depreciated the most (down 1.2%) on concerns over Brexit and Italy's budget deficit. INR weakened by 0.4% due to rising oil prices even as the government imposed custom duties on US$ 12bn of imports to check the growing trade deficit.

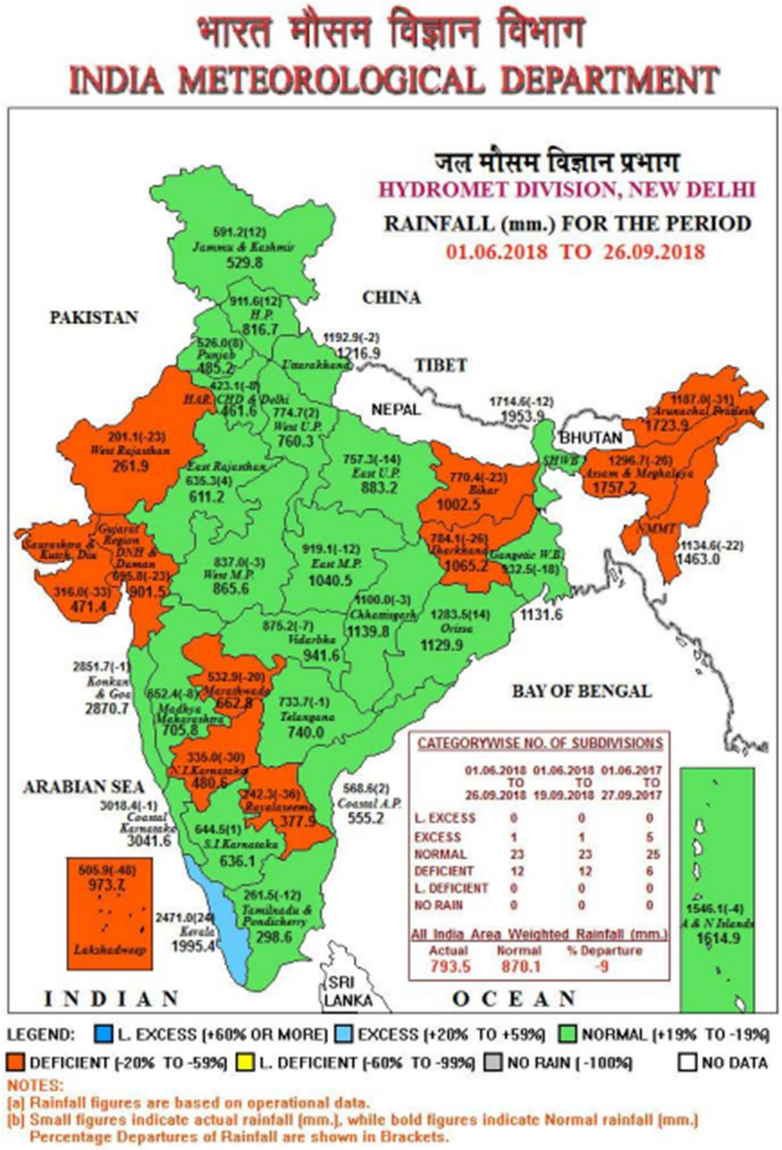
- **Equity:** Global indices closed mixed. Ongoing trade war concerns led Dow to close lower by 1.1%. DAX too fell on the back of political uncertainty in Italy. Apart from this, removal of the accommodative stance from Fed's policy document has also fuelled uncertainty. Sensex closed lower by 1.7%, thus under-performing other Asian markets.

- **Upcoming key events:** Manufacturing and services PMIs of major economies are due this week. US jobs report, due towards the end of the week will be keenly watched. Apart from manufacturing and services PMI, RBI policy decision and movements in oil prices would set the tone for markets this week.

Monsoon tracker

- For the week ending 26 Sep 2018, monsoon rains were 20% above normal. However, for the period 1 Jun 2018 to 26 Sep 2018, monsoon rains were 91% of LPA at the end of the Jul-Sep'18 monsoon season, compared with a forecast of 97%. While most of the states received normal rainfall, Western Rajasthan, Gujarat, Bihar, Eastern India and parts of Southern peninsula have received deficient rainfall in the aforementioned period.
- As the south-west monsoon has started receding, the likelihood of below normal rains this year has not affected the acreage of Kharif crops. The overall sowing of Kharif crops has marginally dipped by (-) 1.9% this year with normal area for whole kharif season standing at 106mn ha. Sown area of sugarcane improved sharply by 9% while acreage of rice was lower by (-) 2.4%.

FIG 1 – DISTRIBUTION PATTERN OF SOUTH-WEST MONSOON



Source: IMD, Bank of Baroda Research

India macro developments

- Centre has trimmed down its H2 gross borrowing by Rs 200bn to Rs 2.47tn versus estimate of Rs 2.67tn as government now expects higher inflows in small savings schemes after interest rates for these schemes were hiked recently. Gross Borrowings in FY19 have been reduced by Rs 700bn to Rs 5.3tn as against budgeted estimate of Rs 6.1tn. With indirect tax collections below budget estimates, the decrease in borrowings will provide some comfort to the bond market.
- India's fiscal deficit stood at 3.5% of GDP in Aug'18, on a 12M trailing basis, compared with 4.1% in Aug'17. This consolidation in deficit, despite declining revenues, has been possible on account of decline in both revenue (8.4% in Aug'18 vs 13.4% in Aug'17) and capital expenditure (-6% in Aug'18 vs 20.7% in Aug'17). Within revenues, tax revenue growth has slipped to 9.2% in Aug'18 vs 14.6% in Aug'17, largely owing to steep decline seen in centre's indirect tax collection (-12.1% vs 18.1% in Aug'17).
- ADB in its latest release remained optimistic on India's growth outlook on the back of strengthening domestic demand and rising exports. It maintained its growth forecast for India at 7.3% & 7.6% in FY19 & FY20 respectively. However, depreciating currency and bouts of volatility on external front could pose downside risk to growth.
- With the expectation of normal monsoon, India's foodgrain production is likely to touch a record high of 141.6mn tonne in 2018-19 (0.6% higher than last year) as per 1st advance estimates. This will be led by higher rice production (1.8%). The bumper crop would support exports and MSP hike (17%) will cover against depressed prices, thereby boosting rural incomes.
- As per World Gold Council's report, India's gold demand is expected to pick up by 25% in H2CY18 in comparison to a decline of 9% seen in H1. This will be driven by higher MSP which in turn would boost rural purchasing power, thus signalling robust consumption demand in the economy.
- RBI reported that currency in circulation (CIC) increased by Rs 83bn (on a weekly basis) and stood at Rs 19.4tn as on 14 Sep 2018. Overall, reserve money rose by 19% on a YoY basis because of increased currency demand compared with a fall of (-) 4.5% a year ago. On a FYTD basis, reserve money rose by 3.1% as against 10.3% in the previous year.
- India's FX reserves for the week ending 14 Sep 2018 rose to US$ 402bn. On a weekly basis, forex reserves increased by US$ 1.3bn compared with an increase of US$ 1.2bn last week. On CYTD basis, reserves are down by US$ 7.6bn, compared with an accretion of US$ 39.4bn in the same period last year. Pressure on forex reserves is in line with INR depreciation (12% in CYTD18).

Global macro developments

- Minutes of Japan's recent policy meet (30-31 July) reflect that members were consistent in their view about moderate pace of expansion in the economy in FY18 and weakening price developments. While their target for core inflation is between 0.5%-1%, the actual figure is more likely to be in between 0%-0.5%. Higher productivity, labour force participation rates and excess supply, are keeping the wage-price inflation low. Members believe that the 2% inflation target will not be met before FY2019-20.
- Business confidence in Germany declined marginally in Sep'18 to 103.7 (est.: 103.2) from 103.8 in Aug'18. Despite the marginal dip, business morale remains high signalling underlying economic strength amidst uncertain global economic environment. Amongst the sub-indices construction and retail trade while services remained stable.
- Germany's PPI increased by 3.8% in Aug'18 on a YoY basis compared to 3.6% inflation seen in Jul'18. This was largely led by price acceleration in fuels and petroleum products which increased by 17.7% in Aug'18. On a MoM basis, prices rose by 0.3% in Aug'18 vs 0.1% in the previous month.
- US Fed raised fund rate by 25bps in the range of 2-2.25% on the back of strengthening domestic economy and robust macro fundamentals such as inflation and unemployment. Fed projections suggests another hike by the end of 2018 and 3 more hikes in 2019. Real growth rate has been revised upward to 3.1% in 2018 from 2.8% projected earlier.
- Japan's machinery orders rose by 18.8% in Jul'18 on a MoM basis, rebounding sharply from (-) 14.4% in Jun'18. Core machinery orders rose by 11% in Jul'18 vs (-) 8.8% in Jun'18, thus indicating strong capex growth in the economy. Owing to labour shortages, Japanese firms are expected to continue raising their capex spending. Orders from overseas also improved, from (-) 12.2% in Jun'18 to 6% in Jul'18, suggesting export revival.
- Reeling under the impact of higher tariff imposed by the US, China's factory growth came to a halt in Sep'18, falling to the level of 50.0 in Sep'18 as against 50.6 in Aug'18. The softening demand was on account of slowdown in both new and export orders. On the price front, input price pressure continued to hit manufacturers sharply adding concerns over the firms' concerns over profitability and investment outlook.

FIG 2 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	3.06	(0)	18	20	75
UK	1.57	2	8	30	20
Japan	0.13	(0)	3	9	6
Germany	0.47	1	7	17	(1)
India	8.02	(6)	11	12	138
China	3.63	(7)	(0)	15	1
2Y yields (Δ bps)					
US	2.82	2	14	29	137
UK	0.82	1	6	10	37
Japan	(0.11)	(1)	0	0	(0)
Germany	(0.52)	1	5	14	17
India	7.84	(5)	21	30	153
China	2.97	(1)	10	(19)	(48)
Currencies (Δ %)					
EUR	1.1604	(1.2)	(0.9)	(0.7)	(1.5)
GBP	1.3031	(0.3)	0.0	(1.3)	(3.1)
JPY	113.70	(1.0)	(1.8)	(2.7)	(1.2)
AUD	0.7224	(0.9)	(1.2)	(2.4)	(8.0)
INR	72.49	(0.4)	(2.7)	(5.9)	(10.7)
CNY	6.8688	(0.2)	(0.7)	(3.7)	(3.1)
Equity & Other indices (Δ %)					
Dow	26,458	(1.1)	1.3	9.0	18.2
FTSE	7,510	0.3	(0.7)	(1.7)	2.6
DAX	12,247	(1.5)	(2.5)	(0.5)	(3.6)
NIKKEI	24,120	1.0	5.6	8.1	18.4
Shanghai Comp	2,821	0.9	1.9	(0.9)	(15.5)
SENSEX	36,227	(1.7)	(6.4)	2.3	15.8
Brent (US$/bbl)	82.72	5.0	7.2	4.1	44.1
Gold (US$/oz)	1,191	(0.8)	(1.3)	(4.9)	(7.5)
CRB Index	415.0	0.2	0.8	(5.5)	(3.0)
Rogers Agri Index	764.4	(0.7)	(2.1)	(4.5)	(5.5)
LIBOR (3M)*	2.40	2	8	6	106
INR 5Y Swap*	7.72	2	23	10	178
India FII data (US$ mn)	**27 Sep**	**WTD**	**MTD**	**CYTD**	**FYTD**
FII-Debt	(75.9)	(297.4)	(1,368.3)	(7,017.4)	(7,263.4)
FII-Equity	85.6	(661.9)	(1,080.0)	(1,771.5)	(3,897.0)

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

FIG 3 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
01-Oct	Japan manufacturing PMI	Sep	--	52.9	--
	India manufacturing PMI	Sep	--	51.7	--
	Germany retail sales, % MoM	Aug	0.4%	(0.4%)	--
	France manufacturing PMI	Sep	52.5	52.5	--
	Germany manufacturing PMI	Sep	53.7	53.7	--
	Eurozone manufacturing PMI	Sep	53.3	53.3	--
	Italy unemployment rate, % YoY	Aug	10.6%	10.4%	--
	UK manufacturing PMI	Sep	52.5	52.8	--
	Euro area unemployment rate, % YoY	Aug	8.1%	8.2%	--
	India eight infrastructure industries, % YoY	Aug	--	6.6%	--
	US manufacturing PMI	Sep	--	55.6	--
	US ISM manufacturing PMI	Sep	60.3	61.3	--
02-Oct	South Korea industrial production, % YoY	Aug	1.3%	0.9%	--
	RBA Cash Rate Target	Oct-18	1.5%	1.5%	--
	Japan consumer confidence index	Sep	43.1	43.3	--
	Euro area PPI, % MoM	Aug	0.2%	0.4%	--
03-Oct	Japan services PMI	Sep	--	51.5	--
	France services PMI	Sep	54.3	54.3	--
	Germany services PMI	Sep	56.5	56.5	--
	Eurozone services PMI	Sep	54.7	54.7	--
	UK services PMI	Sep	54.0	54.3	--
	Euro area retail sales, % MoM	Aug	0.2%	(0.2%)	--
	US services PMI	Sep	--	52.9	--
	US ISM non-manufacturing PMI	Sep	58.0	58.5	--
04-Oct	Australia trade balance, AUD bn	Aug	1.5	1.6	--
	Thailand consumer confidence	Sep	--	83.2	--
	India services PMI	Sep	--	51.5	--
	US initial jobless claims	29-Sep	--	2,14,000	--
	US factory orders, %	Aug	1.0%	(0.8%)	--
05-Oct	South Korea CPI, % YoY	Sep	1.6%	1.4%	--
	Germany factory orders, % MoM	Aug	1.0%	(0.9%)	--
	Germany PPI, % YoY	Aug	2.9%	3.0%	--
	France trade balance, € bn	Aug	--	(3.5)	--
	RBI Repo Rate	Oct-18	6.8%	6.5%	--
	US trade balance, US$ bn	Aug	(50.7)	(50.1)	--
	US change in nonfarm payrolls	Sep	1,88,000	2,01,000	--
	US unemployment rate, % YoY	Sep	3.8%	3.9%	--
	US average hourly earnings, % MoM	Sep	0.3%	0.4%	--

Source: Bloomberg, Bank of Baroda Research

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