Weekly Macro Perspectives

March 28, 2017

L&T Financial Services

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1. Global economic briefs

- Credit strategists are increasingly disturbed by a sudden and rare contraction of US bank lending, fearing a synchronized slowdown in the US & China this year that could catch euphoric markets badly off guard.
- However, other data points on consumer confidence and home prices showed that US economy is regaining strength. Hence, Dallas Federal Reserve Bank President Robert Kaplan has suggested that US central bank should be careful not to jolt the economy with aggressive rates hikes. Even Chicago Federal Reserve Bank President Charles said last week that two interest-rate increases may be the right amount of tightening for the US economy in 2017, given uncertainty surrounding the economic data.
- The Bank of Japan maintained its short-term interest rate target of -0.1%, as its Board members opted for an easy monetary policy in view of still benign CPI inflation. Bank of Japan has also decided not to raise the bond yield target of 10-year government bonds, even as the overseas bond yields have gained. Rather, the central bank wishes to concentrate solely on the growth of the domestic economy.
- While the central bank of Russia just reversed course and unexpectedly cut rates to its lowest level since 2014 as inflation eased, Argentina's central bank could not relax monetary policy due to a significant increase in electricity rates.
- Britain's manufacturers told Prime Minister Theresa May yesterday to drop her threat that she might take the country out of the European Union without a new trade deal, saying they would bear the brunt of trade barriers with the EU. May plans to trigger the two-year Brexit process tomorrow (March 29) and she has warned the other 27 EU countries that no deal would be better than a bad deal.
- Profits of Chinese industrial firms surged almost 32% in Jan-Feb, 2017 -- the fastest pace in nearly 6 years -- as prices of commodities from coal to iron ore raced higher.
- Euro zone economy has been showing increasing signs of economic strength. The IHS Markit's Flash Composite Purchasing Managers' Index (PMI), an influential guide to the buying plans of businesses and hence growth, hit a near six-year high in Mar-17 for the Euro zone. Interestingly, German central bank President suggested yesterday that the ECB should slowly start to retreat from its easy-money policies, indicating divisions within the ECB over the timing of an exit.

2. India: Agriculture and rural economic news

- According to India's official weather bureau, India is likely to emerge unscathed from the El Nino weather pattern, as it is expected to set in only during the latter part of the four-month monsoon season, signaling a timely arrival of crop-nourishing rains.
- However, according to a private weather forecaster Skymet, many regions of India are likely to witness below-normal rainfall in the monsoon season of 2017 due to El Nino effect. However, the agency's initial monsoon forecasts have been off the mark for past two years.
- According to the annual Global Food Policy Report, India needs to be watchful of the impact of demonetisation on agricultural production & incomes and demand & credit in rural areas in 2017.
- India's government imposed 10% import duty today on wheat and some lentils (tur dal) with immediate effect in a bid to protect farmers' interest, amid projection of a record crop this year.

3. India's overall economic & policy developments

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- India's current account deficit (CAD) widened to 1.4% of GDP in Q3, FY17 from 0.6% in Q2, FY17, driven by a fall in dollar earnings by services & lower remittances. Even the capital account surplus halved due to a large FPI outflows and some moderation in net FDI inflows in the third quarter. A wider CAD, FPI outflows, moderation in FDI inflows & huge redemptions of NRI deposits gave rise to a BOP deficit, which is seen to be a "transitory" phenomenon.
- However, India attracted total FDI of $46.4 bln in 2016 versus $39.b bln in 2015. During 2014-16, FDI inflows to India rose at a CAGR of 28% after a period of near stagnation in 2009-13.
- On March 27th, India's Finance Minister introduced the four GST bills, notably, Central GST, Integrated GST, Union Territory GST and the Compensation Law, to implement the biggest tax reform since independence. The GST bills are based on the principle of "shared sovereignty" and the government wants to pass these landmark tax reforms through consensus.
- According to a noted economist – Martin Feldstein, India has a huge opportunity to be part of the global supply chain, as wages rise in China and businesses explore other manufacturing bases.
- According to RBI, Indian banks loans and deposits rose by 4.1% and 12.7% on year respectively, as on Mar 3, 2017. While outstanding loans grew by Rs 308.2 bln to Rs 75.16 trln in the two weeks to Mar 3, aggregate deposits increased by Rs 560.4 bln to Rs 105.43 trln.
- India's Broad Money Supply, i.e., M3 growth stood at 7.0 % (y-o-y), as on Mar 3, 2017 (versus 10.6% a year ago), due to a drastic y-o-y fall in the growth of "currency with the public" since Nov 8th.
- India's foreign exchange reserves richly increased by $2.67 bln to $366.78 bln in the week ended Mar 17, 2017 according to the RBI's latest weekly data. The country's forex reserves had marginally increased by $98.6 mln to $364.11 bln in the previous week.

4. India's industrial & services sectors scenario

- India's services trade surplus moderated to 2.9% of GDP in Jan-17 from 3.5% in Jan-16, due to a sharp rise in services imports amid subdued exports. Analysts see risks to services trade balance skewed to the downside on account of rising protectionism aimed at the IT/ITES sector.
- Ahead of the introduction of GST-related legislation in Parliament this week, India's government has set up 10 groups to iron out sectoral issues faced by trade and industry to ensure a smooth transition to the new regime with just a little over three months to go.
- With iron ore prices on a rise and domestic demand likely to pick up by mid-April, India's steel producers have already raised product prices by Rs 1,000 per tonne from 15th March and are gearing up for another hike by the same quantum from April. This time most of the companies, according to the source, are raising prices.
- India may impose anti circumvention duty on certain stainless steel products originating from seven destinations to insulate domestic players. The government has resumed investigations into circumvention of anti-dumping duties after a stay order was vacated recently by court. The products originate from China, Korea, EU, South Africa, Taiwan, Thailand and the US.
- Indian firms' borrowing from foreign sources stood at $2.23 bln in Feb-17, as per the RBI data. In Feb-16, the domestic companies had raised more than $1.35 bln from overseas markets through external commercial borrowings (ECBs).

5. G-Sec yields soften on the back of stronger rupee

- Indian sovereign bonds gained tremendous strength this week, pushing the benchmark 10-year yield down (to 6.71%) by the most since November, on speculation that stronger rupee would attract more of foreign flows to India.
- According to G-Sec traders, the presence of foreigners is mainly guiding the moves in the bond market. Foreign investors are bullish on Indian bonds, given the attractive yields & INR appreciation.
- According to the Bloomberg news, bond yields slipped across Asia yesterday, with regional currencies advancing, after US President Donald Trump's failure to pass his health-care bill cast doubts on his ability to push through other fiscal and tax plans.
- While weaknesses in activity indicators and surplus liquidity in money markets will exert a downward pressure on G-Sec yields, uncertainties in policy outlook, front-loading of market borrowings in H1, FY18 and increasing pressure of SDLs would keep the downside capped. While non-food inflation will remain benign, there could be spikes in food inflation due to waning of seasonality and hardening prices of cereals, esp. rice.

6. INR strength may not continue for very long

- INR too rallied to (65.04 per USD) this week, after capping a fifth straight weekly advance last week that was the longest stretch of such wins from Oct, 2012.
- INR has been outperforming its Asian peers over the past three months and has now touched the 17-months' high against the US Dollar. Various factors like India's improved external sector position and the recent landslide victory of the Modi government in UP elections, have contributed to the INR's improving strength.
- However, being bullish on INR is not supported by fundamentals at current levels. Moreover, a part of INR's gains are seasonal in nature. Also, there is a strong possibility that RBI will try to shore up FER position, as import demand will quickly turn up once recovery gains momentum. Fundamentally speaking, a gradual & orderly depreciation in INR appears to be a more relevant theme in the current context.

7. Choppy outlook seen for Indian equities in FY18

- Equity markets posted handsome gains of nearly 17% in FY17, largely led by strong global and domestic liquidity despite lingering concerns over earnings revival and the downside associated with demonetisation.
- The liquidity driven rally has already pushed benchmark indices above their historic averages and a possibility of some consolidation cannot be ruled out, going forward.
- However, there could be some opportunities in the interim, as the global economy is picking up steam and the government is poised to reinforce reforms agenda.
- On the whole, experts see a choppy movement in local equities in FY18, on account of several uncertainties/risks like monsoon, implementation challenges in GST, the course of Brexit and the evolution of economic policies in the US that may affect investment sentiment within emerging economies.

8. Brent crude settled at $51.33 per bbl on Mar 28, 2017

- Between Mar 1 & Mar 27, Brent crude prices crashed by almost 10%, as surging US stockpiles dim optimism that OPEC & its partners will curb output enough to rebalance the market.

- In a knee-jerk reaction, Brent crude prices rose 2% on Mar 28th after a severe disruption to Libyan oil supplies and as officials suggested OPEC and other producing countries could extend an output-cuts deal to the end of the year. Brent crude LCOc1 rose 58 cents, or 1.14% to settle at $51.33 per barrel on Mar 28th.
- Still, resurgent US oil production and record domestic crude inventories have kept pressuring oil prices. Analysts polled by Reuters have predicted that data will show US crude oil stocks rose 1.4 mln barrels in the latest week. Data from the American Petroleum Institute data showed US crude stocks rose by 1.9 mln barrels to 535.5 mln, compared with analysts' expectations for an increase of 1.4 mln barrels.

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