

WEEKLY WRAP

03 September 2019

US-China tariffs in focus

Global sovereign yields fell as economic outlook remains weak. China's manufacturing sector contracted fourth month in a row and Germany's GDP contracted. India's growth also slipped to 5%. Against this backdrop, DXY index gained. INR was able to buck the trend as government announced a number of economic measures to improve growth and FDI inflows. Equities ended the week higher after US and China look at negotiating a trade deal. Global markets will be driven by progress on this and macro data this week.

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Markets

- **Bonds:** Global yields closed lower amidst US-China trade talks, political turmoil in Britain and impending fear of recession (inverted US yield curve). US 10Y yield fell by 4bps (1.5%). Major central banks may look at stimulus. Crude prices rose by 1.8% (US\$ 59/bbl) driven by concerns over hurricane Dorian. India's 10Y yield fell by (-) 1bps (6.56%) supported by RBI's higher surplus transfer to government and recent economic measures. System liquidity is in surplus of Rs 1.2tn as on 30 Aug 2019 vs Rs 1tn in the previous week.
- **Currency:** Except INR, other global currencies closed lower against the dollar. DXY edged up by 1.3% in the week as US-China look to restart trade negotiations. GBP depreciated by (-) 0.9% on rising fears of no-deal Brexit. EUR also fell by (-) 1.5% to the lowest since May'17 as growth in the region continues to remain weak. INR snapped its 7-week losing streak to end higher by 0.4% supported by government measures to revive growth.
- **Equity:** Except Nikkei and Shanghai Comp (-0.4%), other global indices closed the week higher as US and China look at restarting talks. Dow surged by 3%, followed by Dax and FTSE at 2.8% and 1.6% respectively. Sensex too gained 1.7% led by capital and consumer durable stocks. In addition, a slew of economic measures announced by government also supported the market.
- **Upcoming key events:** Developments on US-China trade negotiations will remain in focus this week. Apart from this, manufacturing and services PMI of major economies (US, Eurozone, China, India) will also be released. US durable goods orders and jobs data will also be closely watched.



India macro developments

- The Bimal Jalan Committee on Economic Capital Framework (ECF) recommended that realised gains can be distributed while unrealised gains cannot be (Rs 7tn as on 31 Jun'18). Realised gains have been referred as Contingent Risk Buffer and recommended at 5.5% to 6.5% of RBI's balance sheet. The surplus distribution policy will target only realised equity in the range of 6.5-5.5% and net surplus thereafter to be distributed.
- As per recommendations of Jalan Committee, RBI's Central Board has decided to transfer Rs 1.76tn to the government comprising Rs 1.23tn surplus and Rs 526bn of excess provisions identified as per ECF. This is nearly twice the amount estimated in Budget. Out of Rs 1.76tn, Rs 280bn has been transferred as interim dividend by RBI in Feb'19. This will help the government to meet its FY20 capex target of Rs 3.38tn.
- As per news reports, government might provide stimulus to real estate sector reeling due to muted demand and liquidity woes. Major initiatives which might be forthcoming are setting up of a stress fund for completion of stalled projects and changes in the definition of affordable housing.
- In order to improve FDI inflows, Cabinet has permitted 100% FDI under the automatic route in contract manufacturing. Significant easing of local sourcing norms for Single Brand Retail Trading (SBRT) including permission to start online sales before starting brick and mortar stores. In the mining sector, 100% FDI under automatic route has been permitted for sale of coal, coal mining activities including associated processing infrastructure.
- As per news reports, the panel on Direct Tax Code has suggested changes to personal income tax. These include-introducing 5 tax brackets (5%, 10%, 20%, 30% and 35%) vs current structure of 5%, 20% and 30%. If the recommendations are accepted, it would imply lower tax rates for those in Rs 0.5-1mn bracket (10% vs current 20%) and in Rs 1-2mn bracket (20% vs current 30%), thereby supporting domestic consumption.
- Central government's gross tax revenue growth on FYTD basis remained unchanged from last year at 3.9% in Jul'19. Direct tax growth slowed (5.8% vs 6.7% last year), led by lower income tax collections (6% vs 11.3%). Indirect tax growth improved marginally (2.4% vs 1.9%). Muted collections led to slowdown in spending, with capex falling by (-) 3.4% vs 17% last year and revenue expenditure growth easing to 7.9% vs 9.1%.

Global macro developments

- Germany's Ifo business climate index fell from 95.8 in Jul'19 to 94.3 in Aug'19. The decline was led by manufacturing (-6.1) and trade (-2.4). Morale of services sector too deteriorated sharply (13 vs 18 in Jul'19). Future business index reflects pessimism across the board, with confidence in manufacturing sector at levels last seen during crisis of 2009.
- US consumer confidence fell to 135.1 in Aug'19 vs 135.8 in Jul'19, (est. 129.5). The present situation index rose to its highest in 19 years at 177.2, offsetting a decline in the expectations index (107 vs 112.4 in Jul'19). While consumer spending likely remained robust in Q2CY19, escalation in US-China trade war may have a dampening effect on consumer expectations.
- China's industrial profit growth in Jul'19 remained weak at (-) 1.7% vs 17.1% in Jan-Jul'18, on YTD basis. The drag was led by public sector firms (-8.1%). Industry-wise, oil processing, smelting and motor vehicles are the worst hit. Private sector, on the other hand is leading the recovery with YTD profits up by 7% vs 10.3% in the same period last year.
- US durable goods orders rose by 2.1% in Jul'19 on a MoM basis vs 1.8% in Jun'19, owing to 47.8% jump in non-defence aircraft and parts. Core orders growth on the other hand, eased to 0.4% from 0.9% in Jun'19. Overall shipments also declined to 3-year low of (-) 1.1% vs 1% in Jun'19, indicating weak economic momentum at the start of Q3CY19.
- US Q2CY19 GDP growth (QoQ annualised basis) was revised downward to 2% from 2.1% earlier and 3.1% in Q1. Barring private consumption expenditure (revised upward), all other components were revised downward. While PCE rose by a robust 4.7% in Q2 vs 1% in Q1, private investment fell by (-) 6.1% vs +6.1% in Q1. Residential investment declined by (-) 2.9% vs (-) 1% in Q1, indicating continued weakness in real estate.
- CPI inflation in Germany cooled off to 1.4% in Aug'19 vs 1.7% in Jul'19 (est., 1.5%) led by a deceleration in energy prices (0.6% vs 2.4%). With oil prices continuing to remain soft, inflation is unlikely to edge up. This raises hopes for a fresh stimulus from the ECB as growth in the region continues to languish.
- China's official manufacturing PMI slipped further in Aug'19 to 49.5 from 49.7 in Jul'19. The decline was led by new orders index (49.7 vs 49.8 in Jul'19). New export orders declined for the 15th consecutive month, albeit at a slower pace in Aug'19 (47.2 vs 46.9 in Jul'19). Survey indicates, output of small and medium firms has contracted more vs expansion seen by large manufactures (mostly state backed).

FIG 2 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current [^]	1W	1M	3M	12M
10Y yields (Δ bps)					
US	1.50	(4)	(56)	(63)	(136)
UK	0.48	0	(16)	(41)	(95)
Japan	(0.27)	(4)	(12)	(18)	(38)
Germany	(0.70)	(2)	(30)	(50)	(103)
India	6.56	(1)	17	(47)	(139)
China	3.06	(1)	(12)	(23)	(53)
2Y yields (Δ bps)					
US	1.50	(3)	(34)	(42)	(112)
UK	0.40	(5)	(5)	(20)	(33)
Japan	(0.30)	0	(9)	(13)	(18)
Germany	(0.93)	(4)	(17)	(27)	(32)
India	5.78	(2)	(26)	(66)	(192)
China#	2.58	(1)	0	6	(26)
Currencies (Δ %)					
EUR	1.0982	(1.5)	(1.6)	(1.7)	(5.3)
GBP	1.2156	(0.9)	0.0	(3.7)	(6.2)
JPY	106.28	(0.8)	2.1	1.9	4.3
AUD	0.6733	(0.3)	(2.0)	(3.0)	(6.3)
INR	71.41	0.4	(3.7)	(2.4)	(0.6)
CNY	7.1560	(0.9)	(3.9)	(3.6)	(4.8)
Equity & Other indices (Δ %)					
Dow	26,403	3.0	(2.9)	6.4	1.7
FTSE	7,207	1.6	(5.7)	0.6	(3.0)
DAX	11,939	2.8	(1.7)	1.8	(3.4)
NIKKEI	20,704	0	(4.6)	0.5	(9.5)
Shanghai Comp	2,886	(0.4)	(2.2)	(0.4)	5.9
SENSEX	37,333	1.7	(0.2)	(6.0)	(3.4)
Brent (US\$/bbl)	60.43	1.8	(6.6)	(6.3)	(21.9)
Gold (US\$/oz)	1,520	(0.4)	6.3	16.5	26.6
CRB Index	387.2	(1.3)	(4.4)	(6.9)	(5.9)
Rogers Agri Index	682.7	0.1	(6.5)	(9.2)	(13.0)
LIBOR (3M)*	2.13	(1)	(12)	(37)	(19)
INR 5Y Swap*	6.19	(8)	(40)	(46)	(123)
India FII data (US\$ mn)					
	29 Aug	WTD	MTD	CYTD	FYTD
FII-Debt	102.2	521.4	1,510.6	4,164.5	3,619.9
FII-Equity	(87.1)	(508.9)	(2,278.7)	7,126.0	280.8

Source: Bloomberg, Bank of Baroda | *Indicates change in bps, #1Y yield, ^As of 30 Aug 2019

FIG 3 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
2-Sep	Jibun Bank Japan manufacturing PMI	Aug	--	49.5	--
	Caixin China manufacturing PMI	Aug	49.8	49.9	--
	Thailand CPI, % YoY	Aug	0.6%	1.0%	--
	Markit India manufacturing PMI	Aug	--	52.5	--
	Markit Spain manufacturing PMI	Aug	48.5	48.2	--
	Markit France manufacturing PMI	Aug	51.0	51.0	--
	Markit/BME Germany manufacturing PMI	Aug	43.6	43.6	--
	Markit Eurozone manufacturing PMI	Aug	47.0	47.0	--
	Markit UK manufacturing PMI	Aug	48.4	48.0	--
	India eight infrastructure industries index	Jul	--	0.2%	--
	Indonesia CPI, % YoY	Aug	3.5%	3.3%	--
3-Sep	Reserve Bank of Australia cash rate target	3-Sep	1.0%	1.0%	--
	Euro Area PPI, % YoY	Jul	0.2%	0.7%	--
	Markit US manufacturing PMI	Aug	50.0	49.9	--
	US ISM manufacturing PMI	Aug	51.2	51.2	--
4-Sep	Jibun Bank Japan services PMI	Aug	--	53.4	--
	Australia GDP, SA, % QoQ	Q2CY19	0.5%	0.4%	--
	Caixin China services PMI	Aug	51.7	51.6	--
	Markit India services PMI	Aug	--	53.8	--
	Markit France services PMI	Aug	53.3	53.3	--
	Markit Germany services PMI	Aug	54.4	54.4	--
	Markit Eurozone services PMI	Aug	53.4	53.4	--
Markit/CIPS UK services PMI	Aug	51.0	51.4	--	
5-Sep	Australia trade Balance, AUD mn	Jul	7,200	8,036	--
	Germany factory orders, % MoM	Jul	(1.4%)	2.5%	--
	US initial jobless claims, in thousands	31-Aug	215	215	--
	Markit US services PMI	Aug	51.0	50.9	--
	US factory orders, % MoM	Jul	1.0%	0.6%	--
	US durable goods orders, % MoM	Jul	2.1%	2.1%	--
	US ISM non-manufacturing index	Aug	54.0	53.7	--
6-Sep	Germany industrial production, SA, % MoM	Jul	0.4%	(1.5%)	--
	Taiwan CPI, % YoY	Aug	0.7%	0.4%	--
	Euro Area GDP, SA, % QoQ	Q2CY19	0.2%	0.2%	--
	US change in non-farm payrolls, in thousands	Aug	158	164	--
	US unemployment Rate	Aug	3.7%	3.7%	--

Source: Bloomberg, Bank of Baroda

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