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03 March 2023

RESEARCH

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Fortnightly review

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Economic Round-up: February 2023

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A rising tide…

SUMMARY

INDIA ECONOMICS: BONDS WRAP

Global bond yields rose sharply following expectation of a higher terminal Fed Fund rate. Market is now pricing it at 5.5% against earlier expectation of 5%, as visible in the money market rates. India's 10Y yield has also reflected global yield movements to an extent. However, underlying domestic macros such as elevated inflation pressure and tighter liquidity conditions have also contributed towards the same. Interestingly, the correction in short term papers which was seen in the past month, was reversed. Feb'23 witnessed an increase in yield of short-term papers with cut off rising sharply. This was visible in considerable flattening of the yield curve.

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INDIA ECONOMICS: MONTHLY ECONOMIC BUFFET

Recent economic data points from US and other major economies are showing that global growth remains steady so far. While in China economic activity (PMIs, home sales, travel) has rebounded sharply post the reopening of the economy, in the US, labour market strength is supporting domestic demand. Retail sales, services activity and even production activity remains on solid ground. In Europe however, economic momentum seems to have weakened again in Feb'23 (PMIs) after showing improvement in Jan'23. Globally, lower commodity prices are translating into lower input costs which in turn is helping in cooling inflation down. However, the pace of moderation is weaker in US than earlier anticipated. Core inflation also remains sticky in both US and Europe. This is likely to put pressure on central banks to keep rates elevated for long.

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Daily macro indicators

Ticker	28-Feb	01-Mar	Chg (%)
US 10Y yield (%)	3.92	3.99	7bps
India 10Y yield (%)	7.46	7.42	(4bps)
USD/INR	82.67	82.51	0.2
Brent Crude (US$/bbl)	83.9	84.3	0.5
Dow	32,657	32,662	0.0
Hang Seng	19,786	20,620	4.2
Sensex	58,962	59,411	0.8
India FII (US$ mn)	**27-Feb**	**28-Feb**	**Chg ($ mn)**
FII-D	(7.2)	(2.3)	4.9
FII-E	(196.4)	(561.5)	(365.1)

Source: Bank of Baroda Economics Research

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CAPITAL GOODS

- Buoyant commentary from global capital goods players is likely to rub off on Indian companies via potentially higher sourcing
- Supply chain situation and government stimulus are key variables being closely tracked by global companies
- We remain positive on India's capital goods sector amid a capex-heavy domestic budget and global optimism; prefer LT, SIEM and AIAE

Click here for the full report.

BONDS WRAP

01 March 2023

Fortnightly review

Dipanwita Mazumdar
Economist

Global bond yields rose sharply following expectation of a higher terminal Fed Fund rate. Market is now pricing it at 5.5% against earlier expectation of 5%, as visible in the money market rates. India's 10Y yield has also reflected global yield movements to an extent. However, underlying domestic macros such as elevated inflation pressure and tighter liquidity conditions have also contributed towards the same. Interestingly, the correction in short term papers which was seen in the past month, was reversed. Feb'23 witnessed an increase in yield of short term papers with cut off rising sharply. This was visible in considerable flattening of the yield curve.

The gap between 15Year and 6months paper fell sharply to 27bps in Feb'23 against 60bps in Jan'23. The 2-month OIS curve of India is now at 6.75%, going by that logic another 25bps rate hike by RBI might be translated. Adding to this, has been the liquidity situation which went into deficit on an average basis in Feb'23. Durable liquidity fell sharply, so did government cash balances, due to month end spending to meet the budgeted level. Going forward pressure on liquidity would aggravate with maturity of LTROs and TLTROs and possible increase in spending by States. All these would put pressure on India's 10Y yield in the near term which is expected to trade in the range of 7.4-7.5% in the next 30-days.

Global yields inched up in Feb'23

- Sovereign 10Y yields rose significantly globally, in Feb'23, following slew of economic data releases in the US which pointed towards 'soft landing' of the economy. These range from better services activity and home sales, core capital goods orders and personal spending data. Most importantly, core PCE data which is the Fed's official inflation indicator rose more than anticipated. Even payroll data showed tighter labour market conditions. Money market is now pricing terminal rate of ~5.5%, which translates to another 75bps rate hike by Fed in the current cycle.
- Fed minutes highlighted that FOMC members are comfortable keeping Fed fund rate in the restrictive territory. Fed officials such James Bullard, Loretta Mester and Philip Jefferson hinted at faster pace of rate hike to control inflation.
- This was reflected in the direction of US 10Y yield which rose by 41bps in Feb'23, on MoM basis compared to 37bps decline seen in Jan'23. Yield in other major economies followed suit. ECB officials also hinted at raising rates beyond Mar'23 as well, to bring inflation to the targeted level. Market is now pricing 4% terminal rate for the region, post the hot inflation print in France and Spain. Germany's 10Y yield firmed up by 37bps in Feb'23, on MoM basis.

MONTHLY ECONOMIC BUFFET

02 March 2023

Economic Round-up: February 2023

Sonal Badhan
Economist

Recent economic data points from US and other major economies are showing that global growth remains steady so far. While in China economic activity (PMIs, home sales, travel) has rebounded sharply post the reopening of the economy, in the US, labour market strength is supporting domestic demand. Retail sales, services activity and even production activity remains on solid ground. In Europe however, economic momentum seems to have weakened again in Feb'23 (PMIs) after showing improvement in Jan'23. Globally, lower commodity prices are translating into lower input costs which in turn is helping in cooling inflation down. However, the pace of moderation is weaker in US than earlier anticipated. Core inflation also remains sticky in both US and Europe. This is likely to put pressure on central banks to keep rates elevated for long.

Global growth: While economic activity is improving in the US (barring real estate) and China, weakness is re-emerging in Europe. Domestic demand in China (services activity and home sales) got a boost from festive demand and reopening of the economy, which in turn will also provide a boost to other Asian manufacturing hubs (Taiwan, Korea, Thailand). In the US, labour market remains tight, retail sales are higher and services activity is solid footing. Manufacturing is gradually improving, while real estate sector continues to reel under the pressure of high interest rates. Manufacturing activity in Europe on the other hand is under stress owing to weak demand leading to drop in new orders. However, overall the outlook for global is still brighter than earlier anticipated. Although, effects of elevated interest rates on profit margins of firms will have to be keenly watched.

Global Central Banks: While in the last Fed meeting (Jan-Feb'23) it was believed that the central bank will pause soon, it is now almost certain that Fed will hike rates at least twice (March and May) before taking a decision to pause. Resilience in private consumption demand, tight labour market, and uptick in PCE index, are driving this expectation. Even BoE was expected to pause, but now looking at the strength of domestic economy (GDP, manufacturing, tax receipts) it will too raise rate by 25bps in its next 2 meetings. ECB has maintained its hawkish tone and considering stickiness in core CPI, it is also expected to raise key policy rates by 50bps in its next meeting. Central Bank of China is expected to maintain loose monetary policy for now, however if reopening builds up inflationary pressure then it may too consider tightening. BoJ has reiterated its stance to maintain ultra-loose policy for now, although it is expected to raise the yield cap targets in Mar'23.

Key macro data releases: Data on the fiscal state of the government till Jan'23 shows, fiscal deficit has reached 67.8 % (58.9% in FYTD22). Capex remains the bright spot. On the income side, net revenue rose as indirect tax collections picked up pace, supported by GST and custom duties. Direct tax collections continue to moderate.

On the industrial production side, core sector growth in Jan'23 accelerated by 7.8% (4-month high) against an increase of 7% in Dec'22. There has been broad based improvement across the sectors with fertilizers and electricity output clocking double digit growth.

CAPITAL GOODS

02 March 2023

A rising tide…

- **Buoyant commentary from global capital goods players is likely to rub off on Indian companies via potentially higher sourcing**
- **Supply chain situation and government stimulus are key variables being closely tracked by global companies**
- **We remain positive on India's capital goods sector amid a capex-heavy domestic budget and global optimism; prefer LT, SIEM and AIAE**

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Global players upbeat: Global capital goods companies across the board exhibited optimism about growth and profitability in their December quarter commentary, citing the normalisation of ordering patterns as a positive factor along with the expected abatement of inflation in the latter half of H2CY23. This is reflected in the healthy growth guidance of multinationals Honeywell/Cummins/ABB/Siemens at 2-5%/ 12-17%/5%+/7-10% for the forthcoming year. Additionally, supply chain constraints appear to be easing, with Honeywell noting that the semiconductor industry is exhibiting significant improvement and expected to return to normal by CY23-end.

Positive readthrough for most Indian companies: Honeywell Inc's positive outlook on the normalisation of semiconductor supply suggests favourable prospects for the capital goods industry as a whole. Additionally, Siemens AG's upward revision of its forecasts for the digital industries and smart infrastructure businesses points to rising demand traction. Similarly, the ABB Group may benefit from increased outsourcing, particularly in software, as a means of optimising costs in India.

Cummins India has, however, cautioned that it is already struggling with component shortages – a predicament that may worsen for the Cummins Group as China opens up. Similarly, Hitachi's India arm is currently facing the impact of chip shortages, although it believes the situation will improve within the next one or two quarters.

Supply chain and economic stimulus key variables: The prevailing uncertainty in China along with the possibility of government intervention remains a primary headwind for most global capital goods majors. However, following the relaxation of strict lockdown measures, economic activity in China is expected to improve, leading to a decline in operational disruptions. This apart, companies are also monitoring potential stimulus measures by governments that may benefit the global economy.

Retain positive sector outlook: We remain positive on the Indian capital goods sector, buoyed by visibility from the government's capex-heavy budget and the likelihood of gradual margin improvement as supply bottlenecks ease. We retain our bullish view on **LT** (BUY, TP Rs 2,440), **SIEM** (BUY, TP Rs 3,800) and **AIAE** (BUY, Rs 3,300).

Recommendation snapshot

Ticker	Price	Target	Rating
ABB IN	3,311	3,220	HOLD
AIAE IN	2,707	3,300	BUY
KECI IN	463	500	HOLD
KKC IN	1,603	1,600	HOLD
LT IN	2,115	2,440	BUY
POWERIND IN	3,320	3,500	BUY
SIEM IN	3,257	3,800	BUY
TMX IN	2,196	2,200	HOLD

Price & Target in Rupees | Price as of 1 Mar 2023

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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