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FED MID CYCLE RATE ADJUSTMENT NOW A FULL CYCLE ADJUSTMENT GLOBALLY: RBI COULD EASE BY 50-75 BPS IN CURRENT CYCLE, INCLUDING 07 AUG'19, BUT RBI CAUGHT IN A BIND WITH RUPEE FALL

Issue No. 29, FY20
Date: 05 August 2019

The month of August has always thrown up "***unpleasant arithmetic***" for markets and August 19 might just follow such a trend. Not long, after the US Fed announced a 25 basis point rate cut and had termed it as a mid cycle rate adjustment, US President declared that almost the entire exports from China to USA will be now subjected to tariff (20% of Chinese exports go to USA). PBoC has perhaps responded by allowing its currency to depreciate beyond 7 per USD. This will push rupee down. Meanwhile, the US move completely roiled the markets affecting oil prices (declined by $5 per barrel in one day), commodity price index (down 3.2% in one day), global equity markets (US included) and US 10 year yields (below 2% declining by 16 bps in two days). We now believe that the apparent short cycle of monetary policy normalization could very well turn into a uniform rate easing cycle across emerging economies global central banks. **Surprisingly, 2019 seems to be worse than 2008 with external strife of trade wars now getting integrated with domestic growth weakness in emerging economies**. In fact, even 2008 has witnessed a non synchronized rate cutting in contrast to current synchronized actions! With Mexico and Thailand possibly reducing the rates later this month, only two countries will now be left out of the cutting bandwagon.

Back home, we are now expecting the GDP growth to slowdown even further from 5.8% in Q4 of FY19 to 5.6% in Q1 FY20. Our Composite Leading Indicator (CLI) which is a basket of 33 major leading indicators is showing a flattening trend in Q1FY20. The percentage of indicators showing acceleration has now come down from 45% in Q4 of FY20 to a mere 26% in June. Market sentiments are also weak, with Rs 15 lakh crore decline in market capitalization since July. In the current FY so far (upto 19 Jul'19), the ASCBs credit on YoY is at 12.1% compared to last year growth of 12.4%. However, on a q-o-q basis, corporate advances across banks show a muted to negative growth. Retail advances remain positive, though a persistent demand slowdown is already pulling back things (as clearly evident in June).

The bond markets are giving off signs of heightened uncertainty. The spread between Indian 10 Yr and 1 Yr papers has been narrowing considerably this fiscal. This is indicative of weakening sentiments and an impending slowdown. On the other hand, the spread between the 30 Yr paper and 10 yr paper has widened till Jul'19. The corporate bond spread has widened across maturities. Q1 FY20 indirect tax collections have registered de-growth. While expenditure growth has been largely contained, capital expenditure seems to be the casualty. Such a cutback will surely act as growth dampener. Rainfall, though has picked up significant pace, its spatial distribution is a matter of serious concern, with cereal, potato, onion and oilseed growing states bearing the brunt. However there is now a nascent consensus building-up that recent surge in rainfall might give a face lift to rural demand.

Against this global and domestic economic backdrop **we now believe that RBI should cut repo rate by 25 bps in the 07 Aug policy and further reduce it by 50-75 bps to achieve the level of <= 5% by Mar'20**. We however foresee significant volatility in g-sec yields that **could first rise precipitously** (even 6.5-6.6% is not ruled out) and **then decline precipitously** (below 6%), reflecting global headwinds . Banks will cut deposit rates further and lending rates will witness a faster incremental fall in coming months. **This could aid recovery, but it is unlikely before late Q3FY20**. A delayed festive season this fiscal is not going to help either! In our sense a sector specific policy intervention is now a must. Finally, we must find a genuine solution to the long delays at NCLTs!

- The upcoming monetary policy is happening at a crucial time. US has already imposed tariffs on $250 billion worth of Chinese products and has recently announced that an extra $300 billion worth of exports will be taxed at 10%. China has also imposed tariffs on US products worth $110 billion. This fresh announcement by US President makes global trade prospects grim.
- Even Indian economy is facing its own set of problems including automobile sector slowdown, NBFC issues, deficit monsoon so far, flagging tax collections and overall weak market sentiments.

GLOBAL MONETARY EASING AMIDST GLOBAL SLOW

- US Fed has cut the interest rates by 0.25% and given an indication for more rate cuts in the coming months with the caveat that the present rate cut is a mid cycle adjustment given the macroeconomic and financial conditions. Nevertheless with US targeting China again through tariffs, monetary policy normalization could now be extended across economies. The impact of the Fed rate cut on financial & commodity markets has been mixed. Oil prices have nosedived, equity across countries have moved sideways & US 10Y yield is now firmly anchored below 2%. The reaction of other central banks has been mostly unequivocal in cutting.
- Currently, all the major emerging market economies are easing their monetary policy. Thailand & Mexico are the only exceptions who increased their respective key policy rates by 25 bps in Dec'18.
- Even these two countries are expected to cut rates in the upcoming policy later this month, given that Thailand is facing the worst drought and even Mexico is expected to follow the US.
- We now believe that the apparent short cycle of monetary policy normalization could very well turn into an uniform rate easing cycle across emerging economies global central banks, in contrast to 2008, when the easing cycle did witness an non synchronized rate cutting.

Monetary Policy Rate of Select Economies

	Current			2008		Exited in
	Key Policy Rate (%)	Direction of last change	Time of last change	Key Policy rate (%)	Easing or tightening	
India	5.75	Reduce	Jun'19 (25 bps decline)	6.0 to 5.0	Easing	Mar'10
Indonesia	5.75	Reduce	Jul'19 (25 bps decline)	8.0 to 9.25	Tightening	Easing in 2009 to 6.5
Malaysia	3	Reduce	Apr'19 (25 bps decline)	3.5 to 3.25	Easing	Mar'10
Australia	1	Reduce	Jul'19 (25 bps decline)	7.25 to 4.25	Easing	Oct'09
Chile	2.5	Reduce	Jun'19 (25 bps decline)	6.25 to 8.25	Tightening	Easing in 2009 to 0.5
New Zealand	1.5	Reduce	May'19 (25 bps decline)	8.25 to 5.0	Easing	Jun'10
South Korea	1.5	Reduce	Jul'19 (25 bps decline)	5.0 to 3.0	Easing	Jul'10
South Africa	6.5	Reduce	Jul'19 (25 bps decline)	constant 5.25	-	Easing in 2009 to 7.5
Sri Lanka	7.5	Reduce	May'19 (50 bps decline)	11 to 11.5	Tightening	Jan'14
USA	2.00-2.25	Reduce	Jul'19 (25 bps decline)	4.25 to (0.00 - 0.25)	Easing	Dec'15
Thailand	1.75	Increase	Dec'18 (25 bps hike)	3.25 to 2.75	Easing	Jul'10
Mexico	8.25	Increase	Dec'18 (25 bps hike)	7.5 to 8.25	Tightening	Easing in 2009 to 4.5
Canada	1.75	Increase	Oct'18 (25 bps hike)	4.25 to 1.5	Easing	Jun'10
UK	0.75	Increase	Aug'18 (25 bps hike)	5.5 to 2	Easing	Nov'17
Colombia	4.25	Reduce	Apr'18 (25 bps decline)	9.5 to 10 to 9.5	Tightening in 2008, rate cut in Dec'18	Easing in 2009 to 1.26
Brazil	6.5	Reduce	Mar'18 (25 bps decline)	11.25-13.75	Tightening	Easing in 2009 to 8.75
Peru	2.75	Reduce	Mar'18 (25 bps decline)	5.25 to 6.5	Tightening	Easing in 2009 to 3.5
China	4.35	Reduce	Oct'15 (25 bps decline)	7.47 to 5.31	Easing	Oct'10
Eurozone	0	Reduce	Mar'16 (5bps decline)	4.25 to 2.5	Easing	Continuing
Japan	-0.1	Reduce	Jan'16 (10 bps decline)	0.3 to 0.1	Easing	Jan'16

Source: SBI Research, Bloomberg

- Looking at 2008, except for certain countries including Latin American countries (Brazil, Chile, Mexico, Colombia, Peru) and Asian countries (Indonesia and Sri Lanka) - all of which eased towards the end-2018 or later in 2009 - all adopted easy monetary policy.
- However, if we look at exit it remained unsynchronized with some countries reversing their stance as early as Oct'2009 (Australia) and others even continuing their easy policy even now (Eurozone). Others also adopted hawkish stance sometime in 2010. However, the USA exited in Dec'15 following which even Japan (Jan'16) and UK (Nov'17) did.
- Thus comparing with 2008, there are larger number of countries opting for rate cuts this time. There were around 7 major countries which increased their rates in 2008 and now after Mexico and Thailand reducing the rates, only two countries, UK and Canada, will be left which have raised the rates this time.

DOMESTIC ECONOMIC GROWTH

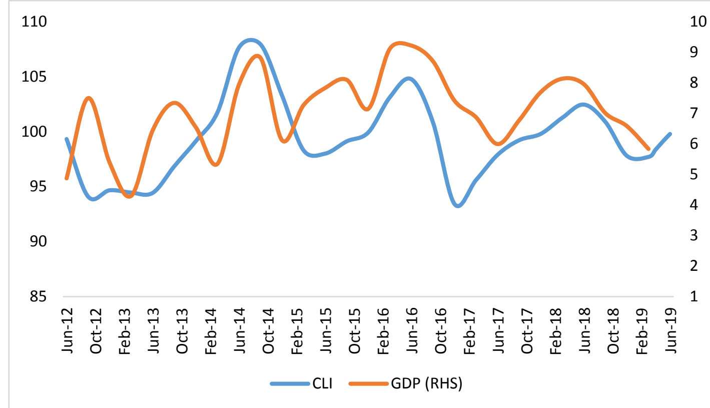
- Our Composite Leading Indicator (CLI) which is a basket of 33 major leading indicators is showing a flattening trend in Q1FY20. The percentage of indicators showing acceleration has comedown from 45% in Q4 of FY20 to 26% in June.
- We are expecting the GDP growth to slowdown further from 5.8% in Q4 of FY19 to 5.6% in Q1 FY20 on account of low automobile sales, deceleration in air traffic movements, flattening of core sector growth and declining Government capex.
- Considering the present macro environment, it will be difficult to achieve the 7% growth target in this fiscal. Our primary estimate suggests that GDP growth will be closer to 6.5% in FY20 which we may be revise further subject to the final estimates of Q1 figures.
- Current slowdown in Automobile sector is both a structural and a cyclical issue. Such a decline is mainly due to decline in lending by NBFCs, subdued rural demand, increase in insurance cost, change in policy on axle norms, increase in used car markets etc., In addition to this, the Government's move to shift to Euro VI (Fuel Emission) norm from Euro IV w.e.f. 2020 has led to consumers postponing there purchase plans and also moving towards usage of share taxis like UBER and OLA.
- Leading indicators suggest moderation in activity in the service sector. Railway freight traffic growth has moderated. Domestic air and railways passenger traffic growth has contracted in May, but turned around modestly in June. Two key indicators of construction activity, viz., cement production and steel consumption, slowed down in June.
- Similarly, Market Capitalization of BSE Listed Companies has also come down significantly in past three months from Rs 154.38 lakh crore in May'19 to Rs 139.87 lakh crore as on 1st Aug'19. Since 5th July to 1st August, the loss in market capitalization is more than Rs 11 lakh crore.

Mapping of Leading Indicators and GDP Growth

Year	Quarter	% of indicators showing acceleration	GDP growth (%)
FY18	Q1	58	6.0
	Q2	70	6.8
	Q3	67	7.7
	Q4	70	8.1
FY19	Q1	70	8.0
	Q2	64	7.0
	Q3	61	6.6
	Q4	45	5.8
FY20	Q1	36	5.6

Source: SBI Research

CLI vis-à-vis GDP



Source: SBI Research

Movements of Leading Indicators in 2019

% YoY	Q1	Apr	May	Jun
Consumption				
Domestic Passenger Vehicle	-2.0	-17.1	-20.5	-17.5
Diesel Consumption	3.5	2.0	2.8	1.4
Telecom Subscribers	0.9	3.1	2.6	-
Consumer credit	16.7	15.7	16.9	16.6
Rural agri wages	5.2	4.8	5.2	-
Domestic Two Wheelers	-8.9	-16.4	-6.7	-11.7
Tractor sales	-4.4	-13.2	-15.7	-13.6
Investment				
Railways Freight Traffic	5.7	1.9	0.6	2.0
Capital goods	-7.0	2.5	0.8	-
Government capex	-62	-34.5	0.2	-34.1
IP: Infrastructure & construction	5.2	7.2	5.5	-
External Sector				
Foreign Tourist Arrivals	1.1	2.9	0.7	5.4
Export value	5.7	0.6	3.9	-9.7
Imports (ex-oil, gold) value	-2.4	-2.2	-1.3	-9.0
Import value	-1.3	4.5	4.3	-9.1
Industry				
IIP	0.7	4.3	3.1	-
Manufcturing PMI	53.5	51.8	52.7	52.1
Corporate (industry) credit	5.9	6.9	6.4	6.4
Coal Output	6.0	3.2	1.9	3.2
Steel output	7.3	19.0	15.3	6.9
Cement Output	11.6	2.3	2.8	-1.5
Electricity Generation	1.4	5.9	7.4	7.3
Services				
PMI Sevices	52.5	51.0	50.2	49.6
LCVs	2.1	-4.9	-7.6	-13.1
MHCVs	-4.9	-17.1	-24.5	-21.5
Railway Passenger Traffic	1.0	0.3	-2.9	0.5
Passenger Traffic: All Airports	3.9	-5.4	-0.7	4.2
Cargo Traffic: All Airports	3.1	-3.2	-4.0	-7.9
Deposits	10.0	9.7	10.1	10.0
Bank Credit	14.2	13.0	12.7	12.0
Other Indicators				
Direct Taxes	17.0	22.9	-33.0	6.9
OECD CLI	100.5	100.5	100.49	-
SBI Composite Index	51.0	55.4	52.8	48.7
% of indicators showing acceleration	**45**	**36**	**36**	**26**

Source: SBI Research; Total Indicators-33

INDIRECT TAX REVENUE A LAGGARD

- Gross tax revenue was Rs 4.00 lakh crore in Q1 FY20, a mere 1.4% yoy growth which is the lowest first quarter growth in the past 6 years. Meanwhile, the total expenditure was Rs 7.21 lakh crore in Q1, a 2% yoy growth. There has been a significant decline in capital expenditure in Q1 (-27% yoy), which is not a good sign for the economy.

DEFICIT MONSOON SO FAR

- Though IMD has predicted normal monsoon for the next two months yet the progress till now is not encouraging (till 31 July) compared to last 5 years as overall rainfall is 9% deficient with most of the foodgrains producing states facing huge deficit like Haryana (-26%), WB (-30%), Gujarat (-27%), etc. Around 45% districts and 14 subdivisions (out of 36) of India are facing deficient rainfall, which is highest since 2014. Due to this Kharif sowing this year is still 7% less than the normal with sowing of rice and pulses are worst affected with oilseeds and coarse cereals showing some recovery.

BANK CREDIT

- The Indian banking industry's credit growth in FY20 (till 19 July) is indicating a downward trend on incremental (YTD) basis, though increased on YoY basis. Further, a deeper analysis of sectoral data for the month of June 2019 indicate that credit flows to Agri. & Allied activities, personal loans strengthened, though they remained muted for micro, small and medium industries.
- Due to the stress in major industry sub-sectors, most of the banks' business is being driven by the retail business but in June quarter the retail business growth has stagnated due to the slowdown in Auto sector.

UNCERTAINTY CLOUDS THE OUTLOOK FURTHER

- The bond markets are giving of signs of heightened uncertainty. The spread between Indian 10 Yr and 1 Yr papers has been narrowing considerably this fiscal till Jul'19. This is indicative of significant weakening sentiments. On the other hand, the spread between the 30 Yr paper and 10 yr paper has widened. The reason could be that investors are not betting on strong long term growth.
- For the corporate bond market, the spread has widened since last year across rating and maturities. For AAA rated 10 Yr papers the spread has gone up from 79 bps in Jul'18 to 122 bps in Jul'19. Similarly, for AA rated bonds the spread has gone up from 135 bps a year ago to 184 bps in Jul'19.
- The current rate cut cycle is expected to continue and we expect RBI to go for 50-75 bps rate cut in the entire cycle, including the 25 bps cut expected in the upcoming policy. We expect the terminal repo rate to go to 5% (if not lower) in this rate easing cycle.

Tax Receipts vs Government Expenditure

	Gross tax	Direct tax	Indirect tax	Total Expenditure	Revenue Expenditure:	Capital Expenditure:
Quarter	YoY%	YoY%	YoY%	YoY%	YoY%	YoY%
Q1FY15	3.4	6.4	0.2	8.2	11.0	-8.6
Q1FY16	17.5	0.3	36.9	4.2	2.4	17.6
Q1FY17	30.6	26.9	33.6	18.8	24.3	-16.4
Q1FY18	15.2	16.6	14.0	27.1	25.8	39.5
Q1FY19	22.1	6.2	34.9	8.7	6.6	27.3
Q1FY20	1.4	9.7	-3.9	2.0	6.1	-27.6

Source: CGA, SBI Research

Subdivision-wise and District-wise Performance of Monsoon in 2019

Total Subdivision (36)	01 June to 31 July					
	2019	2018	2017	2016	2015	2014
Excess	3	7	5	11	4	0
Normal	19	22	23	18	20	15
Deficient	**14**	**7**	**8**	**7**	**10**	**21**
% Departure	-9%	-7%	0%	1%	-3%	-23%
Memo:						
% of Districts with deficient rainfall	**45%**	35%	33%	31%	38%	**59%**

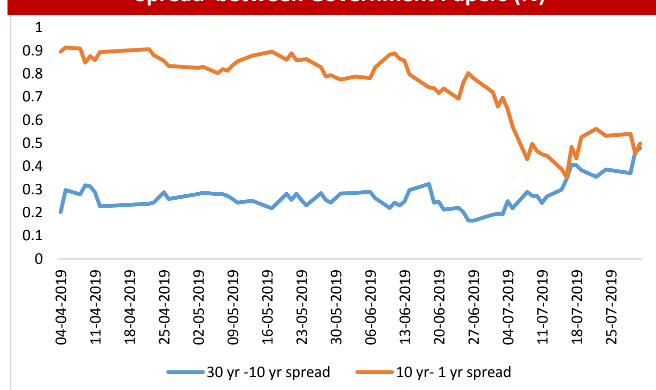
Source: IMD; SBI Research

Advances of Peer-group Banks (Rs Crore)

Banks	Total Advances			Retail Advances		
	Q4FY19	Q1FY20	QoQ%	Q4FY19	Q1FY20	QoQ%
Axis	494798	497276	0.5	245812	258205	5.0
ICICI	586647	592415	1.0	352831	363596	3.1
HDFC	819401	829730	1.3	4,31,357	4,43,154	2.7
SBI	2293454	2238294	-2.4	647844	663559	2.4
BOB	675266	669034	-0.9	108525	112233	3.4
PNB	506194	468429	-7.5	92727	91248	-1.6
CANB	444216	449290	1.1	74359	77492	4.2

Source: SBI Research

Spread between Government Papers (%)



Source: SBI Research

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