FIRST LIGHT

04 October 2022

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Daily macro indicators

Indicator	29-Sep	30-Sep	Chg (%)
US 10Y yield (%)	3.79	3.83	4bps
India 10Y yield (%)	7.34	7.40	6bps
USD/INR	81.85	81.35	0.6
Brent Crude (US$/bbl)	88.5	88.0	(0.6)
Dow	29,226	28,726	(1.7)
Hang Seng	17,166	17,223	0.3
Sensex	56,410	57,427	1.8
India FII (US$ mn)	**28-Sep**	**29-Sep**	**Chg ($ mn)**
FII-D	(45.9)	(97.5)	(51.6)
FII-E	(255.9)	(473.2)	(217.2)

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: Currency Outlook

The last fortnight was marked by sharp volatility in the global markets, with the foreign exchange market being particularly badly hit. The Federal Reserve raised rates further by 75 bps, much in line with expectations. However, the forward guidance was much more hawkish than expected which led to a sharp knee-jerk reaction in the markets. In the currency market, dollar surged to a 20-year high while most global currencies depreciated to multi-year lows. Fallout from UK's expansive fiscal measures provided further negative stimulus to the markets. Even though BoE's announcement to buy gilts helped to calm investors' sentiments. PBOC and BoJ stepped in the market to provide support to their respective currencies. INR too was not immune to the hostile global sentiment and depreciated to a new record low of 81.94/$ on 28 Sep 2022. A combination of adverse global environment along with rising domestic headwinds is likely to keep INR under pressure. It is likely to trade in the range of 81-81.95/$ in the near-term (below the psychological mark of 82).

Click here for the full report.

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India Economics: Bond Market Round-up

Financial tightening continued globally which led to sell-off in the bond market. The sharpest sell-off was seen for UK where expansionary fiscal policy was perceived as a threat to inflation. Fed's projection of 4.6% as the terminal rate for CY23, made investors believe that global rates are bound to rise. On the domestic front as well, RBI frontloaded another 50bps rate hike (total 190bps till date in the current cycle). However, this was much on expected lines, hence India's 10Y yield broadly remained stable, post policy. The main highlight in the domestic bond market in Sep'22, has been the sharper pace of increase in short end yields, whether be it T-bills of all maturity or short tenor government papers. We expect yield curve flattening to continue in the coming days, with short end papers rising at a faster pace than long end papers. This will be on account of liquidity slipping into deficit due to RBI's forex intervention and faster growth in credit.

Click here for the full report.

India Economics: Household Finances

There is considerable euphoria relating to consumption, and the relentlessly high GST collection numbers is a reflection of this phenomenon. But there is also the case of inflation being very high this year driven by various factors. This has tended to push up nominal numbers. For instance, for the first quarter of the year, nominal consumption grew by around 40%, in real terms it was 26%. The difference is the consumption price deflator which accounted for this high increase in nominal terms. This also means that if people are spending more due to inflation, besides the normal pent up demand factor, then savings must be getting affected. This is reflected in the rising current account deficit too which is expected to be in the range of 3-3.5% of GDP this year. In this context, an examination of how household savings have behaved in the last three years will be useful.

Click here for the full report.

India Economics: Monthly Economic Buffet

Major global Central Banks have announced steep policy hikes in Sep'22, and have vowed to remain hawkish as long as inflation levels remains elevated. In addition, weak Q2CY22 GDP prints (US, Germany) and downgraded forecasts for both CY22 (US) and CY23 (US and Eurozone) have further accentuated concerns of slowdown in global growth. OCED now expects global growth to average 2.2% in CY23, down from 2.8% estimated earlier. High frequency data (flash PMIs) are also showing signs of uneven growth in major economies. Inflation trajectory and impact of rate hikes on real economy will be key to watch in the coming months.

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CURRENCY OUTLOOK

03 October 2022

Is 82 the new 80?

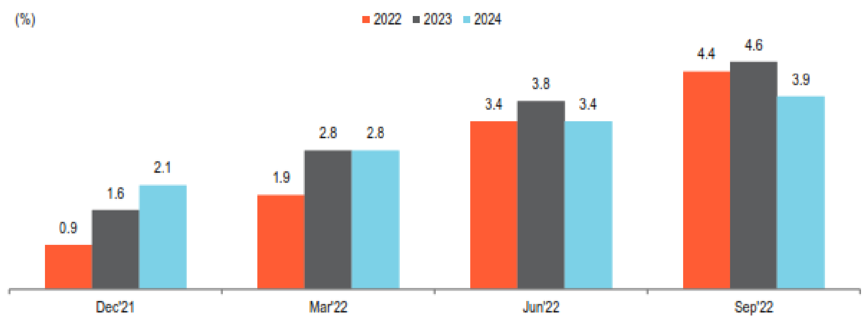
Aditi Gupta
Economist

The last fortnight was marked by sharp volatility in the global markets, with the foreign exchange market being particularly badly hit. The Federal Reserve raised rates further by 75 bps, much in line with expectations. However, the forward guidance was much more hawkish than expected which led to a sharp knee-jerk reaction in the markets. In the currency market, dollar surged to a 20-year high while most global currencies depreciated to multi-year lows. Fallout from UK's expansive fiscal measures provided further negative stimulus to the markets. Even though BoE's announcement to buy gilts helped to calm investors' sentiments. PBOC and BoJ stepped in the market to provide support to their respective currencies. INR too was not immune to the hostile global sentiment and depreciated to a new record low of 81.94/$ on 28 Sep 2022. A combination of adverse global environment along with rising domestic headwinds is likely to keep INR under pressure. It is likely to trade in the range of 81-81.95/$ in the near-term (below the psychological mark of 82).

Currency movement in the last fortnight

Volatility returned to the currency market after the Fed policy meet. All major currencies came under pressure as expectations of more aggressive rate hikes by the Fed spurred demand for the dollar. In the immediate aftermath of the Fed policy, DXY index rose to a 20-year high, registering its largest single day gain in close to 6 years. In the fortnight, DXY index is up by 2.2%.

Figure 1: Fed's economic projections suggest further rate hikes



Source: Federal Reserve, Bank of Baroda

Global currencies fell across the board, with several of them falling to lows last seen during the Asian Financial Crisis in 2008-09. Amongst the worst affected were currencies of New Zealand (NZD), Australia (AUD) and Canada (CAD). In fact, Developed Market (DM) currencies performed worse than Emerging Market (EM) currencies. Notably, GBP fell sharply to a record-low in the last fortnight after the UK government unveiled a new fiscal plan involving sweeping tax cuts, leading to concerns over elevated borrowings and inflation. However, it did consolidate some of the losses as intervention by BoE through gilt buying helped revive sentiments.

BOND MARKET ROUND-UP

03 October 2022

Bond Market Round-up: September 2022

Dipanwita Mazumdar
Economist

Financial tightening continued globally which led to sell-off in the bond market. The sharpest sell-off was seen for UK where expansionary fiscal policy was perceived as a threat to inflation. Fed's projection of 4.6% as the terminal rate for CY23, made investors believe that global rates are bound to rise. On the domestic front as well, RBI frontloaded another 50bps rate hike (total 190bps till date in the current cycle). However, this was much on expected lines, hence India's 10Y yield broadly remained stable, post policy. The main highlight in the domestic bond market in Sep'22, has been the sharper pace of increase in short end yields, whether be it T-bills of all maturity or short tenor government papers. We expect yield curve flattening to continue in the coming days, with short end papers rising at a faster pace than long end papers. This will be on account of liquidity slipping into deficit due to RBI's forex intervention and faster growth in credit.

10Y yield is likely to be broadly stable and is expected to trade in the range of 7.30-7.45% in the current month. Only discomfort might be another above 7% headline CPI print in Sep'22. We expect it to be between 7-7.3%.

Financial conditions tightening continued:

- Global 10Y yields started firming up sharply worldwide. The sell-off spree was the sharpest in the UK market with 10Y yield inching up by 129bps. This was on account of UK's expansionary policies announced at a time when the economy was facing considerable inflationary pressure. Even a bond purchase announcement of US$ 71bn in the next 2 weeks, could hardly comfort yields.

- Sentiments in the bond market also worsened with US materializing a 75bps rate hike in the current policy and indicating a terminal Fed Fund rate projection of 4.6% in CY23. Currently market is pricing in another 75bps rate hike in the next policy of US Fed (CME Fed Watch Tool data). Thus, US 10Y yield rose by 64bps.

- With Germany's inflation touching the highest level in 25-years (10.9%), expectation of 75bps rate hike by ECB crept in. This led its 10Y yield rise by 57bps.

- Even major EMs were not insulated from this financial tightening. Thus, Bloomberg EM bond yield rose by 111bps.

- Sentiments in the domestic market was dampened with reports of delay in India's inclusion in the EM Global Bond Index, on account of procedural issues. Thus, India's 10Y yield rose by 21bps in Sep'22.

HOUSEHOLD FINANCES

03 October 2022

Are we saving less?

Aditi Gupta
Economist

There is considerable euphoria relating to consumption, and the relentlessly high GST collection numbers is a reflection of this phenomenon. But there is also the case of inflation being very high this year driven by various factors. This has tended to push up nominal numbers. For instance, for the first quarter of the year, nominal consumption grew by around 40%, in real terms it was 26%. The difference is the consumption price deflator which accounted for this high increase in nominal terms. This also means that if people are spending more due to inflation, besides the normal pent up demand factor, then savings must be getting affected. This is reflected in the rising current account deficit too which is expected to be in the range of 3-3.5% of GDP this year. In this context, an examination of how household savings have behaved in the last three years will be useful.

Table 1: Structure of household financial savings: FY20-22

	Savings flows (Rs cr)			Shares in total %		
	FY20	FY21	FY22	FY20	FY21	FY22
Financial Assets	**24,07,250**	**31,61,953**	**25,60,478**	**100.0**	**100.0**	**100.0**
Per cent of GDP	12.0	16.0	10.8			
of which:						
1. Total Deposits (a+b)	***8,84,579***	***12,59,767***	***6,95,471***	***36.7***	***39.8***	***27.2***
(a) Bank Deposits	8,27,830	12,19,909	6,53,911	34.4	38.6	25.5
i. Commercial Banks	7,68,855	11,56,334	6,51,733	31.9	36.6	25.5
ii. Co-operative Banks	58,975	63,576	2,178	2.4	2.0	0.1
(b) Non-Bank Deposits	56,749	39,858	41,561	2.4	1.3	1.6
2. Life Insurance Funds	*3,74,170*	*5,63,216*	*4,40,810*	*15.5*	*17.8*	*17.2*
3. Provident and Pension Funds (including PPF)	***5,00,203***	***5,46,700***	***5,81,668***	***20.8***	***17.3***	***22.7***
4. Currency	***2,82,662***	***3,81,976***	***2,69,667***	***11.7***	***12.1***	***10.5***
5. Investments	***97,657***	***1,24,577***	***2,27,977***	***4.1***	***3.9***	***8.9***
of which:				0.0	0.0	0.0
(a) Mutual Funds	61,686	64,084	1,60,600	2.6	2.0	6.3
(b) Equity	26,738	38,531	48,613	1.1	1.2	1.9
6. Small Savings (excluding PPF)	***2,63,723***	***2,81,495***	***3,40,655***	***11.0***	***8.9***	***13.3***

Source: RBI

The storyline here is interesting. First, overall savings of households increased by 31.3% in FY21 which was mainly due to the lockdown which inhibited consumption for several months. Therefore, households perforce diverted income to savings. Subsequently, with normalcy on course in FY22 even though there were lockdowns of diluted variety due to the delta wave, savings fell by 19%. However, if FY22 is compared with pre-covid FY20, the increase in savings is just 6.3% over 2 years. Therefore financial savings have underperformed in the last 2 years. This can be seen from the fact that financial assets as % of GDP was lower at 10.8% in FY22 compared with 12% in FY20.

MONTHLY ECONOMIC BUFFET

03 October 2022

Economic Round-up: September 2022

Sonal Badhan
Economist

Major global Central Banks have announced steep policy hikes in Sep'22, and have vowed to remain hawkish as long as inflation levels remains elevated. In addition, weak Q2CY22 GDP prints (US, Germany) and downgraded forecasts for both CY22 (US) and CY23 (US and Eurozone) have further accentuated concerns of slowdown in global growth. OCED now expects global growth to average 2.2% in CY23, down from 2.8% estimated earlier. High frequency data (flash PMIs) are also showing signs of uneven growth in major economies. Inflation trajectory and impact of rate hikes on real economy will be key to watch in the coming months.

Global growth: As shown by flash PMIs for Sep'22, both manufacturing and services activity in Europe signals further downturn in economic activity. In UK, services activity remains under acute stress while pace of contraction in manufacturing activity seems to be easing. However in case of US, both manufacturing and services activity has shown signs of revival, although services PMI still remains in contractions. Both US Fed (for CY22 and CY23) and ECB (for CY23) have downwardly revised their growth forecasts. This reflects the estimated impact of tight monetary conditions on real economy. In case of Eurozone, energy crisis and stubborn inflation will shave off growth prospects next year. German economy is expected to witness the impact from Q3CY22 onwards. Uneven recovery in China (falling property prices, industrial profits, divergent trends in official and non-official manufacturing PMIs) also poses threat to global growth.

Global Central Banks: In Sep'22 major global Central Banks delivered steep rate hikes, with US Fed increasing rates by 75bps and BoE by 50bps. Stubborn inflationary trends have forced central banks to maintain hawkish stance. They have acknowledged its possible impact on economic activity by downgrading their growth forecasts. This has refuelled recessionary fears, thus tanking equity, currency and debt markets. Major equity indices such as Dow Jones (-4.8%), FTSE (-4.8%), S&P (-5.4%), Nikkei (-5%) and Sensex (-3.4%) have fallen sharply since Fed's policy. DXY is up by 1.3%, and US 10Y has risen by 30bps. India's RBI too increase policy rate by 50bps. However PBOC and BoJ still remain accommodative.

Key macro data releases: India's fiscal situation remains steady so far till Aug'22. Centre's fiscal deficit (% of GDP, 12MMA basis) is at 6.4% as Aug'22. Concerns regarding deficit levels had emerged as government announced extension of PM-GKAY scheme till Dec'22 and 4% increase in central government employees' DA allowance. Laggard disinvestment receipts are another concern. However, with buoyant revenue receipts, and higher than estimated nominal GDP, it is expected that slippage in fiscal deficit will be almost negligible. On the industrial production side, core sector has registered progressively a slowdown in growth rate for the third successive month to 3.3% in Aug'22, partly due to base effect (12.2% growth last year.).

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Note: Recommendation structure changed with effect from 21 June 2021

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