L&T Financial Services

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1. Global economic briefs

- Global financial markets took note of the collective message delivered by the world's top central bankers last week that quantitative easing is being put back in the box and interest rates are going up.
- The US data presents a mixed picture. It's consumer spending rose modestly in May-17 and consumer price inflation cooled, pointing to a slower than expected economic expansion. However, it's factory activity rose sharply in Jun-17 to the highest level in almost three years suggesting that economic growth has gained some steam.
- The manufacturing PMI for China grew at the quickest pace in three months in Jun-17 to 51.7, buoyed by strong new orders in a sign of stabilization of growth.
- South Korea's exports to the EU and China rose in Jun-17, but shipments to the US fell, as per its official statistics.
- Manufacturing activity in Asia's tech producing economies (S. Korea, Taiwan, Japan) expanded in Jun-17, helped by growing global demand for electronics products, but headwinds in external markets could mean a moderation in growth in the second half of the year.
- Official data on British consumers showed that they have suffered the longest decline in their spending power since the 1970s, raising questions about whether the Bank of England is likely to raise interest rates any time soon.
- Mergers and acquisitions in Europe rose 45% (y-o-y) to $234 bln in Q2, 2017, as companies bet the region's economies will bounce back, according to Thomson Reuters data released last week. However, global M&A dropped 12% to $771 bln on the back of a 36% drop in the US M&A activity to $281 bln. A fall in the US deals is primarily attributed to the "uncertainty" created by the President Trump's tax reform & deregulation agenda.
- Australia's central bank stuck to a neutral stance on the economy and interest rates today, a marked divergence from some of its peers abroad who have recently signalled an intent to tighten monetary policy.

2. India: Agriculture and rural economic news

- Southwest monsoon in India that covers nearly 70% of the nation's rainfall was 6% above normal across the country until July 3rd, since its onset. In cumulative terms, out of 36 meteorological subdivisions, 29 subdivisions have received normal to largely excessive rainfall; six have received deficient rainfall and only one has received largely deficient rainfall.
- The regions that are still deficient in rains are Nagaland, Manipur, West Bengal, Jharkhand, Bihar, Chandigarh and Andaman & Nicobar Islands.
- Total area sown for India's summer (kharif) crops touched 22.2 mln ha by 30 June 2017, as per reports received from various states. This was 18.9% higher compared to the same period last year. On a y-o-y basis, area sown under cotton rose by 141.7% to 4.6 mln ha while area sown for pulses rose by 44.2% to 1.9 mln ha. On the other hand, area under oilseeds fell by 8.6% to 2.6 mln ha by 30 June 2017.

3. India's overall economic & policy developments

- India witnessed the launch of its biggest tax reform – GST (Goods & Service Tax) since its Independence at 12 am on July 1. The nation has replaced its numerous federal & state taxes with the GST, designed to unify the country into a single market. Under the new system, goods and services will be taxed under four basic rates -

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5%, 12% 18% and 28%. Some items like vegetables and milk have been exempted from GST, but will still be subject to existing taxes.

- India's Seventh Pay Commission's recommendations on allowances were approved by its Union Cabinet last week with 34 modifications. The revised allowances were effective from July 1st and on the fiscal front may cost the Centre 0.1% of GDP – more than budgeted in FY18.
- At end-Mar 2017, India's external debt witnessed a decline of 2.7% (y-o-y), primarily on account of a decline in Non-resident Indian deposits and commercial borrowings. The decline in the magnitude of external debt was partly due to valuation loss resulting from the depreciation of the US dollar vis-à-vis the Indian rupee. The external debt to GDP ratio stood at 20.2% as at end-Mar 2017 versus 23.5% at end-Mar 2016.
- Indian central government's gross fiscal deficit touched 68.3% of its budgeted target for FY18 in the first two months of the fiscal year itself, as both revenue and capital expenditure grew at the robust pace of 53.5% and 58.1% respectively, while net tax collection grew by 36.4%. Furthermore, non-tax revenue and non-debt capital receipts posted a y-o-y decline in the first two months of FY18.
- India's retail price inflation for industrial workers fell to 1.1% in May-17 from 2.2% in April on the back of a sharp fall in food inflation. Food group recorded deflation of 1.6% as compared to inflation of 0.7% in the previous month.
- According to the RBI's latest Financial Stability report released on June 30th, India's financial system remains stable, even though the banking sector continues to face significant challenges. While the global growth outlook and market sentiments have improved, political stability on the domestic front has further reinforced expectations of accelerated reforms, overall positive business sentiment and macroeconomic stability.
- According to RBI, Indian banks loans and deposits rose at the pace of 6.0% and 11.2% on year respectively, as on June 9, 2017. While outstanding loans rose by Rs 597.2 bln to Rs 76.58 trln in the two weeks to Jun 9, aggregate deposits increased by Rs 240.6 bln to Rs 105.78 trln. The Credit-Deposit ratio stood at 72.40% as on June 9 versus 72% as on May 26.
- India's Broad Money Supply, i.e., M3 growth stood at a lower 7.4 % (y-o-y), as on June 9, 2017 (versus 10.1% a year ago) primarily led by lesser currency in circulation with public (-13.8%, y-o-y).
- India's foreign exchange reserves touched their record high of $382.53 bln in the week to June 23, mainly backed by the rise in foreign currency assets, according to the RBI. Forex kitty increased by $576.4 mln this week- over & above the previous week's increase of $799 mln to $381.96 bln.

4. India's industrial & services sectors scenario

- India's policy think-tank -Niti Aayog has suggested that the nation should rethink its high coal output target against the backdrop of its sluggish power demand. The demand for coal-based power should be carefully assessed so that the over $ 1 bln annual investment being made by CIL (Coal India Ltd) in raising its production capability is not left stranded.
- Indian industry borrowed $1.05 bln from foreign markets in May-17, including through rupee denominated bonds.
- The index of eight core industries rose by 3.6% in May-17 versus 2.8% in the preceding month. Barring fertilisers and coal production, the other six sectors posted a rise in production. However, steel production slowed down to 3.7% in May, lower than the 9.3% in April.
- India's manufacturing PMI declined for a consecutive month to 50.9 in Jun-17 from 51.6 in May, led by a moderation in domestic new orders and production ahead of GST implementation. However, export orders were seen rising sharply. The input price index rose at its slowest pace in ten months, while the output price

index edged up. The average manufacturing PMI edged up to 51.7 in Q1, FY18 from 51.2 in Q4, FY17, showing some pick-up.

5. Indian money market review last week

- India's weighted average call money rate (WACR) averaged at 6.00% last week (Jun 26-30) versus 6.09% in the week earlier (Jun 19-23) on surplus systemic liquidity. Reversal of earlier held reverse repos has been aiding the systemic liquidity.
- While 91-day T-bill rate moved in the band of 6.28% to 6.29% during last week; 364-day T-bill rate hovered between 6.36% & 6.38%. On an average, yields on 91-D TB increased by two bps while those on 364-D TB remained unchanged.
- Three-month CP rate hovered in the band of 6.69% to 6.70% last week, signaling a marginal easing by two bps in a week's time.
- Currently, liquidity surplus in the banking system is pegged at Rs 2.75 trln.

6. Signs of consolidation seen in the G-Sec market

- India's new sovereign benchmark bond (6.79% 2027) yield hardened by five basis points last week (Jun 26-30) and closed at 6.51% on the back of fresh supply of bonds & higher US yields.
- Yield on 10-year G-Sec jumped 11 bps yesterday, after the RBI announced late on Friday (June 30) that it will sell Rs 100 bln worth of government bonds (OMOs) on July 6th to suck excess liquidity. Higher levels of US treasury yields & crude prices are also weighing on sentiment.
- According to observers, a sharp rise in the US yields has prompted RBI to make this move so that interest-rate-parity is maintained between the US yields & local yields.
- The G-Sec traders take OMOs negatively as it means liquidity will be drained out permanently plus there will be additional supply to deal with. But given that the next CPI print is expected to be very benign, government bonds may consolidate at prevailing levels. Traders will wait for the next CPI print before building fresh positions.

7. Increased vulnerability in INR

- INR further depreciated by 0.10% last week (Jun 26-30) to 64.58 per USD amid fresh withdrawal of funds by FPIs. According to FX experts, currency traders also preferred to stay on sidelines ahead of the GST rollout from July 1st.
- INR closed at a 3-month low of 64.86 to the dollar yesterday, around 0.5% weaker than its previous close, tracking losses in other Asian and emerging market currencies. The weakness was primarily due to strength in the US dollar on account of US President Donald Trump's talk with his Chinese and Japanese counterparts about North Korea's nuclear plan.
- Like other Asian currencies, Indian currency is increasingly becoming vulnerable to a spike in US yields and the global risk sentiment.

8. Increased uncertainty in Indian stock markets

- Last week, a "tightening warning" by global central banks sent global markets down. This set a sell-off in most major global markets in anticipation of increase in interest rates. A sharp increase in crude oil prices also spooked financial markets.
- Indian stocks too ended lower by 0.7% last week dragged down by banking, capital goods, auto, oil & gas and the realty sectors.
- However, Indian equities traded with significant gains yesterday (July 3), following the launch of India's biggest indirect tax reform – the GST – at the start of July 1st. Investors' sentiments were also buoyed by positive global cues and healthy buying in FMCG, automobile and consumer durables stocks.
- Indian stocks are facing too much uncertainty at this juncture. Moreover, yesterday's stock rally was not supported by FPIs. Going forward, more clarity on the GST impact & global cues would set local markets' trajectory.

9. Brent crude at $49.68 per bbl on July 3, 2017

- Global Brent prices rose more than 2% yesterday (July 3) – their longest stretch of daily gains in more than five years after data pointed to diminished US output.
- After 23 straight weeks of increased rigs, drilling activity for new oil production in the US fell for the first time since January, dropping by two rigs, while US government data showed crude output fell in April for the first time this year.
- According to a note by ANZ bank, the dips in US production and drilling were "a small but significant shift in the dynamics in the oil market" and that this would take some pressure off OPEC's struggling efforts to rein in oversupply.

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