


**WEEKLY WRAP**

31 December 2018

**All eyes on US**

Global yields fell as US consumer confidence was below estimates and growth outlook continued to remain weak over concerns of an escalating US-China trade spat. In India's case yields went up as RBI Governor indicated the central bank will keep liquidity in deficit mode and central government is looking at pump priming agri economy ahead of general elections. Global equity markets had a volatile week. Outlook for equity markets is relatively muted in 2019. Markets will look at Central Banks, in particular US Fed, to prop the world economy as growth is slowing down.

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**Markets**

- **Bonds:** Except India, global yields closed lower. The decline can be explained by concerns over global growth, in particular US and China. US 10Y yield declined by 7bps (2.72%) driven by fading consumer confidence (far below estimate). Indian 10Y yield shot up by 11bps (7.39%) as RBI governor indicated that the central bank would prefer to keep liquidity in a 'slight deficit' mode. Fiscal deficit for the year is already at Rs 7.2tn vs. BE of Rs 6.2tn even as the centre is considering measures to prop the agri economy. System liquidity was in deficit of Rs 1.5tn as on 28 Dec 2018 vs Rs 1.6tn in the previous week.
- **Currency:** Weaker economic data from the US along with concerns over partial US government shutdown fuelled concerns over global economic outlook. As a result DXY declined by (-) 0.6%. JPY rallied to end higher by 0.9% on safe-haven demand. INR ended the week higher by 0.3% supported by lower oil prices (-3%) and FPI inflows.
- **Equity:** Global indices closed mixed. Dow ended the week in green, rising by 2.7% followed by Sensex (0.9%) and FTSE (0.2%). On the other hand, Asian and European markets were lower. Outlook on equity markets is far more bearish in 2019 as global growth slows.
- **Upcoming key events:** Markets will closely watch global manufacturing and services PMIs, US new home sales and Euro Area CPI. Apart from this, Germany's retail sales and South Korea's exports data will also be released. On domestic front, core sector, manufacturing & services PMI data will be released.



## India macro developments

- RBI's latest publication revealed that SCBs balance sheet was growing at a moderate pace of 7.6% in FY18 compared with 8% in FY17. Overhang of stressed assets has contributed to this slower pace of expansion. GNPA ratio of SCBs rose to 11.2% in FY18 vs 9.3% in FY17. While those for PSBs, it increased to 14.6% in FY18 vs 11.7% in FY17. The report has also highlighted that NPAs have begun to stabilise in H1FY19. The recovery rate through IBC has also increased to 46.1% in H1FY19 vs 41.3% in FY18.
- As per news reports, government is mulling upon 3 options to reduce farmer distress. These include: (1) monetary transfer of Rs 1700-2000/acre to all land owing farmers; (2) meeting the gap between MSP and actual price at which the crop is sold; and (3) waiving farm loans upto Rs 1 lakh. The cost to exchequer is touted to be between Rs 1tn for the first scheme, Rs 500bn for the second and Rs 3tn for the third.
- Central government's fiscal deficit has reached Rs 7.2tn in Nov'18 on a FYTD basis vs BE of Rs 6.2tn. Centre's tax revenue rose by 10.5% between Apr-Nov'18 vs 5.8% in Apr-Nov'17, mainly led by increase direct tax collection (16.5% vs 13.7% in FYTD18). Indirect tax collections are also showing considerable improvement (5.2% vs -0.4%). In the same period, total expenditure growth slowed to 9.1% in FYTD19 vs 14.9% in FYTD18. This was driven by slowing growth of both capex and revenue expenditure.
- Government recently slashed GST rates of 23 goods and services. With this rationalisation, over 98% items are in the 18% tax bracket. Notably, cement and automobiles continue to be in the 28% tax slab as the revenue implication of putting it in a lower slab would have been far impinging (Rs 330bn). Overall, this is likely to cost the exchequer Rs 55bn a year and over Rs 13.8bn in the remaining three months of FY19.
- RBI reported that currency in circulation (CIC) increased by Rs 60bn (on a weekly basis) and stood at Rs 20tn as on 21 Dec 2018. Overall reserve money grew by 17% on a YoY basis compared to 55% a year ago. On FYTD basis, reserve money is growing at a slower pace of 6.3% against 15.7% in the previous year.
- Government recently tightened FDI norms for e-commerce firms. As per the new regulation, related entity can no longer sell on a platform w.e.f 1 Feb 2019. Single vendor has also been barred to sell more than 25% to one portal. These moves would create some space for the brick and mortar retailers and enable a level playing field for all sellers.

## Global macro developments

- China's official manufacturing PMI indicates contraction in activity in Dec'18. The index slipped from 50 in Nov'18 to 49.4 in Dec'18 (est.: 49.9)-its lowest level since Feb'16. New export orders fell for the 7th consecutive month in Dec'18 (46.6 vs 47 in Nov'18). Services activity on the other hand, continues to hold ground as the index inched up from 53.4 in Nov'18 to 53.8 in Dec'18.
- Consumer confidence in the US faded in Dec'18. The index fell to 128.1 vs est. of 133.6 & previous month's level of 136.4. Both consumers' assessment of current and future business conditions declined in Dec'18. Elsewhere, jobless claims for the week ending 22 Dec 2018 declined to 216,000 vs previous week's level of 217,000.
- Japan factory output declined by (-) 1.1% on a MoM basis in Nov'18 vs 2.9% rise in Oct'18. This was mainly led by decline in production of general purpose machinery. A survey of manufacturers by METI indicates that respondents expect output to have risen by 2.2% in Dec'18 but decline by 0.8% in Jan'19.
- New Industrial profits in China declined by (-) 1.8% in Nov'18 on a YoY basis, from 3.6% in Oct'18. Between Jan-Nov'18 profit growth slowed to 11.8% vs 16.3% in Jan-Oct'18. The slowdown was driven by manufacturing firms where profit growth fell to 9.9% from 11.5% in the same time period. Slower credit growth, softening PPI and rising trade worries are driving the trend.
- BoJ's minutes for its Oct'18 policy meet indicates growing dilemma amongst the members to maintain ultra-low rates and its impact on profitability of financial institutions. While some members argued that greater flexibility should be allowed for bond yield movement, others argued that this might undermine Central Bank's commitment to achieve 2% inflation target.
- New orders for manufactured durable goods increased 0.8% in Nov'18 vs (-) 4.3% in Oct'18. However, orders for non-defence capital goods ex-aircraft, a proxy for business spending, fell by (-) 0.6% after a 0.5% increase in Oct'18 suggesting slowing economic activity in Q4. Separate data also showed that GDP growth in the US was revised downward to 3.4% in Q3CY18 from 3.5% earlier and 4.2% in Q2CY18. This was on the back of lower PCE and exports.
- Japan's CPI rose by 0.9% on a YoY basis in Nov'18 vs 1.4% in Oct'18. Core inflation rose by 0.3% vs 0.4% in Oct'18. The easing was led by decline in prices of furniture and household durables, clothing, and rent. On a CYTD basis, headline inflation has averaged only 1% vs BoJ's target of 2%, thereby providing support to BoJ's decision to maintain loose monetary policy.

**FIG 1 – MOVEMENT IN KEY GLOBAL ASSET CLASSES**

| Particulars                             | Current       | 1W         | 1M         | 3M          | 12M         |
|---|---------------|------------|------------|-------------|-------------|
| <b>10Y yields (Δ bps)</b>               |               |            |            |             |             |
| US                                      | 2.72          | (7)        | (34)       | (34)        | 29          |
| UK                                      | 1.27          | (5)        | (11)       | (30)        | 7           |
| Japan                                   | 0.00          | (4)        | (10)       | (13)        | (6)         |
| Germany                                 | 0.24          | (1)        | (11)       | (23)        | (18)        |
| India                                   | 7.39          | 11         | (26)       | (64)        | (1)         |
| China                                   | 3.31          | (3)        | (9)        | (32)        | (58)        |
| <b>2Y yields (Δ bps)</b>                |               |            |            |             |             |
| US                                      | 2.52          | (12)       | (29)       | (30)        | 61          |
| UK                                      | 0.74          | (3)        | (1)        | (8)         | 31          |
| Japan                                   | (0.14)        | 0          | (1)        | (3)         | (1)         |
| Germany                                 | (0.61)        | (1)        | (2)        | (9)         | (1)         |
| India                                   | 6.83          | (4)        | (43)       | (101)       | 23          |
| China                                   | 2.69          | 2          | 19         | (28)        | (116)       |
| <b>Currencies (Δ %)</b>                 |               |            |            |             |             |
| EUR                                     | 1.1444        | 0.6        | 0.7        | (1.4)       | (4.2)       |
| GBP                                     | 1.2699        | 0.4        | (1.0)      | (2.5)       | (5.5)       |
| JPY                                     | 110.27        | 0.9        | 3.0        | 3.0         | 2.3         |
| AUD                                     | 0.7047        | 0.1        | (3.5)      | (2.5)       | (9.6)       |
| INR                                     | 69.95         | 0.3        | 1.0        | 3.5         | (9.2)       |
| CNY                                     | 6.8785        | 0.4        | 1.1        | (0.1)       | (5.3)       |
| <b>Equity &amp; Other indices (Δ %)</b> |               |            |            |             |             |
| Dow                                     | 23,062        | 2.7        | (9.1)      | (12.8)      | (7.1)       |
| FTSE                                    | 6,734         | 0.2        | (3.9)      | (10.3)      | (11.7)      |
| DAX                                     | 10,559        | (0.7)      | (6.5)      | (13.8)      | (18.7)      |
| NIKKEI                                  | 20,015        | (0.8)      | (9.7)      | (17.0)      | (12.2)      |
| Shanghai Comp                           | 2,494         | (0.9)      | (4.1)      | (11.6)      | (24.3)      |
| SENSEX                                  | 36,077        | 0.9        | 1.0        | (0.4)       | 6.6         |
| Brent (US\$/bbl)                        | 52.20         | (3.0)      | (11.2)     | (36.9)      | (21.8)      |
| Gold (US\$/oz)                          | 1,278         | 1.7        | 4.7        | 7.3         | (1.3)       |
| CRB Index                               | 410.0         | (0.4)      | (0.4)      | (1.2)       | (5.1)       |
| Rogers Agri Index                       | 759.6         | (0.2)      | (1.5)      | (1)         | (5.7)       |
| LIBOR (3M)*                             | 2.80          | (2)        | 10         | 40          | 111         |
| INR 5Y Swap*                            | 7.25          | 9          | (27)       | (47)        | 63          |
| <b>India FII data (US\$ mn)</b>         |               |            |            |             |             |
|   | <b>27 Dec</b> | <b>WTD</b> | <b>MTD</b> | <b>CYTD</b> | <b>FYTD</b> |
| FII-Debt                                | (23.3)        | 49.4       | 707.1      | (6,865.1)   | (7,111.0)   |
| FII-Equity                              | 224.3         | 79.3       | 508.8      | (4,381.0)   | (6,506.5)   |

Source: Bloomberg, Bank of Baroda Research | \*Indicates change in level

FIG 2 – DATA RELEASE CALENDAR

| Date                     | Event  | Period                    | Estimate | Previous | Actual  |    |
|--------------------------|--|---------------------------|----------|----------|---------|----|
| 31-Dec                   | South Korea CPI, % YoY                       | Dec                       | 1.7%     | 2.0%     | --      |    |
|                          | China non-manufacturing PMI                  | Dec                       | 53.2     | 53.4     | 53.8    |    |
|                          | China manufacturing PMI                      | Dec                       | 50.0     | 50.0     | 49.4    |    |
|                          | China composite PMI                          | Dec                       | --       | 52.8     | --      |    |
|                          | India eight infrastructure industries, % YoY | Nov                       | --       | 4.8%     | --      |    |
|                          | Singapore GDP annual, % YoY                  | CY18                      | 3.3%     | 3.6%     | --      |    |
| 1-Jan                    | South Korea exports, % YoY                   | Dec                       | 2.5%     | 4.5%     | --      |    |
| 2-Jan                    | Singapore GDP, % YoY                         | Q4CY18                    | --       | 2.2%     | --      |    |
|                          | Nikkei Thailand manufacturing PMI            | Dec                       | --       | 49.8     | --      |    |
|                          | Nikkei Indonesia manufacturing PMI           | Dec                       | --       | 50.4     | --      |    |
|                          | Caixin China manufacturing PMI               | Dec                       | 50.2     | 50.2     | --      |    |
|                          | Thailand CPI, % YoY                          | Dec                       | 1.0%     | 0.9%     | --      |    |
|                          | Indonesia CPI, % YoY                         | Dec                       | 3.1%     | 3.2%     | --      |    |
|                          | Nikkei India manufacturing PMI               | Dec                       | --       | 54.0     | --      |    |
|                          | Markit Italy manufacturing PMI               | Dec                       | 48.4     | 48.6     | --      |    |
|                          | Markit France manufacturing PMI              | Dec                       | 49.7     | 49.7     | --      |    |
|                          | Markit Germany manufacturing PMI             | Dec                       | 51.5     | 51.5     | --      |    |
|                          | Markit Eurozone manufacturing PMI            | Dec                       | 51.4     | 51.4     | --      |    |
|                          | Markit UK PMI manufacturing SA               | Dec                       | 52.5     | 53.1     | --      |    |
|                          | Markit US manufacturing PMI                  | Dec                       | 53.9     | 53.9     | --      |    |
|                          | US advance goods trade balance, US\$ bn      | Nov                       | (76.0)   | (77.2)   | --      |    |
|                          | US new home sales                            | Nov                       | 568,000  | 544,000  | --      |    |
|                          | Germany retail sales, % MoM                  | Nov                       | 0.4%     | (0.3%)   | --      |    |
|                          | 3-Jan  | US ADP employment change  | Dec      | 180,000  | 179,000 | -- |
|                          |  | US initial jobless claims | 29-Dec   | 220,000  | 216,000 | -- |
| US ISM manufacturing PMI |  | Dec                       | 57.8     | 59.3     | --      |    |
| 4-Jan                    | Nikkei Japan manufacturing PMI               | Dec                       | --       | 52.4     | --      |    |
|                          | Caixin China services PMI                    | Dec                       | 53.0     | 53.8     | --      |    |
|                          | Nikkei India services PMI                    | Dec                       | --       | 53.7     | --      |    |
|                          | France CPI, % YoY                            | Dec                       | 1.8%     | 1.9%     | --      |    |
|                          | Markit Italy services PMI                    | Dec                       | 50.1     | 50.3     | --      |    |
|                          | Markit France services PMI                   | Dec                       | 49.7     | 49.6     | --      |    |
|                          | Markit Germany services PMI                  | Dec                       | 52.5     | 52.5     | --      |    |
|                          | Markit Eurozone services PMI                 | Dec                       | 51.4     | 51.4     | --      |    |
|                          | Euro Area PPI, % YoY                         | Nov                       | 4.2%     | 4.9%     | --      |    |
|                          | Euro Area CPI, % YoY                         | Dec                       | 1.8%     | 2.0%     | --      |    |
|                          | US change in nonfarm payrolls                | Dec                       | 180,000  | 155,000  | --      |    |
|                          | US unemployment rate                         | Dec                       | 3.7%     | 3.7%     | --      |    |
|                          | Markit US services PMI                       | Dec                       | 53.5     | 53.4     | --      |    |

Source: Bloomberg, Bank of Baroda Research

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