

Weekly Macro Perspectives

January 17, 2015

1. Highlights of IIF's (Washington) Report on Capital Flows to Emerging Markets, (Jan 14, 2015)

- After a rough ride in 2014, the IIF research team expects 2015 to be another stressful year for capital flows to emerging markets.
- The IIF projects total EM inflows to decline further, after a substantial fall last year, as the Fed starts to raise policy rates and as EM growth remains lacklustre.
- Flows during the year are again likely to be volatile, as markets are affected by shifting expectations of the Fed's policy trajectory, oil market uncertainty and political risks.
- Country differentiation remains a key theme for 2015. While many large EMs with well-known vulnerabilities have sought to strengthen their macro policy frameworks, and benefit from lower oil prices, analysis of past Fed tightening cycles suggests risks of heightened incidence of EM crises during the year ahead.
- The top recipients of EM portfolio flows in 2014 were Asian and Latin American countries, led by India, Indonesia, and Brazil. By contrast, countries in EM Europe underperformed as spill-overs from the Russia/Ukraine conflict took a heavy toll on investor confidence and Turkey's macro and political vulnerabilities weighed on investors' minds.
- However, within emerging Asia, improved policy fundamentals and reduced political uncertainty along with sharply lower oil prices should keep inflows at quite high levels, with the three leading destinations being China, India and Indonesia. The key external downside risk arises from the possibility of surprises in the path of Fed tightening.
- With regard to internal risks, reformist initiatives in India and Indonesia could face political headwinds which could deter investors.

2. Indian farm sector news

- It is unlikely that the loss in foodgrain production due to a delayed and deficient monsoon in the kharif (summer crop) season of FY15 will be compensated in the ongoing rabi (winter crop) season.
- As per data released on by the Indian Farm Ministry (Jan 16), total area sown under rabi crops is 57.7 mln ha, nearly 7.0% lower than the area sown by this time last year.
- Wheat, the main rabi cereal crop, has been sown in nearly 30.4 mln ha (down 3.2%, yoy). Area under pulses, at 13.3 mln ha is lagging by over 12.0%.

- Total area under coarse cereals stands at 5.4 mln ha (down 6.9%, yoy). Similarly, sowing area under total oilseeds is 7.7 mln ha (down 3.8%, yoy).
- This is the first time in a decade that India has seen deficit rains in both southwest and northeast monsoon seasons.

3. Indian non-farm sector news and policy highlights

- Large conglomerates from India and abroad announced huge investment and job creation plans at the three-day Vibrant Gujarat Summit, which kicked off on Jan 11, 2015 in presence of Prime Minister Narendra Modi and leaders from across the world.
- India's industrial production growth rebounded to 3.8% in November (our forecast: 3.1%, consensus forecast: 2.6%) from -4.2% in October, above expectations. Industrial production had suffered during October on account of a large number of holidays. Industrial growth in November was supported by capital goods (6.5%, yoy) and consumer non-durables (6.0%, yoy).
- India's CPI-based inflation stood at 5.0% in December (our forecast: 5.6%, consensus forecast: 5.3%) versus 4.4% in November, as the favourable base effect in food articles inflation got normalised in December. Meanwhile, core CPI inflation eased to 5.4% in December from 5.7% in November in line with the market expectations.
- India's WPI inflation stood at 0.1% (our forecast: 0.3%, consensus forecast: 0.6%) partly helped by a 44.0% fall in global crude oil prices on yoy basis for the month of December.
- Outside the policy cycle, India's central bank cut its policy repo rate by 25 bps to 7.75% on Jan 15th. The factors that supported this action as cited by the RBI were ebbing food price pressures, declining crude oil prices that are expected to be durable in nature, weak domestic demand and moderation of household inflation expectations to single digits for the first time since Sept, 2009.
- While many expect this action of RBI to be the beginning of a rate-cutting cycle, according to RBI, "key to further easing are data that confirm continuing disinflationary pressures... sustained high quality fiscal consolidation *as well as* steps to overcome supply constraints and assure availability of key inputs such as power, land, minerals and infrastructure" with the latter necessary to raise potential growth.
- India's trade deficit narrowed to a 10-month low in December to \$9.4 bln (5.6% of GDP) versus \$16.9 bln in November and the sequential narrowing was driven by lower oil and gold & silver imports.
- On the negative side, India's exports declined by 3.8% in December versus a growth of 7.3% in November led mainly by gems & jewellery and commodity-related exports like oilseeds, cotton, rice, cereal preparations, etc. Other exports like exports of engineering goods & readymade garments slowed in December but remained positive.

- India's imports declined by 4.8% in December partly due to a 28.9% decline in oil imports and 13.9% decline in gold & silver imports. Non-oil, non-gold imports remained positive (at 11.8% in December) for the eighth consecutive month indicating continued recovery in domestic activity.
- India's telecom regulator TRAI has rejected the Department of Telecom's proposal to set the base price of 3G spectrum higher by 43.0% compared to the 2010 auction price. The government is set to auction a limited amount of 3G spectrum in the 2,100 MHz band in the 22 Feb auctions. While the regulator has been trying to convince the government to keep the base price as low as possible to ensure fair competition, the government is more concerned about revenue maximization and is unlikely to lower the reserve price at all. It is in fact keen to hike it by 43.0%. The Telecom Commission will now take the final call shortly.
- The RBI is considering allowing banks to buy infrastructure bonds, in a bid to jumpstart a market that has suffered from low trading volumes after launching last year. Allowing banks to buy infrastructure bonds would mark a reversal for the central bank, which last year allowed lenders to only issue the debt, while limiting purchases to investors such as pension funds, provident funds, and insurers.
- According to RBI, Indian banks loans and deposits rose by 10.5% (yoy) and 11.5% (yoy) respectively, as on Dec 26, 2014. While outstanding loans rose by Rs 432.2 bln to Rs 63.47 trln in the two weeks to Dec 26, aggregate deposits increased by Rs 432.1 bln to Rs 83.36 trln.
- Broad Money Supply, i.e., M3 growth slightly improved to 11.1% (yoy) as on Dec 26, 2014 if compared to the growth in previous few weeks.
- India's foreign exchange reserves increased by \$236.4 mln to \$319.48 bln as on Jan 9, 2015, as per the RBI's latest weekly report. The reserves had fallen by \$471.4 mln to \$319.24 bln in the previous week ended Jan 2, 2015.

4. Indian money market review

- Weighted average call money rate further declined this week from 8.15% on Monday (Jan 12) to 7.93% on Friday (Jan 16) on the back of surplus liquidity in the banking system.
- Average daily borrowings from Repo window this week were higher at Rs 193.34 bln versus Rs 120.24 bln last week.
- However, average daily borrowings via the MSF route were lower at Rs 5.59 this week as against Rs 15.91 bln last week.
- The RBI managed the liquidity well through its regular term repos on Tuesday and Friday with the repo amount around Rs 155 bln.

- The 91-day T-bill rates moved this week in the band of 8.10% to 8.39%, while the 364-day T-bill rates moved in the range of 7.90%-8.20% with a declining tendency during the week.
- Banks had six CD issuances this week. Interest rates on these CDs moved between 8.18% (Rs 3 bln for 2 months) and 8.64% (Rs 500 mln for 12 months).
- With tepid credit growth, banking system is flush with excess liquidity. This has created a declining bias in credit market rates. For example, in the month of December, SBI had excess liquidity of Rs 700 bln.

5. Bullish sentiment seen in Indian government bonds next week

- The yield on India's 10-year GOI benchmark paper eased by 13 bps this week to 7.71%, as the RBI cut the benchmark policy rates by 25 bps on Thursday (Jan 15) and many have interpreted this action as the start of a rate reduction cycle.
- Fixed income strategists almost unanimously agree that the RBI may cut rates further by 75 bps in the current calendar year, which will translate into good returns on long term bond investments.
- Bank treasurers expect the 10-year benchmark bond yield to ease to as low as 7.40% by end of March and could fall by another 10 bps in the next one month.

6. RBI is seen to prevent any sharp appreciation of rupee next week

- Indian rupee appreciated by 0.74% this week and closed at 61.87 per USD on Jan 16th.
- For the third week in a row, the Indian rupee rallied by another 45 paise this week to log its one-and-half-month closing high of 61.87 against the Greenback on persistent USD selling by exporters and banks amid surprise key interest rate cut by the RBI on Jan 15th.
- Another factor that attracted more inflows this week was a favourable trade balance data for the month of December.
- However, given the fact that India's exports have again weakened and rupee is still overvalued (if compared to its fair value), the RBI kept on intervening to prevent any sharp appreciation.
- Forex experts see the trading range of spot rupee within the band of 61.40-62.40 next week.

7. Outlook for Indian equities remains positive

- The plunging oil prices raised concerns across the globe this week of deflationary conditions in the developed world.
- However, global stock markets closed the week on a mixed note.

- The Indian stock markets ended the week in green (up 2.4%) with a major boost coming from RBI's decision to cut repo rate by 25 bps. Barring oil & gas and metals, all sectoral indices ended the week on a positive note with the stocks in the realty and capital goods sector leading the gains.
- According to equity experts, while it is difficult to predict short-term movements of the market, the outlook for equities remains positive. Most of the market participants feel that gains from equities this year could surely match the gains of last year.

8. Brent crude closed at \$50.17 per bbl on Jan 16, 2014

- Brent crude settled at \$50.17 per barrel on Friday (Jan 16) and on week-on-week basis, it lost 2.2% to notch an eight-week decline.
- According to the report of International Energy Agency (Jan 16), "How low the market's floor (for crude price) will be, is anybody's guess. But the selloff is having an impact. A price recovery — barring any major disruption — may not be imminent, but signs are mounting that the tide will turn". The IEA report fueled hopes that oil has reached a bottom. As per the IEA report, collapsing crude prices would cut into supply growth from oil producers outside of the Organization of the Petroleum Exporting Countries.

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