Weekly Macro Perspectives

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L&T Financial Services

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1. Global economic briefs

- Chancellor Angela Merkel's conservative alliance won German election on Sept 24th, guaranteeing her a fourth term as chancellor, though a strong showing for the nationalist Alternative for Germany party suggests Europe's largest economy could face political turbulence. The AfD party is anti-immigrant and wants to weaken European integration.
- New Zealand's ruling National Party won the largest number of votes in the country's general election on Sept 23rd, securing a comfortable margin over the Labour Party. However, votes were not sufficient to ensure a majority. A final tally including overseas votes will be released on Oct. 7. The uncertainty of when a majority coalition will be formed has been weighing on the Kiwi.
- With Prime Minister Shinzo Abe dissolving the lower house of parliament on Sept 28th, Japan too is gearing up for elections set for Oct. 22. The contest is shaping up to be a brawl between Abe and Tokyo Gov. Yuriko Koike, with the main debate centering on a consumption tax increase planned for Oct., 2019.
- The Federal Reserve needs to continue gradual rate hikes despite broad uncertainty about the path of inflation, Fed Chair Janet Yellen said on Sept 26 in remarks that acknowledged the central bank's struggles to forecast one of its key policy objectives.
- British manufacturing growth cooled in Sept-17 on rising cost pressures, according to a PMI survey. However, Euro zone factories had their best month since early 2011, as new orders accelerated. Moreover, the number of unemployed in the Euro zone eased by 42,000 to 14.751 mln in Aug-17 against Jul-17, even as the jobless rate remained at 9.1%.
- Bank of Japan's quarterly tankan survey showed an improved outlook for the Japanese economy. The PMI survey also showed factory output and new orders accelerating for Japan. Even with this, however, a pick-up in hiring and manufacturing input prices was not very high.
- In South Korea also, manufacturing activity expanded at the fastest pace in almost two years in Sept-17.
- Citigroup's US economic surprise index broke into positive territory for the first time since late April thanks to better-than-anticipated manufacturing and construction data released yesterday.
- China's central bank cut the amount of cash that some banks must hold as reserves for the first time on Sept 30 since February 2016 in a bid to encourage more lending to struggling smaller firms and energize its lackluster private sector.
- While the uptick in the world economy is cause for celebration, the latest Competitiveness Report by the World Economic Forum has spotted some problems on the horizon. A decade after the financial crisis, the financial sector remains vulnerable. The increasing levels of private debt in emerging economies, and the growth of unregulated capital markets, are just two of the elements that worry the authors of the report.

2. India: Agriculture and rural economic news

- India received below normal rainfall this year with the Monsoon season ending on a 5.2% deficit on Sept 30, 2017. While 50% of the nation's districts have had normal rains, more than a third – 215 districts – are left with deficient rainfall, which could impact the kharif crop to an extent.
- The overall monsoon shortfall is also showing in water storage levels. According to India's Central Water Commission, 91 major reservoirs in the country were at 66% of capacity on Sept 28th. This was 89% of the levels in the corresponding period last year and 87% of the 10-year average.
- According to the Indian government's first advance estimate of India's summer sown (kharif) crop, total kharif food grain output is expected to fall to 134.67 mt from the record 138.52 mt last year, reflecting a fall of 2.8%.

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This is expected to hit rural incomes in some areas, although the government said the harvest of 134.67 mt, estimated with the help of inputs from states and other sources, would still be 5% higher than the five-year average of 128.24 mt.

- Referring to the main rural employment scheme of MGNREGA, India's Rural Development Minister said last week that the budget for the rural job scheme has gone up considerably from about Rs 370 bln in FY12 to about 580 bln in FY17. It was also informed that the coverage of the Pradhan Mantri Gram Sadak Yojana (PMGSY) has increased from 64% to 81% in the last three years and there is a possibility that the scheme will be completed with 100% rural road connectivity by 2019.

3. India's overall economic & policy developments

- Fitch Ratings has lowered India's economic growth forecast for the current fiscal to 6.9% from 7.4% after the GDP growth "unexpectedly faltered" in the April-June quarter.
- Indian central government's fiscal deficit has increased to 96.1% (versus 76.4% a year ago) of the budgeted target during Apr-Aug, 2017. While net tax revenues have grown healthily, there was a massive shortfall in non tax revenue due to a fall in transfer of profits from the RBI.
- India's external debt rose by 3% to US $ 485.8 bln in the quarter ending June, 2017 as compared to March 2017 quarter. While long-term debt increased by 3.4% sequentially to US $ 397 bln by end-June 2017, short-term external debt rose by one per cent to US $ 88.8 bln.
- India's central government has maintained its gross borrowings target for H2, FY18 at Rs 2.08 trln as planned but did not rule out an increase later, if warranted by economic circumstances. As per the government sources, a decision on additional borrowing will be taken at the end of November or early December, 2017.
- The investment data of FIIs and mutual funds for the period of last ten years have revealed that mutual funds have been the net buyers in the Indian equity market for the last three years, while foreign investors are investing cautiously. In particular, in 2017, domestic mutual funds have picked up shares worth over Rs 750 bln whereas FIIs recorded an investment worth Rs 380 bln in the stock market.
- In order to provide relief to retail consumers from rising international prices of crude oil, India's government has cut the central excise duty on petrol & diesel by Rs 2 per litre effective 4th October, 2017.
- According to RBI, Indian banks loans and deposits rose at the pace of 6.8% and 10% on year respectively, as on Sept 15, 2017. While outstanding loans increased by Rs 105 bln to Rs 77.81 trln in the two weeks to Sept 15, aggregate deposits fell by Rs 403.4 bln to Rs 107.07 trln. The Credit-Deposit ratio marginally improved to 72.67% as on Sept 15th versus 72.30% as on Sept 1st.
- India's Broad Money Supply, i.e., M3 growth stood at a much lower level of 6.8 % (y-o-y), as on Sept 15, 2017 (versus 10.6% a year ago). Disaggregated information on "Sources of M3 growth" reveal that growth in bank credit to commercial sector has fallen by 240 bps (y-o-y) as on Sept 15th, 2017 due to weak investment sentiment.
- After touching a record high, India's foreign-exchange reserves marginally fell by $262.3 mln in the latest reported week (Sept 22) to $402.25 bln, as per the RBI report. In the previous week, the reserves had touched a life time high of $402.509 billion after rising by $1.782 billion.

4. India's industrial & services sectors scenario

- Capital expenditure budget for all ministries and departments of the Indian government stands at Rs 3.75 trln for the year FY18. As per the government reports, another Rs 250 bln is expected to come in as a few central

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public sector enterprises such as the National Highways Authority of India and state-owned oil and steel companies committed to increase their capital spending.

- India's manufacturing PMI stood unchanged at 51.2 in Sept-17 and the sub indices showed weak domestic & export orders and lower output due to de-stocking post the launch of GST. Cost burden increased further this month as input prices grew at a faster pace compared to output prices. The PMI averaged much lower in Q2, FY18 as compared to Q1, FY18.
- India's Telecom Commission has extended the tenure for spectrum payment to 16 year from the current 10 years and reduced interest rate on delayed payments from 14% to 12%, aiming to ease the pressure on the financially struggling telecom sector. These measures will be sent to the Cabinet for final approval.
- Offline sales of consumer durables have remained flat in India even though the festive season has begun. This is the first festive season after demonetisation and implementation of the Good and Service Tax (GST) which is hurting the consumer-facing businesses.

5. Indian money market review last week

- India's weighted average call money rate (WACR) averaged at 5.89% last week (Sept 25-29) versus 5.91% in the week earlier (Sept 18-22), as liquidity continued to stay in surplus mode.
- While 91-day T-bill rate moved in the band of 6.08-6.10% last week, 364-day T-bill rate stayed in the range of 6.23-6.27%. On an average, the yield stayed flattish on 91D TBs and increased by a basis point on 364D TBs.
- However, three-month CP rate moved in the range of 6.63%-6.68% last week reflecting a fall of 3 bps on an average within a week.
- On 29th Sept, the RBI announced another sale of government securities worth Rs 100 bln through OMOs. The proposed sale will take place on Oct. 12 through multi-security auction using the multiple price method. Since July, the RBI has sold gilts worth Rs 600 bln through OMOs in order to durably reduce the massive liquidity surplus in the banking system.

6. Cautious optimism in government bonds market

- Yield on the 10-year benchmark GOI paper stayed unchanged at 6.66% last week, even as it moved widely during the interim week.
- The hawkish undertone of the global central banks, especially from the US Federal Reserve officials weakened the sentiment for Indian government bonds. However, it found some support from value buying.
- While an increased momentum in headline CPI due to cost push pressures has dampened the sentiment for government securities, a sharp deceleration in growth prints has revived hopes for a likely dovish monetary policy announcement on Oct 4th. Hence, traders are cautiously optimistic on government bonds. Moreover, there is a strong possibility of "value buying" at the current rates, as liquidity remains supportive.

7. INR seen with a neutral to negative bias

- INR depreciated by 0.74% last week to 65.28 against the US dollar. On Oct 3rd, it further dropped by 22 paise to close at 65.50, as dollar kept rising amid increasing expectations of a rate hike by the US Federal Reserve.

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- Increased demand for the US dollar from importers and corporates along with massive capital outflows have largely contributed to the INR's weakness. Moreover, forex trading sentiment has turned a bit shaky ahead of today's monetary policy announcement.
- FX experts expect INR to trade with neutral to negative bias in the range of 65.20 to 65.80 in the near term.

8. More volatility seen in Indian equities in the near term

- Developed countries' financial markets saw cautious yet positive ending last week amid positive economic data on major economies of the world and a hint from Janet Yellen that Fed would raise US interest rates in December.
- However, majority of the Asian markets ended negative with the exception of Japan.
- Indian markets lost 2% over the previous week on the back of domestic growth concerns, fiscal worries and geopolitical tensions. The sectors that lost heavily last week were banking, power, FMCG, pharma & capital goods.
- While many stock experts have reaffirmed their faith in the long-term structural story of India, the current confluence of factors like rising oil prices, growth deceleration & fiscal worries will weigh on the market sentiment and make equity trading more volatile in the near term. Investors will keenly read the RBI's macroeconomic assessment in today's policy review.

9. Brent crude at $55.67 per bbl in Asian trade on Oct 4

- Brent crude prices fell in Asia on Oct 4 after US industry estimates on inventories came in mixed, with the US benchmark edging toward $50.
- Brent is currently ruling at $ 55.67 per barrel in Asian trade.
- Oil prices eased today, pulled down by caution that a rally that lasted for most of the third quarter would not extend through the last three months of the year. Traders said they would be watching for fuel inventory data from the US Energy Information Administration (EIA), due to be published later today, for further market guidance.

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