L&T Financial Services

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1. Global Economic Briefs

- China's central bank has announced that it would cut the reserve requirement ratios for some banks by 50 bps, releasing $108 bln in liquidity, to accelerate the pace debt-for-equity swaps and spur lending to smaller firms. This move was widely anticipated by investors amid concerns over a potential economic drag from a trade dispute with the US.
- The US President has threatened to escalate a trade war with Europe by imposing a 20% tariff on all US imports of EU-assembled cars. This was in reaction to the EU reprisals against the US tariffs on European steel and aluminum. The EU has targeted $3.2 bln in the exports of American goods to the EU.
- According to market experts, the fundamentals of US economy are good and markets are using trade disputes as betting events. According to experts, accelerating inflation is the only threat to US economy at this juncture. The carefully monitored pace of Fed's rate hikes will most probably keep the US growth engine moving along in the months to come.
- The US President's talk of 25% tariffs on cars has Japan's government and automakers scrambling to avoid a potential $21 bln blow, with little diplomatic scope to shift highly globalized production networks to America.
- As per the Reuters news, China told France on June 25th it would buy more of its farm produce, hinted at future Airbus purchases and pledged to work on market access, shoring up its trade ties with Europe amid the increasing danger of a tariff war with the US. Conflicting signals from the Trump administration over proposed restrictions on foreign investment in US technology companies, along with news that recently imposed import tariffs are starting to disrupt supply chains, sent global stock markets tumbling on June 25th.
- Economic calendar for the week ahead includes the final reading of US GDP for Q1, 2018; personal consumption expenditures (PCE) inflation for the US – the Fed's preferred metric for inflation; final reading on British growth data that will decide the likelihood of BOE raising interest rates this year and the first estimate (flash estimate) of Euro zone inflation figures, which are likely to lend support to the ECB's decision not to rush stimulus withdrawal.

2. India: Monsoon, Kharif Sowing & Water Reservoir Scene

- India's weather dept - India Meteorological Department (IMD) has said that south-west monsoon has revived and is making a steady advance towards central and northern parts of the country. Conditions are becoming favourable for pre-monsoon thunderstorm activity over parts of northwest India from 27th June 2018.
- A week-long break in south-west monsoon, after an early start has slowed the progress of kharif (summer crop) sowing in India so far. Except for maize, ragi and sugarcane, the acreages of most kharif crops, so far, are trailing last year's levels.
- An usual seasonal threat to India's food inflation is seen for June-18, as the prices of vegetables across Punjab, Haryana and Pune have escalated sharply over the last one week. This includes vegetables of mass consumption such as tomatoes and onions.
- Live water storage available in 91 critical reservoirs of India as of 21st June 2018 was 29.7 BCM. This is a tad higher than the year-ago level of 29.4 BCM and the 10-year average at this time of the month of 30 BCM. This is at 18% of these reservoirs' total live water storage capacity.

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3. India's Overall Economic & Policy Developments

- The minutes of RBI's last monetary policy revealed that all MPC members had unanimously voted for a 25 bps rate hike in June citing the risks to inflation trajectory from oil prices, increasing inflation expectations & closing of the output gap. At the same time they retained a neutral policy stance to move the policy either way against the backdrop of increased global uncertainties like – rising trade tensions & commodity prices plus domestic uncertainties over progress of monsoon and the exact extent of fiscal slippage in a pre-election year. While it is not explicitly stated in minutes, the RBI's actions will also be driven by what other EM central banks would do, as no central bank would tolerate heightened volatility in the exchange rate. We expect RBI to frontload the rate hikes in FY19.
- The RBI raised the benchmark rate by 25 bps in June 2018 for the first time in four-and-a-half years. However, several MFIs including Fusion have managed to bring down the cost of funds over the past three to four quarters with an improvement in credit quality and operational efficiency.
- India has begun bilateral talks with US to resolve trade disputes. Pricing of medical devices, additional tariffs on Indian steel and aluminium exports and duty cuts for $ 5.6 bln of Indian exports are high on ministry's agenda for the two day meeting that begins on June 26th.
- The gross bad debt ratio of the banking system may touch a two-decade high, with banks under prompt corrective action (PCA) expected to be the worst hit, warned the Financial Stability Report released by the RBI on June 26th.
- According to RBI, Indian banks loans and deposits rose at the pace of 12.7% and 8.4% on year respectively, as on June 8, 2018. While outstanding loans increased by Rs 429 bln to Rs 85.99 trln in the two weeks to June 8, aggregate deposits rose by Rs 514.8 bln to Rs 114.04 trln. The average Credit-Deposit ratio marginally improved in the last reported fortnight to 75.40% as on June 8 from 75.36% as on May 25.
- India's Broad Money Supply, i.e., M3 growth stayed at 10.4% (y-o-y), as on June 8, 2018 (versus 6.9% a year ago), as "currency in circulation with the public" has been growing at a faster pace (29.5%, y-o-y). Bank credit to commercial sector and the net foreign exchange assets of the banking industry have emerged as the primary sources of growth in broad money supply.
- India's "foreign exchange reserves" stood at $410.07 bln as on June 15th. They fell by $3.04 bln in the latest reported week due to a fall in foreign currency assets.

4. India's Industrial & Services Sectors Scenario

- Miners at Karnataka may have to cut prices of iron ore as sales of the raw material from the state have fallen sharply. However, steel prices are likely to firm up in FY19, said the Care Ratings on the back of increasing demand from the user industries like construction & infrastructure, engineering & fabrication and automobiles.
- According to India's interim Finance Minister, the nation will require about $4.5 trln worth of funding over the next decade to create infrastructure.
- The National Infrastructure & Investment Fund (NIIF) is considering to launch a $2 bln long-term fund in India. The new fund will focus on major infrastructure projects and look for partners who are willing to take long-term risks with NIIF. The new fund has already been registered.
- Once the 498-km-long Bilaspur-Manali-Leh railway line becomes operational, it would be the highest in the world overtaking China's Qinghai-Tibet Railway. It is one of the four strategic railway lines being built by the Indian Railways to fortify India's borders with China.

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5. Indian Money Market

- The inter-bank call money rate ended at 6.10% on June 26th - below the RBI's repo rate of 6.25%, as the reversal of fixed rate reverse repo added Rs 121.33 bln to liquidity.
- Currently, liquidity in the banking system is pegged at a deficit of around Rs 680 bln post outflows on account of goods and services tax payments.
- Interest rates on 3-Month CPs for NBFCs are at 7.47-7.52% (down by 93 bps, month-on-month), whereas rates on 1-Yr CPs for NBFCs are at 8.45-8.50% (down by 32 bps, month-on-month).
- However, spreads have remained sticky on long term instruments. For instance the spreads between Corp bond vs gilt yields for 3-yr instruments are at 64 (67 last month); for 5-yr instruments at 50 (47 last month) and 10-yr instruments at 63 (58 last month).

6. Weak Appetite for Indian Government Bonds

- Weak rupee & the rise in oil prices have kept appetite for government bonds weak. The 10-year GOI benchmark yield ended at 7.8286% on June 26th versus 7.8630% a week ago.
- FPIs' holdings of Indian government bonds have reduced by Rs 10.23 bln over the last week. A weak rupee has negatively impacted FPIs' returns on Indian debt, reducing the attractiveness of these investments.
- Market participants are expecting an OMO announcement as that alone would give market participants some relief in an environment of rising crude oil prices and weak currency.

7. INR Exudes a Strong Depreciation Bias

- Indian rupee continues to stay weak at 68.24 per US dollar on June 26th, even as it has marginally appreciated over it's previous week's level when it had crashed to 68.38 amid a very strong dollar index.
- INR has stayed weak on continued concerns over trade war between major world economies and increased demand for dollars from oil importers.
- Various factors are weighing on INR currently like –elevated oil prices, increasing protectionist tendencies in global trade, political chaos in Italy & Spain, domestic political uncertainty created by the upcoming state elections & the national elections in 2019, rising bad debt piles & stresses in financial sector, etc.
- According to noted Forex experts, INR is likely to consolidate between 67.20 and 68.50 in the near term but given the risks, a move towards 69.50 followed by 70.00, even if it is short-lived, cannot be ruled out before the end of the year.

8. Cautious Near-Term Outlook for Indian Equities

- While most of the EM stock markets are down on the back of growing global uncertainties, India is at the middle of the pack.
- Globally, the factors like the Fed raising rates, relatively stronger dollar, sharp increase in oil prices and rising trade tensions have impacted sentiment for EM equities.
- So far as India is concerned, there are concerns about the nation's economic outlook on the back of growing NPA stresses and political uncertainty.

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* While equity investors have become cautious in committing capital aggressively at this point, they are focusing on “cyclicals” from a medium-term perspective.

9. Brent crude at $76.31 per bbl on June 27, 2018

* Brent crude prices rose 2.1% today to $76.31 per barrel after a senior official said Washington expects all countries to cut oil imports from Iran to zero by Nov-18 or risk sanctions.
* Iran exports more than 2 mln barrels a day of oil. President Trump in May-18 withdrew from a nuclear deal with Iran and reimposed sanctions that seek to force companies not to buy any Iranian oil.
* Energy experts said the upward move in oil prices was not driven solely by the Iran news, pointing to expectations for large weekly draw-downs in US oil inventories and a continued shutdown of an important oil-upgrader facility in Canada. That could lead to bigger inventory draw-downs in the weeks to come.

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