Weekly Macro Perspectives

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L&T Financial Services

Dr. Rupa Rege Nitsure
Group Chief Economist

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L&T Finance holdings Limited
Brindavan, Plot No. 177
C. S. T Road, Kalina, Santacruz (E)
Mumbai - 400 098, India

T +91 22 6212 5343
E rupa.nitsure@ltfs.com

1. Global economic briefs

- As per the government reports, US economy grew significantly faster (@2.9%) in Q4, 2017 on the back of surging consumer spending (that hit a three-year high), higher wholesale business inventories and updated statistical adjustments.
- At Jerome Powell's first meeting as the Fed Chairman (Mar 20-21), the Fed had raised its benchmark overnight lending rate to a range between 1.5% and 1.75% reflecting greater confidence in the economy and also raised the rate path, possibly in the coming meetings.
- Investment strategists are warning that a trade war initiated by President Trump's new tariffs on steel, aluminum & certain other Chinese products would wreak havoc on global supply chains and negatively affect growth, inflation, productivity & real incomes.
- Finance Minister of Japan has cautioned that Japan must avoid entering a free trade agreement (FTA) with the US to rectify trade imbalances. Japan's industrial production rebounded in Feb-18 (to 4.1%) – recovering from a 6.8% decline in Jan-18, driven by higher output of cars, construction equipments & semi conductors. However, risk to the outlook remains in the form of Japanese exports of steel & aluminum that are likely to weaken if Japan fails to win an exemption from US tariffs imposed recently.
- Plans for the European Central Bank (ECB) to halt its bond buying programme have been called into question as new economic data suggest that GDP growth in the EU zone may have peaked. Weaknesses in growth are getting reflected in decelerating corporate credit growth and weak PMI prints for the recent months. The Euro zone's Economic Sentiment Indicator (ESI) also fell in Mar-18.
- After Donald Trump's move, China has reduced taxes for factories, transport firms, builders, telecom operators & farmers from May 1st, as it comes under pressure from tax cuts made by US President Donald Trump. The move comes as the world's major economies (like Japan, the UK) are slashing taxes after the US unveiled tax cuts worth US$1.5 trln in Dec-17.

2. India: Agriculture and rural economic news

- There are indications that India could see a normal monsoon in 2018 even as its weather department – the IMD is still a fortnight away from an official pronouncement. The IMD's recent bulletin on El Nino Southern Oscillation (ENSO) has ruled out possibility of El Nino, at least till Aug, 2018.
- China has reaffirmed its commitment to accelerate the provision of market access for Indian agricultural products, including non-basmati rice, rape-seed meals, soya-meals, pomegranate and pomegranate arils, okra, banana and other fruits and vegetables. It will do so expeditiously as the two countries agreed on a roadmap for addressing the huge imbalance in their bilateral trade.
- India's government is considering a proposal to promote agri start ups with a view to attracting budding entrepreneurs to the farm sector and boost exports. The proposal is part of the Commerce Ministry's draft agriculture export policy on which comments have been invited from all the stakeholders.
- India's government is likely to come up with an agriculture policy in two to three weeks. Additionally, its new strategic think-tank - NITI Aayog held discussions with central & state ministries on incentivising private enterprises to procure farm products at minimum support prices (MSPs) and extending a scheme similar to Madhya Pradesh's Bhavantar Bhugtan Yojana to the rest of the country.

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3. India's overall economic & policy developments

- According to the Nobel laureate and globally acclaimed economist Joseph Stiglitz, "employment and environment are the two big worries for the Indian economy going into the future". While India will continue to grow and become a strong economy, "job creation" will remain a major concern for the nation as it is creating jobs primarily in the urban centres – that are a small fraction of the new entrants into the labour force.
- India's fiscal deficit for Apr-Feb, FY18 soared to Rs 7.15 trln, exceeding the revised target of Rs 5.94 trln for the full year FY18. Total revenue collection stood at Rs 12.83 trln, of which total tax revenue stood at Rs 10.35 trln, non tax revenue at Rs 1.42 trln and non debt capital receipts at Rs 1.05 trln. Total expenditure incurred by the government during the period was over Rs 19.99 trln and of this, Rs 17.02 trln was on revenue account and Rs 2.97 trln was on capital account.
- India's domestic passenger traffic is expected to grow by 18% and international passenger traffic from India by 10% in FY18, according to the rating agency - ICRA. The strong demand has pushed the passenger load factor (PLF) to an all-time high of 86.5% in FY18.
- On March 26th, the RBI announced Indian government's borrowings calendar for H1, FY19 which showed 23% lesser borrowing (at Rs 2.88 trln of G-Sec) as compared to the first half of the previous financial year. This is a sharp deviation from the past practice, as the government generally frontloads nearly 60-65% of it's borrowings requirement to the first half of the financial year. Lesser issuance of bonds will be facilitated by greater dependence on National Small Savings Fund inflows and lesser buybacks. To make the composition more balanced, it is proposed to increase the share of shorter (1-4 yrs) and longer (20+ yrs) duration bonds and to reduce the share of commonly issued bonds of 10-14 yrs of duration. Also, the government plans to launch inflation indexed bonds linked to CPI (retail inflation). This announcement came as a huge positive for the Indian bond market that had witnessed more than an increase of 100 bps in yields since July, 2017.
- As CPI inflation is trending lower at a pace faster than expected; as the recovery in non-agricultural sectors is still weak and skewed and as "investment" rather than "savings" has become a major concern, we expect the RBI to keep all policy rates unchanged (while maintaining a neutral stance) in its first bi-monthly monetary policy review on April 4-5, 2018. We expect it to settle at a more conservative guidance for both growth and CPI inflation in FY19, as cleansing of the balance sheets of banks currently underway may adversely impact the supply of credit and growth. Inflation too may trend lower on account of continued weaknesses in aggregate demand and higher statistical base in H2, FY19.
- With a view to addressing the systemic impact of sharp increase in the yields on Government Securities, the RBI has decided to grant banks the option to spread provisioning for mark to market (MTM) losses on investments held in AFS and HFT for the quarters ended Dec 31, 2017 and Mar 31, 2018. The provisioning for each of these quarters may be spread equally over up to four quarters, commencing with the quarter in which the loss is incurred.
- According to RBI, Indian banks loans and deposits rose at the pace of 11.1% and 6.4% on year respectively, as on Mar 16, 2018. While outstanding loans increased by Rs 309.5 bln to Rs 83.77 trln in the two weeks to Mar 16, aggregate deposits fell by Rs 265.7 bln to Rs 111.61 trln. The average Credit-Deposit ratio marginally improved in the last reported fortnight to 75.06% as on Mar 16 from 74.61% as on Mar 2.
- India's Broad Money Supply, i.e., M3 growth slightly eased to 9.8% (y-o-y), as on Mar 16, 2018 (versus 7.2% a year ago), as mobilization of time deposits dipped in the latest fortnight. Additionally, growth in bank credit to commercial sector too slowed down in the latest reported fortnight.

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E rupa.nitsure@ltfs.com

- India's "foreign exchange reserves" were at the healthy level of $422.53 bln as on Mar 23, 2018. However, the Indian rupee is among the worst performing currencies in Asia this year as FPIs have pulled money out of bonds and inflows into stocks have slowed. The Fed's decision to raise interest rates in its last policy and forecast a steeper path of hikes in 2019 is putting pressure on emerging market currencies like the INR.

4. India's industrial & services sectors scenario

- According to India Infoline research, the Q4, FY18 has seen bulk National Highway Authority of India (NHAI) order flows and considering the tender pipeline, this pace is likely to continue till FY19. Furthermore, road projects from the Ministry of Road Transport and Highways and various states are creating business opportunities for road contractors.
- A disaggregated analysis of industrial performance shows that India's labour-intensive industries are languishing. Both industrial production data and exports performance validate this. Since Q3, FY17 these industries have been under pressure due to various economic & policy events like demonetisation, messy migration to GST, overvaluation of INR in terms of real effective exchange rate and now the shrinkage of trade finance amid the growing instances of bank frauds.
- India's auto components industry (of the size Rs 3,000 billion) sees opportunity in the challenge posed to it by the global shift to electric vehicles (EV), as it's trying hard to make EV parts. Regulatory moves that will increase the penetration of hybrid vehicles in India could offer a path of transition for the parts makers from supplying to internal combustion engine vehicles to EVs. Several companies have already got patents for electric motors and power management systems.

5. Indian money market liquidity

- Money markets were closed on March 29-30 on account of public holidays and are closed today (Apr 2) also for annual closing of accounts by banks.
- With systemic liquidity remaining tight, India's central bank (RBI) conducted a seven-day repo auction on March 28th, along with six-day variable rate repo auction.
- Currently, liquidity deficit in the banking system is estimated at Rs 600 bln.

6. Improved sentiment in G-Sec but uncertainty continues

- The 10-year GOI benchmark yield plunged by 29 bps to 7.33% on Tuesday (Mar 27), recording its largest single day fall since August 2013, as G-Sec traders cheered the steps taken by the government to reduce market borrowings in H1, FY19.
- However, government bonds failed to hold onto the gains, as many felt that the actual increase was overdone given the uncertainty on four counts – the extent to which the RBI will raise FPI limit in gilts; the actual size of borrowings in H2, FY19 given that it's a pre-election year; the extent to which PSBs will participate in G-Sec auctions and the direction of global crude oil prices.
- The benchmark yield ended at 7.40% on March 28th.
- According to G-Sec experts, lingering uncertainty would keep the benchmark yield in a wider range of 7.30-7.50% in the near term.

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7. INR to trade with a depreciation bias

- On the last trading day of the previous week, INR fell sharply due to aggressive dollar purchases by PNB to settle its dues against letters of undertaking maturing by Mar 31st, as per the Cogencis news.
- The INR ended at 65.17 a dollar as against 64.9750 a dollar on the previous day.
- We expect INR to trade with a depreciation bias, going forward due to widening of current account deficit (CAD) for India and normalization of monetary policies in developed countries. Uncertain outlook on crude oil prices has also been weighing on all EM currencies including the INR.
- We expect INR to weaken to 67 to 68 a dollar by end-December, 2018. However, it will be an orderly depreciation, with the support of healthy FX reserves position.

8. Indian equities to witness volatility ahead of monetary policy

- Indian stocks ended the last trading day of the previous week (Mar 28) in the red tracking Asian & European markets, which fell after US markets ended sharply lower on Mar 27 due to a sell off in tech stocks.
- Widening of fiscal deficit for India also weighed on the stock sentiment.
- However, Indian equities surged today by 1%, led by the stocks belonging to auto & pharmaceutical companies.
- Benchmark indices are likely to rise further due to strong vehicle sales reported by the automobile firms. Also, the concession given by the RBI today to banks to spread over the M-to-M losses over up to four quarters may augur well for banking stocks. However, we expect sentiment to turn cautious before the monetary policy announcement on April 5th.

9. Brent crude at $69.63 per bbl today (Apr 2)

- Today, oil prices fell for a third straight day after government data showed that oil inventories grew last week and investors turned their focus from the geopolitical risks that boosted prices last week.
- Brent crude prices fell by 0.89% to $69.63 per barrel on ICE futures Europe.
- The US Energy Information Administration reported today that crude stockpiles increased by 1.6 mln barrels last week. The American Petroleum Institute, an industry group, had released data showing a 5.3 mln-barrel increase in crude supplies for the week ended Mar 23.

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