FIRST LIGHT

02 August 2022

RESEARCH

BOB Economics Research | Currency Outlook

INR stages a comeback

BOB Economics Research | Bonds Wrap

Fortnightly review

BOB Economics Research | Monsoon Update

Monsoon and sowing progress

BOB Economics Research | Monthly Economic Buffet

Economic Round-up: July 2022

Daily macro indicators

Indicator	28-Jul	29-Jul	Chg (%)
US 10Y yield (%)	2.68	2.65	(3bps)
India 10Y yield (%)	7.33	7.32	(1bps)
USD/INR	79.76	79.27	0.6
Brent Crude (US$/bbl)	107.1	110	2.7
Dow	32,530	32,845	1.0
Hang Seng	20,623	20,157	(2.3)
Sensex	56,858	57,570	1.3
India FII (US$ mn)	**27-Jul**	**28-Jul**	**Chg ($ mn)**
FII-D	(67.4)	(92.7)	(25.3)
FII-E	(11.8)	809.0	820.8

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: Currency Outlook

Global currencies edged up against a weaker dollar. DXY index fell amidst expectations that the Fed may slow down the pace of monetary policy tightening going forward. JPY, GBP and EUR strengthened against the dollar. INR too ended the fortnight higher by 0.9% after depreciating to a fresh record low. A weaker dollar and revival in FPIs supported gains in USD/INR. Apart from the RBI policy meet, US CPI and jobs report will guide the trajectory of INR in the coming two weeks. We expect, INR to trade in the range of 79.15-79.75/$ in the next fortnight.

Click here for the full report.

India Economics: Bonds Wrap

Global sovereign 10Y yields have moderated in the current fortnight with Germany and US 10Y yield falling as much as 32 and 27bps respectively. Fear of recession improved demand for sovereign securities. India's 10Y yield also fell by 12bps against only a tad decline in the previous fortnight, led by concerns of a spillover impact of global financial tightening and growth slowdown. However, the most notable fact in the current fortnight has been the significant jump in yields of short end papers which has reduced the yield gap (10Y and short end papers). This has made the yield curve considerably flatter compared to the previous fortnight.

Click here for the full report.

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India Economics: Monsoon Update

South-West monsoon has registered above normal rainfall at 8% (above LPA) till 31 Jul 2022. The actual rainfall for this period has exceeded and moved past the normal range. Out of 36, 7 subdivisions have received deficient rainfall during this period. Sown area of pulses and oilseeds have inched up, however rice sowing remains a concern. Across India, over 39 districts have received deficient rainfall (-66% to-99% below LPA). It is imperative to remain vigilant as the rainfall has not be spatially distributed raising concern about the crop sown in these districts along with crop loan assigned to them. We will be closely monitoring the rainfall distribution in the coming weeks to understand the same.

Click here for the full report.

India Economics: Monthly Economic Buffet

High frequency indicators (PMIs, consumer/business sentiment index) in US, China and Eurozone are pointing towards slowdown in economic activity. Reduced supply of gas to Europe has further aggravated concerns. This has even led to downgrade of global growth forecasts by the IMF. While so far major central banks (Fed, ECB, BoE) remain on policy tightening spree, it is being anticipated that pace of rate hikes will have to ease in order to stop global economy slipping into recession.

Click here for the full report.

CURRENCY OUTLOOK

01 August 2022

INR stages a comeback

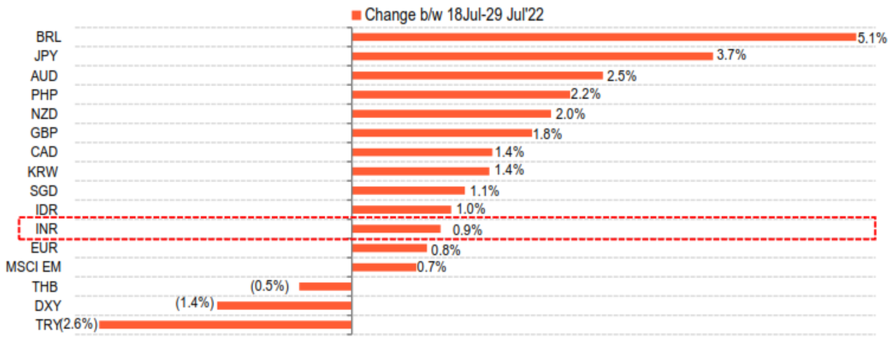
Aditi Gupta
Economist

Global currencies edged up against a weaker dollar. DXY index fell amidst expectations that the Fed may slow down the pace of monetary policy tightening going forward. JPY, GBP and EUR strengthened against the dollar. INR too ended the fortnight higher by 0.9% after depreciating to a fresh record low. A weaker dollar and revival in FPIs supported gains in USD/INR. Apart from the RBI policy meet, US CPI and jobs report will guide the trajectory of INR in the coming two weeks. We expect, INR to trade in the range of 79.15-79.75/$ in the next fortnight.

How have global currencies fared?

Most global currencies edged higher in the last fortnight against a weak dollar. DXY retreated even as Fed raised policy rate by another 75 bps, taking the cumulative rate hikes to 225 bps this year. However, comments from Fed Chair were less hawkish than earlier, suggesting that the pace of rate hikes may slow down going further. A higher than expected contraction in US GDP in Q2CY22 also bolstered the case for slower policy tightening. However, a further surge in US PCE price index may change this view and the future trajectory of the Fed will depend on incoming data before it meets again in Sep'22.

Figure 1: Currency movement



Source: Bloomberg, Bank of Baroda | Data as of 29 Jul 2022 | Note: Figures in bracket denote depreciation against USD

Brazilian Real (BRL) has strengthened most sharply and rose by 5.1% led by higher iron ore prices. Further, Brazil posted only a small CAD (lowest in 5-years) in Mar'22 which also supported BRL. JPY too rose by 3.7% to a ~6-week high, against the weaker dollar. It was further supported by better than expected exports, PMI and industrial production data. BoJ restarted its ultra-accommodative stance while raising the inflation forecast upwards and growth forecast downwards. Amongst advanced economies, British pound (GBP) has gained 1.8% in the fortnight as surging inflation in the UK (40-year high), has led to expectations of a 50 bps rate hike by Bank of England (BoE). Further, flash PMIs suggest an improvement in economic activity, lending support to the currency.

BONDS WRAP

01 August 2022

Fortnightly review

Dipanwita Mazumdar
Economist

Global sovereign 10Y yields have moderated in the current fortnight with Germany and US 10Y yield falling as much as 32 and 27bps respectively. Fear of recession improved demand for sovereign securities. India's 10Y yield also fell by 12bps against only a tad decline in the previous fortnight, led by concerns of a spillover impact of global financial tightening and growth slowdown. However, the most notable fact in the current fortnight has been the significant jump in yields of short end papers which has reduced the yield gap (10Y and short end papers). This has made the yield curve considerably flatter compared to the previous fortnight.

Importantly, in the 22 Jul 2022, auction, 91-day TBill borrowing cost rose to its 3-year high. This happened primarily on account of reduction in surplus liquidity in the system. It is worth mentioning that system level liquidity surplus reached its lowest since 23 Sep 2019 remaining between Rs 492-499bn (0.3% of NDTL) on 26th and 27th Jul. RBI's conduct of 3-day variable day repo auction of Rs 500bn (last conducted on 21 Jan 2022) was also to support the liquidity in the system. The sudden reduction in liquidity surplus was on account of higher credit demand, RBI's forex intervention and seasonal upshot of government's cash balance (Rs +5tn against +Rs 3tn seen in the previous fortnight).

Going forward in the next fortnight, we expect India's 10Y yield will trade in the range of 7.35-7.45%, with upside risks on account of withdrawal of liquidity. All eyes will be on RBI's policy and its forward guidance. We expect a 25bps rate hike against market consensus of 35-50bps. Even CPI print scheduled next week will also impact bond yield trajectory. We expect some softening of the print on account of moderation in commodity prices.

Growth concerns led to sharp drop in yields globally:

Sovereign yield movement for the current fortnight ending 29 Jul 2022, was driven by risks of recession as indicated by muted industrial production, 26-month low flash composite PMI reading and rising unemployment benefits for the 3rd straight week in the US. Even in the Eurozone, flash composite PMI print was at its 17-month low. Germany's IFO business climate index dropped to its more than two month low. Most importantly, the latest World Economic Outlook update of IMF also sharply downgraded (compared to Apr) global growth forecast by 40bps and 70bps respectively in CY22 and CY23. The most notable downgrade was observed for AEs led by US (140bps downgrade in growth forecast in CY22). Even for China, growth forecast has been trimmed down by 110bps in CY22. For India, the downgrade was of 80bps with growth estimated to be at 7.4% in FY23 and at 6.1% in FY24.

Domestic 10Y yield traded in the range of 7.31-7.45% in the current fortnight. Sharp moderation was led by a risk off sentiment on account of global growth concerns.

MONSOON UPDATE

01 August 2022

Monsoon and sowing progress

Jahnavi Prabhakar
Economist

South-West monsoon has registered above normal rainfall at 8% (above LPA) till 31 Jul 2022. The actual rainfall for this period has exceeded and moved past the normal range. Out of 36, 7 subdivisions have received deficient rainfall during this period. Sown area of pulses and oilseeds have inched up, however rice sowing remains a concern. Across India, over 39 districts have received deficient rainfall (-66% to-99% below LPA). It is imperative to remain vigilant as the rainfall has not be spatially distributed raising concern about the crop sown in these districts along with crop loan assigned to them. We will be closely monitoring the rainfall distribution in the coming weeks to understand the same.

Monsoon:

For the period 1 Jun 2022 to 31 Jul 2022, South West Monsoon is 8% above LPA compared with last year.

- Amongst 36 sub divisions, 7 of them have been on receiving end of deficient rainfall.
- On further bifurcations there are over 39 districts (Table2) that have received rainfall in the range of -60% to -99% of LPA.
- It is important to note the rainfall has been erratic in the past few weeks and is not well distributed across regions.
- Crops sown in these area remain a cause of concern and a vigil eye need to be kept out in terms of crop loan assigned to these districts.
- Furthermore, we will be closely tracking the rainfall distribution in the remaining two months of South West monsoon.

Kharif sowing

For the week ending 29 Jul 2022, overall kharif sown area has declined by 2.2% compared with last year. Sown area of cotton (5.3%), pulses (2.9%) and oilseeds (0.8%) has improved. However, area sown for rice has declined further by 13.3% and raised uneasiness over the future prospects of rice production. The focus is bound to shift towards monitoring the distribution of rainfall in the coming weeks.

MONTHLY ECONOMIC BUFFET

01 August 2022

Economic Round-up: July 2022

Sonal Badhan
Economist

High frequency indicators (PMIs, consumer/business sentiment index) in US, China and Eurozone are pointing towards slowdown in economic activity. Reduced supply of gas to Europe has further aggravated concerns. This has even led to downgrade of global growth forecasts by the IMF. While so far major central banks (Fed, ECB, BoE) remain on policy tightening spree, it is being anticipated that pace of rate hikes will have to ease in order to stop global economy slipping into recession.

Global growth: With GDP growth faltering in US and China and other high frequency indicators showing signs of stress, risks to slowdown in global growth have increased. In US, jobless claims have picked up to highest since Nov2'21, while consumer confidence and home sales have dipped. In China, following a rebound in economic activity in Jun'22, manufacturing PMI has slipped again in Jul'22. IMF has slashed global growth forecast by 40bps to 3.2% for CY22, stating the "outlook has darkened significantly since Apr'22". ADB has lowered forecasts for South Asia's growth, mainly owing to downward revision in India and Sri Lanka's forecasts. This has re-ignited debates over the future course of policy tightening by major central banks.

Global Central Banks: So far, Fed remains on track to increase policy rates and has delivered another 75bps hike in Jul'22. Even ECB raised rates (50bps) more than expected and at the fastest pace in 11 years. Central Banks of Singapore, Canada and Philippines have also tightened their monetary policies. This week, both BoE and RBI are expected to increase rates. However, deviation in global central bank actions continues, with BoJ and Bank of Russia remaining accommodative.

Key macro data releases: India's core sector registered growth of 12.7% in Jun'22. Even if compared against Jun'19 which was pre-pandemic growth was impressive at 8%. The performance however was not broad-based. While, power and coal were the drivers with growth, steel production, crude oil and gas trailed in terms of growth. Trade deficit expanded to a new historic high of US$ 26.2bn in Jun'22 from US$ 24.3bn in May'22, taking Q1FY23 print to US$ 70.8bn versus US$ 31.4bn in Q1FY22, mainly owing to higher commodity prices. Exports in Q1 were up by 25% while imports rose by 50%.

Headline CPI print for Jun'22 came in at 7% (unchanged from May'22). For Q1FY23, the print stands at 7.3%, against RBI's forecast of 7.5%. Food inflation moderated slightly to 7.7% from 8% in May'22. Core inflation edged down to 5.9% in Jun'22 from 6% in May'22, supported by transport and communication. We believe RBI will hike rates by 25 bps which is contrary to market expectations of 50 bps.

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