

WEEKLY WRAP

08 July 2019

Fiscal prudence drives yields lower

Global growth remained weak as manufacturing and services PMI for China and Germany was lower than expected. Thus yields fell. Equity markets rose as US-China resumed trade talks. Indian yields fell by 18bps after government announced its plan to reduce fiscal deficit to 3% in FY21/22 from 3.3% in FY20. INR also rose by 0.9%. US yields and US\$ rose after better than expected payroll and manufacturing data. We see Indian yields heading lower in the medium-term if oil prices remain at current levels.

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Markets

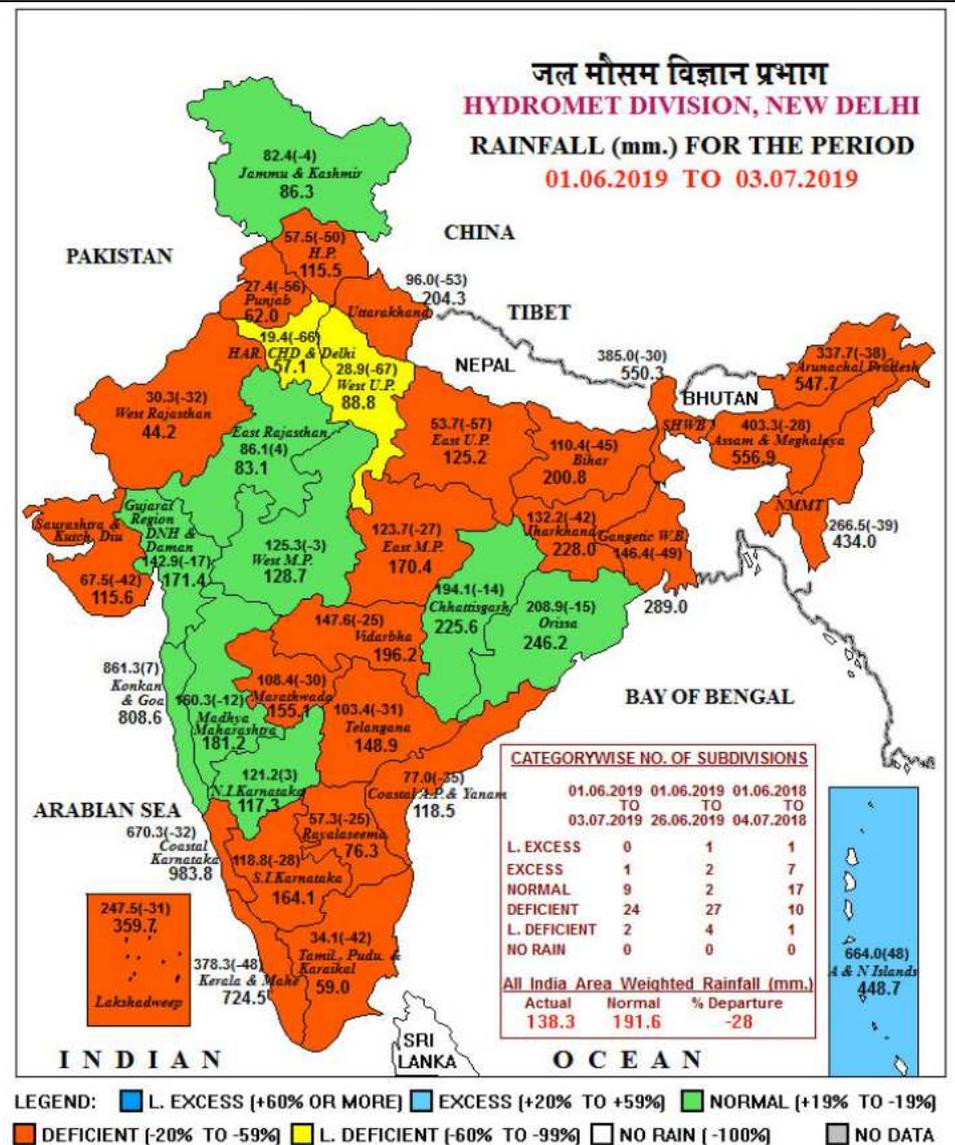
- **Bonds:** Barring US and Japan, global yields closed lower driven by muted manufacturing activity. However US 10Y yield close higher by 3bps (2.03%) supported by robust jobs data. Despite, OPEC's extension of production cuts till Mar'20, crude prices declined by (-) 3.5% in the week, driven by global growth concerns. India's 10Y yield fell by 18bps (6.7%) as government maintained fiscal prudence by cutting its fiscal deficit target to 3.3% in FY20. System liquidity surplus surged to Rs 1.5tn on 5 Jul 2019 vs Rs 403bn in the previous week.
- **Currency:** Barring INR, other global currencies closed lower against the dollar. DXY edged up by 1.2% after stronger than expected US jobs report and optimism over US-China trade truce. EUR depreciated by (-) 1.3% as German manufacturing sector (PMI and factory orders) remained weak. GBP also declined by (-) 1.5% in the week on the back of lower services and manufacturing PMI. INR appreciated by 0.9% led by lower oil prices.
- **Equity:** Global equity indices ended higher, led by Nikkei (2.2%) and FTSE (1.7%). Resumption of trade talks between US and China and expectation of a rate cut by Fed boosted stock market. Tracking global cues, Sensex rose by 0.3% in the week. However, it was lower on Friday after Budget.
- **Upcoming key events:** In the current week markets await US FOMC minutes and global industrial production and inflation data. Apart from that, China's trade numbers and Malaysia's policy decision will also be closely watched. On the domestic front, CPI and industrial production prints are due for release this week.



Monsoon Tracker

- For the period 1 Jun 2019 to 7 Jul 2019, monsoon is (-) 21% below LPA compared with (-) 7% last year. In the last few days, there has been a pick-up in rainfall with last week rains being only (-) 6% below normal.
- Led by significant drop in the sown area of pulses (-71.6%) and foodgrains (-33.6%), overall Kharif sowing area has fallen by (-) 26.7% as on 5 Jul 2019 compared with last year. Major decline is also visible in oilseeds (-43%) and cotton (-16%).

FIG 1 – DISTRIBUTION PATTERN OF SOUTH-WEST MONSOON



Source: IMD, Bank of Baroda Research

India macro developments

- GST collections for May'19 reached Rs 999bn compared to Rs 1tn in Apr'19. The marginal decline was on account of lower CGST collections which fell from Rs 468bn in Apr'19 to Rs 346bn in May'19. SGST collections however remained robust at Rs. 503bn in May'19 vs Rs 450bn in Apr'19.
- India's eight core sector (encompassing 40% weight in overall IIP) grew by 5.1% in May'19 compared to 6.3% in Apr'19, on YoY basis. Steel and electricity sector grew at a robust pace of 19.9% & 7.2% in May'19 respectively, compared to 19% & 5.9% in Apr'19. Manufacturing PMI for India decelerated to 52.1 in Jun'19 compared with 52.7 in May'19, driven by moderate pace of increase in new orders and output.
- Indian government has raised the MSP of kharif crops amidst concerns over delayed and subdued monsoon. MSP of Ragi has been raised by 8.7% in 2019-20, highest amongst kharif crops. For paddy, the increase has been marginal at 3.7%.
- India's Economic Survey has given a blue sky scenario for a US\$ 5tn economy by 2025 which requires GDP growth of 8% with investments as the key driver of growth. Along with this, new set of reforms such as clearing legal logjam, labour reforms, reducing cost of capital and incentivizing MSMEs to invest, will help in achieving this ambitious target. The Survey also reiterated fiscal prudence will drive real interest rates lower and thus lead to higher savings rate to achieve the virtuous cycle of growth.
- RBI reported that currency in circulation decreased by Rs 164bn (on a weekly basis) and stood at Rs 22tn as on 28 Jun 2019. Overall reserve money grew by 13.5% on a YoY basis compared to 21.1% a year ago. On FYTD basis, reserve money is growing at a slower pace of 2% against 3% in the previous year.
- India's forex reserves rose to a lifetime high at US\$ 427.7bn in the week ending 28 Jun 2019. On a weekly basis, forex reserves rose by US\$ 1.3bn compared with an increase of US\$ 4.2bn last week. In CY19, forex reserves have increased by US\$ 34.3bn vs a decline of (-) US\$ 3.3bn last year, supported by RBI's dollar-rupee swap as well as strong FII inflows.
- In the union budget for FY20, the FM has laid the roadmap for an investment led recovery through focus on labour reforms, Make in India and infrastructure spending. Revenue estimates have been trimmed down particularly for GST and income tax collection. On the other hand, non-tax revenues under dividends, railways and 5G auction have been revised upwards. This, along with prudent expenditure management has allowed a lower fiscal deficit of 3.3% in FY20 (3.4% in Interim Budget).

Global macro developments

- US ISM manufacturing index declined to 51.7 in Jun'19 compared to 52.1 in May'19. Manufacturing activity in the Eurozone also remained muted as reflected in the PMI reading (3-month low of 47.6 in Jun'19 vs 47.7 in May'19). Caixin China manufacturing PMI was in contraction at 49.4 in Jun'19 as against 50.2 in May'19. Trade tensions and muted global environment have weighed down sales volume, export orders and production in major economies.
- Germany's retail sales fell by (-) 0.6% in May'19 on a MoM basis vs (-) 0.4% in Apr'19. On a YoY basis, sales rose by 4% in May'19 vs est. 2.7% and 4.8% in Apr'19, led by online commerce and delivery services. German economy relies heavily on private consumption for growth and as a result is expected to slowdown in Q2CY19.
- US factory orders declined by (-) 1.3% in May'19 vs (-) 2.8% in Apr'19 on a MoM basis, led by defence capital goods and aircraft parts. Core factory orders however rose by 0.4% in May'19 vs (-) 1% on the back of computer & electronic products and communications equipment. Separately, initial jobless claims for the week ended 29 June fell by 8,000 to 221,000.
- Global services activity remained mixed in Jun'19. Services PMI in the Eurozone rose to its highest since Oct'18 at 53.6 in Jun'19 vs 52.9 in May'19 led by Germany and France. US ISM non-manufacturing index moderated to its lowest since Jul'17, at 55.1 in Jun'19 vs 56.9. China's Caixin services PMI also edged down to 52 in Jun'19 vs 52.7. Trade tensions and muted global demand have impacted services activity in these economies.
- Retail sales in the Euro Area declined by (-) 0.3% in May'19 vs (-) 0.1% in Apr'19 (est. 0.4% rise), on MoM basis. This has been the second straight month of decline reflecting muted demand conditions. On YoY basis as well, retail sales grew at a slower pace of 1.3% in May'19 vs 1.8% in Apr'19.
- S. Korea's current account registered a surplus of US\$ 49.5bn in May'19 vs US\$ 6.6bn deficit in Apr'19. This was driven by surplus in primary income account at US\$ 11.6bn vs deficit of US\$ 43.3bn in Apr'19. However, goods trade surplus slipped to US\$ 53.9bn in May'19 vs 56.7bn in Apr'19. Continued trade spat with Japan is expected to take more toll on the goods trade balance in the coming months.
- US labour market conditions remained buoyant. Nonfarm payroll increased by 224,000 in Jun'19, highest in past 5 months and against previous month's level of 75,000. Labour force participation rate also increased to 62.9% in Jun'19 compared with 62.8% in May'19. Unemployment rate was at 3.7% in Jun'19. However, average hourly earnings remained unchanged at 3.1% in Jun'19.

FIG 2 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	2.03	3	(10)	(46)	(79)
UK	0.74	(10)	(16)	(38)	(53)
Japan	(0.16)	0	(5)	(13)	(19)
Germany	(0.36)	(4)	(16)	(37)	(66)
India	6.70	(18)	(32)	(66)	(117)
China	3.18	(6)	(6)	(8)	(35)
2Y yields (Δ bps)					
US	1.86	10	(2)	(48)	(68)
UK	0.56	(6)	(4)	(15)	(19)
Japan	(0.21)	1	(2)	(6)	(8)
Germany	(0.75)	0	(10)	(18)	(9)
India	6.17	(13)	(24)	(42)	(144)
China**	2.58	(5)	5	18	(46)
Currencies (Δ %)					
EUR	1.1225	(1.3)	(0.2)	0.1	(4.4)
GBP	1.2521	(1.4)	(1.4)	(4)	(5.7)
JPY	108.47	(0.6)	(0.3)	2.9	1.8
AUD	0.6980	(0.6)	(0.2)	(1.8)	(6.1)
INR	68.42	0.9	1.2	1.2	0.7
CNY	6.8936	(0.4)	0.2	(2.6)	(3.8)
Equity & Other indices (Δ %)					
Dow	26,922	1.2	6.3	1.9	10.1
FTSE	7,553	1.7	4.7	1.4	(0.8)
DAX	12,569	1.4	5.0	4.7	0.6
NIKKEI	21,746	2.2	6.6	(0.3)	(0.2)
Shanghai Comp	3,011	1.1	5.2	(7.3)	9.6
SENSEX	39,513	0.3	(1.4)	1.7	10.8
Brent (US\$/bbl)	64.23	(3.5)	3.6	(8.7)	(16.7)
Gold (US\$/oz)	1,399	(0.7)	5.6	8.3	11.5
CRB Index	405.6	(0.6)	(2.3)	(4.5)	(7.1)
Rogers Agri Index	745.9	(0.7)	(1.2)	(0.7)	(7.4)
LIBOR (3M)*	2.29	(3)	(19)	(30)	(4)
INR 5Y Swap*	6.62	(12)	(2)	27	(109)
India FII data (US\$ mn)					
	4 Jul	WTD	MTD	CYTD	FYTD
FII-Debt	44.1	198.4	198.4	1,626.7	1,082.0
FII-Equity	80.7	(455.5)	(455.5)	10,883.3	4,038.1

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

FIG 3 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
8-Jul	Japan current account balance, ¥ bn	May	1,381	1,707	--
	Japan core machine orders, % MoM	May	(3.7%)	5.2%	--
	Germany industrial production SA, % MoM	May	0.4%	(1.9%)	--
	Germany exports SA, % MoM	May	0.9%	(3.7%)	--
9-Jul	Japan machine tool orders, % YoY	Jun	--	(27.3%)	--
	Malaysia overnight policy rate, %	9-Jul	3.0%	3.0%	--
	Italy retail sales, % MoM	May	--	0.0%	--
	China new yuan loans, CNY bn	Jun	1,675	1,180	--
10-Jul	Japan PPI, % YoY	Jun	0.4%	0.7%	--
	China CPI, % YoY	Jun	2.7%	2.7%	--
	China PPI, % YoY	Jun	0.3%	0.6%	--
	France industrial production, % MoM	May	0.3%	0.4%	--
	Italy industrial production, % MoM	May	0.2%	(0.7%)	--
	UK industrial production, % MoM	May	1.5%	(2.7%)	--
	UK trade balance, £ mn	May	(3,200)	(2,740)	--
US FOMC meeting minutes	19-Jun	--	--	--	
11-Jul	Germany CPI, % YoY	Jun	1.6%	1.6%	--
	France CPI, % YoY	Jun	1.2%	1.2%	--
	US CPI, % MoM	Jun	0.0%	0.1%	--
	US initial jobless claims	6-Jul	221,000	221,000	--
12-Jul	Japan industrial production, % MoM	May	--	2.3%	--
	Euro Area industrial production, SA, % MoM	May	0.2%	(0.5%)	--
	India CPI, % YoY	Jun	--	3.1%	--
	India industrial production, % YoY	May	--	3.4%	--
	US PPI final demand, % MoM	Jun	0.1%	0.1%	--
	China exports, % YoY	Jun	(0.6%)	1.1%	--

Source: Bloomberg, Bank of Baroda Research

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