Bank of Baroda

WEEKLY WRAP

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Markets rally on US-China trade deal

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Growth concerns came to the fore as macro data in US (retail sales, industrial production) and China (exports, Q3GDP) disappointed. However, progress in US-China trade talks and hopes of an orderly Brexit lifted markets. Yields rose. So did equities. Indian equity markets too rallied even as IMF cut India's growth forecast for FY20 to 6.1% (6.9% earlier). MPC members too are concerned about growth and would like to continue to be accommodative. We believe RBI is likely to cut rates by another 25bps in Dec'19.

Markets

- **Bonds:** Except India, global yields closed higher led by positive momentum in US-China trade talks. US 10Y yield rose by 7bps (1.80%). UK 10Y yield rose by 11bps to 0.75% on receding possibility of a no-deal Brexit even as investors await the parliamentary proceedings. Crude prices fell by (-) 0.7% (US$ 59/bbl) driven by rising US inventories. India's 10Y yield closed lower by 3bps (6.7%) as growth concerns still linger. System liquidity surplus was at Rs 1.6tn as on 18 Oct 2019 vs Rs 2.2tn in the previous week.

- **Currency:** With the exception of JPY and INR, other major global currencies closed higher in the week. DXY fell by (-) 1.1% in the week as US retail sales and industrial production fell more than expected. Progress in US-China trade deal and Brexit also impacted investor sentiments. While EUR rose by 1.1%, GBP appreciated by 2.8% to its highest since May'19. INR depreciated by (-) 0.2% in the week on growth concerns, even as FII inflows were robust at US$ 1.5bn.

- **Equity:** Barring Shanghai Comp and FTSE, global indices ended the week in green driven by optimism around US-China trade deal. Brexit developments also impacted investor sentiments. Shanghai Comp fell by (-) 2.3% as GDP data was subdued. Sensex ended the week higher (2.8%) led by auto, real estate and metal stocks.

- **Upcoming key events:** Apart from Brexit negotiations, flash PMIs of major economies (US, Germany, France and Japan) will drive markets this week. US durable goods and existing home sales data is also due to be released. Domestic markets will be driven by corporate earnings.

India macro developments

- CPI inflation in India rose to a 14-month high at 4% in Sep'19 led by food inflation, particularly vegetable (15.4%) and meat and fish (10.3%). However, core inflation moderated to 4% from 4.3%, led by transport and communication. Given the seasonal/rain related reasons for spike in vegetable prices we believe food inflation will come-off. Thus RBI should look at propping growth with 25bps cut in Dec'19.
- WPI inflation eased to 0.3% in Sep'19 from 1.1% driven by lower fuel and power inflation at (-) 7.1%. Even manufactured product inflation fell to (-) 0.4% in Sep'19. Food inflation however rose marginally to 6% in Sep'19 from 5.8% led by higher onion prices. The macro backdrop fits in with lower than estimated WPI inflation as producer pricing power is limited.
- IMF has slashed India's growth forecast downward by 90bps to 6.1% in FY20. This was in line with muted global growth (revised downward by 20bps to 3% in CY19), subdued domestic demand and financial woes of NBFCs. However, growth is expected to pick up to 7% in FY21 supported by government's recent corporate tax cut, rural consumption support programme and lagged impact of monetary transmission.
- India's trade deficit narrowed to US$ 10.9bn in Sep'19 vs US$ 13.5bn in Aug'19. Exports fell again, by (-) 6.6% led by oil and gems & jewellery. Imports too contracted further (-13.9%). Despite onset of festive season, gold imports fell by (-) 50.8% due to higher prices. Non-oil-non-gold imports also fell by (-) 8.9%. Given muted global and domestic growth backdrop, we expect trade deficit to ease in FY20 and thus support INR.
- India's fuel demand in H1FY20 eased to 1.7% vs 3.8% in H1FY19. It is also lower than 2.9% increase seen in H2FY19. In Sep'19 alone, fuel demand fell by (-) 0.1% vs 4.1% in Aug'19, driven by industrial fuel (-17.5%) and diesel (-3.3%). On a quarterly basis too, demand for diesel remained low (-0.2% vs 2.2% in Jun'19), followed by petrol (8.1% vs 10.1% in Jun'19).
- MPC minutes show four out of six members favour accommodative stance and further rate cuts as long as economy is firmly on the path to recovery. The remaining two are data dependent. Growth indicators such as IIP, non-food credit, exports and non-oil-non-gold imports have disappointed since the last policy. However, led by higher vegetable prices, headline inflation did touch 4%. We believe this will ebb as fresh crop arrives in the market in the next few weeks/months. Thus another 25bps rate cut is on the cards.

Global macro developments

- China's PPI fell by (-) 1.2% in Sep'19 vs (-) 0.8% in Aug'19. Apart from weak demand, this can also be attributed to softening prices of oil and raw materials and VAT cuts introduced w.e.f Apr'19. On the other hand, CPI rose by 3% in Sep'19 vs 2.8% in Sep'19. This was largely on account of 69.3% jump in pork prices, pushing food inflation up by 11.2% vs 10% last month. Core inflation remains muted at 1.5% vs 1.1% in Aug'19.
- Germany's investor economic sentiment index (ZEW) declined marginally to (-) 22.8 in Oct'19 from (-) 22.5 in Sep'19 (est. -29.2). In addition, industrial production rose by 0.3% in Aug'19, raising hopes that the country might not fall into recession. However, uncertainty around Brexit and trade deal continue to remain a concern.
- Retail sales in the US fell for the first time in 7-months by (-) 0.3% on MoM basis in Sep'19 (est.: +0.3%), vs 0.6% increase in Aug'19. This was led by muted spending on building materials, online purchases and automobiles. Strain on consumption demand and inflation below 2% target may prompt Fed to cut rates further in the coming policy meet.
- Bank of Korea reduced its policy rates for the 2nd time in CYTD19 by 25bps to 1.25%. It also expects GDP growth in CY19 to be weaker than estimated (2.2%). IMF has also cut Korea's GDP forecast from 2.6% to 2% for CY19. Korea's exports have been contracting throughout CYTD19 and deflationary risks have resurfaced with CPI falling by (-) 0.4% in Sep'19-a first in 10 years. As a result, another rate cut is expected by early next year.
- Japan's CPI rose by 0.1% in Sep'19 on a MoM basis vs 0.2% in Aug'19. Core CPI remained flat (0%) after increasing by 0.2% in Aug'19. The softening was mainly driven by lower prices of medical care (-0.1% vs 0% in Aug'19) and transportation & communication (-0.7% vs 0.1%). On a YoY basis, too core inflation remained muted at 0.6%.
- CPI inflation in the Euro Area rose by 0.8% in Sep'19 (est. 0.9%) compared with 1% in Aug'19 on a YoY basis. This was the slowest pace of increase since Nov'16 and was driven by a decline in energy prices (-1.8% in Sep'19 vs -0.6% in Aug'19). However, core-CPI which excludes volatile energy and unprocessed food prices rose by 1.2% in Sep'19, up from 1.2% in Aug'19. Separate data also showed that the region's exports to rest of the world fell by (-) 2.2% in Aug'19 vs +6.2% in Jul'19. Imports also declined by (-) 4.1% vs +2.3% in Jul'19.

FIG 1 – MOVEMENT IN KEY GLOBAL ASSET CLASSES

Particulars	Current	1W	1M	3M	12M
10Y yields (Δ bps)					
US	1.80	7	8	(25)	(140)
UK	0.75	11	12	4	(78)
Japan	(0.13)	5	8	1	(28)
Germany	(0.34)	11	18	0	(79)
India^	6.70	(3)	8	28	(123)
China	3.22	5	12	7	(39)
2Y yields (Δ bps)					
US	1.62	3	(6)	(19)	(129)
UK	0.55	5	3	5	(22)
Japan	(0.23)	6	6	(4)	(12)
Germany	(0.66)	4	5	11	(8)
India	5.58	(10)	(17)	(49)	(205)
China#	2.56	0	2	(2)	(35)
Currencies (Δ %)					
EUR	1.1150	1.1	1.2	(0.5)	(2.7)
GBP	1.2960	2.8	3.9	3.9	0
JPY	108.62	(0.2)	(1.0)	(0.7)	3.7
AUD	0.6868	1.4	1.5	(2.4)	(3.0)
INR	71.15	(0.2)	0.1	(3.2)	3.3
CNY	7.0760	(0.1)	0.2	(2.8)	(1.8)
Equity & Other indices (Δ %)					
Dow	26,828	0.2	(0.4)	(1.3)	6.0
FTSE	7,164	(0.7)	(2.5)	(4.7)	1.7
DAX	12,748	2.1	2.2	3.7	10.6
NIKKEI	22,549	3.4	2.7	5.3	(0.3)
Shanghai Comp	2,940	(2.3)	(2.2)	1.8	10.7
SENSEX	39,298	2.8	3.4	3.3	15.1
Brent (US$/bbl)	58.96	(0.7)	(8.3)	(6.8)	(26.1)
Gold (US$/oz)	1,485	(0.6)	(2.1)	4.2	21.5
CRB Index	392.2	0.1	1.7	(3.4)	(5.9)
Rogers Agri Index	727.0	0.1	4.1	(0.8)	(7.9)
LIBOR (3M)*	1.95	(5)	(20)	(33)	(53)
INR 5Y Swap*	6.47	8	13	2	(123)
India FII data (US$ mn)	**17 Oct**	**WTD**	**MTD**	**CYTD**	**FYTD**
FII-Debt	39.7	22.7	60.8	4,034.1	3,489.5
FII-Equity	178.5	1,474.5	738.6	8,899.3	2,054.1

Source: Bloomberg, Bank of Baroda | ^7.26% GS 2029, #1Y yield, *Indicates change in bps

FIG 2 – DATA RELEASE CALENDAR

Date	Event	Period	Estimate	Previous	Actual
21-Oct	Japan exports, % YoY	Sep	(3.6%)	(8.2%)	--
	China new home prices, % MoM	Sep	--	0.6%	--
	Thailand customs exports, % YoY	Sep	3.0%	(4.0%)	--
	Taiwan export orders, % YoY	Sep	(4.6%)	(8.3%)	--
22-Oct	UK public sector net borrowing	Sep	9.1	5.8	--
	US existing home sales, in mn	Sep	5.46	5.49	--
23-Oct	New Zealand trade balance, NZD mn	Sep	(1,375)	(1,565)	--
	Malaysia CPI, % YoY	Sep	1.3%	1.5%	--
	France manufacturing confidence	Oct	101	102	--
	Taiwan industrial production, % YoY	Sep	0.7%	2.3%	--
	Euro Area consumer confidence	Oct	(6.7)	(6.5)	--
24-Oct	S.Korea GDP, % YoY	Q3CY19	2.0%	2.0%	--
	Jibun Bank Japan flash manufacturing PMI	Oct	--	48.9	--
	Jibun Bank Japan flash services PMI	Oct	--	52.8	--
	Markit France flash manufacturing PMI	Oct	50.2	50.1	--
	Markit France flash services PMI	Oct	51.7	51.1	--
	Markit/BME Germany flash manufacturing PMI	Oct	42.1	41.7	--
	Markit Germany flash services PMI	Oct	52.0	51.4	--
	Riksbank interest rate	24-Oct	(0.3%)	(0.3%)	--
	Markit Eurozone flash manufacturing PMI	Oct	46.0	45.7	--
	Markit Eurozone flash services PMI	Oct	52.0	51.6	--
	ECB main refinancing rate	24-Oct	0.0%	0.0%	--
	US durable goods orders, % MoM	Sep	(0.6%)	0.2%	--
	US initial jobless claims	19-Oct	--	214,000	--
	Markit US flash manufacturing PMI	Oct	--	51.1	--
	Markit US flash services PMI	Oct	--	50.9	--
	US new home sales	Sep	710,000	713,000	--
	Bank Indonesia policy rate, %	24-Oct	5.00%	5.25%	--
25-Oct	Japan machine tool orders, % YoY	Sep	--	(35.5%)	--
	Germany GfK consumer confidence index	Nov	9.8	9.9	--
	Germany IFO business climate index	Oct	94.5	94.6	--

Source: Bloomberg, Bank of Baroda

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