Weekly Market Update

29 Nov 2020

Record highs all around

- Third announcement of positive preliminary vaccine results helped markets get off to a strong start last week.
- This new round of vaccine optimism and diminishing political uncertainty helped stocks build on recent gains for the holiday-shortened week. Most of the major benchmarks hit record highs, with Dow Jones Industrial Average gaining the most attention by crossing the 30,000 threshold for the first time.
- The political environment appeared supportive.
  - Yellen's dovish tenure while at the Fed and, more importantly, the fact that's she's a known entity, appeared to put investors at ease.
  - Reports that Biden's transition team was pushing Congressional Democrats to compromise with Republicans on fiscal stimulus also appeared to boost sentiment
- In US, there is an acceleration in new infections and record-high hospitalisation rates. More and more states are tightening restrictions and more are likely to follow suit

US Economy : Relapse

- Economic data appeared to play a role in draining some of the week's gains on Wednesday.
- Initial jobless claims rose unexpectedly to 778,000, their highest level in five weeks, while personal incomes fell 0.7% in October, offsetting September's gain.
- University of Michigan's November consumer sentiment was revised slightly lower and hit its lowest level (76.9) since August. The Conference Board's measure of consumer confidence, reported Tuesday, also fell more than expected.
- Core (excluding defense and aircraft) capital goods orders surprised on the upside, however, rising 0.7% in October and building on September's surge of 1.9%. New home sales also surprised on the upside.
- November PMIs for services continued higher (57.7 from 56.9) along with manufacturing (56.7 from 53.4). The most upbeat parts were job creation and orders, with the order to inventory-ratio at 2018-highs.
- US ISM (Tuesday) should either be unchanged or slightly down based on the PMIs released this week. The jobs report on Friday is set to be another grim reminder of the real economy

Vaccine – no more the Silver Bullet

- The prospect of the deployment of a Covid-19 vaccine has raised expectations that the stop-start cycle seen this year will make way for a lasting economic recovery in 2021.
- There is concern however that bringing the pandemic under control could take more time than is currently assumed in economic projections.
- Under such a scenario, worries about possible new restrictions would remain elevated, although one can assume that, because of vaccination, these measures would be less strict than before and more local.
- Nevertheless, in the more exposed sectors, investment and employment could be clear victims.
- Vaccine news represents a light at the end of the tunnel. However, given the rampant resurgence in the virus case count, hospitalizations and deaths, the major economies remain in the dark depths of the tunnel.
- The vaccine is not the perfect elixir for what ails the World either from a health or economic perspective

Europe Recovery: Running out of Breadth

- After a more vigorous than expected recovery following the end of lockdown, the trend now decisively had become less energetic. After an historic contraction in Q2 2020, and a mechanical rebound in Q3, economic activity is likely to slow significantly over the next few quarters.
- The winter months would be challenging in terms of limiting the spread of the virus and a sequence of temporary lockdowns might prove to be necessary.
- The simmering threat of a veto of the EU Recovery Fund by either Poland or Hungary has yet to be taken seriously by FX markets (a deal is expected) and the EUR will also take note of any progress on Brexit.
- ECB monetary policy account set the thresholds for further easing and those thresholds will be met. New easing to concentrate on the PEPP and TLTROs, but the pace of bond buying is unlikely to be increased.
- Last week's Euro area PMI and the German IFO survey revealed that business confidence in the service sector in Europe has fallen, In contrast, European manufacturers overall continue to buck the negative trend, also visible in stable export expectations.

EURUSD : 2017 Play book

- In August/September 2017, EUR/USD tested 1.20 a couple of times before the ECB's Benoit Couré intervened rhetorically over several days. EUR/USD traded lower over the following months in conjunction with dovish ECB signals.
- In August/September 2020, EUR/USD has tested 1.20 again before Phillip Lane, managed to dampen the expectations of EUR strength with rhetorical intervention.
- Subsequently Dovish ECB signals have been as strong as one can expect
- However, EUR/USD continues to grind higher, buoyed by the broadly weaker dollar.
- Local inputs to the EUR story this week come from the EZ flash November CPI, seen still at -0.3% y/y and a soft October retail sales figure.
- It is once again a potential make-or-break week for face-to-face EU-UK trade negotiations

UK Economy : Tough terrain ahead

- According to the independent Office for Budget Responsibility's forecast, the U.K. economy will have contracted by 11.3 % by the end of 2020, "the largest fall in output for more than 300 years,".
- Economic output is not projected to return to pre-crisis levels until the end of 2022. Failure to solve twin crises in Virus and Brexit could spell political and economic disaster.
- Fragile Economy has to navigate through Brexit - Any disappointing news would exacerbate the weakness significantly
- Hence this is the crucial phase for Brexit talks, but with the hard deadline of the end of the transition period just one month away on 31 December, the coming days truly are critical.
- Our base case continues to be that a free trade agreement will be signed. However, what is not always widely appreciated is that even with a deal, Brexit has already been and will continue to be significantly economically damaging – primarily for the UK, and to a much lesser degree for its closest European trading partners.
- Estimates from both official and independent institutions suggest that, even with a free trade agreement (FTA) that involves zero tariffs and zero quotas (our base case), Brexit will – over time – reduce UK GDP by around 5 percentage points compared to a scenario of continued EU membership.

Emerging Markets –China impact fades

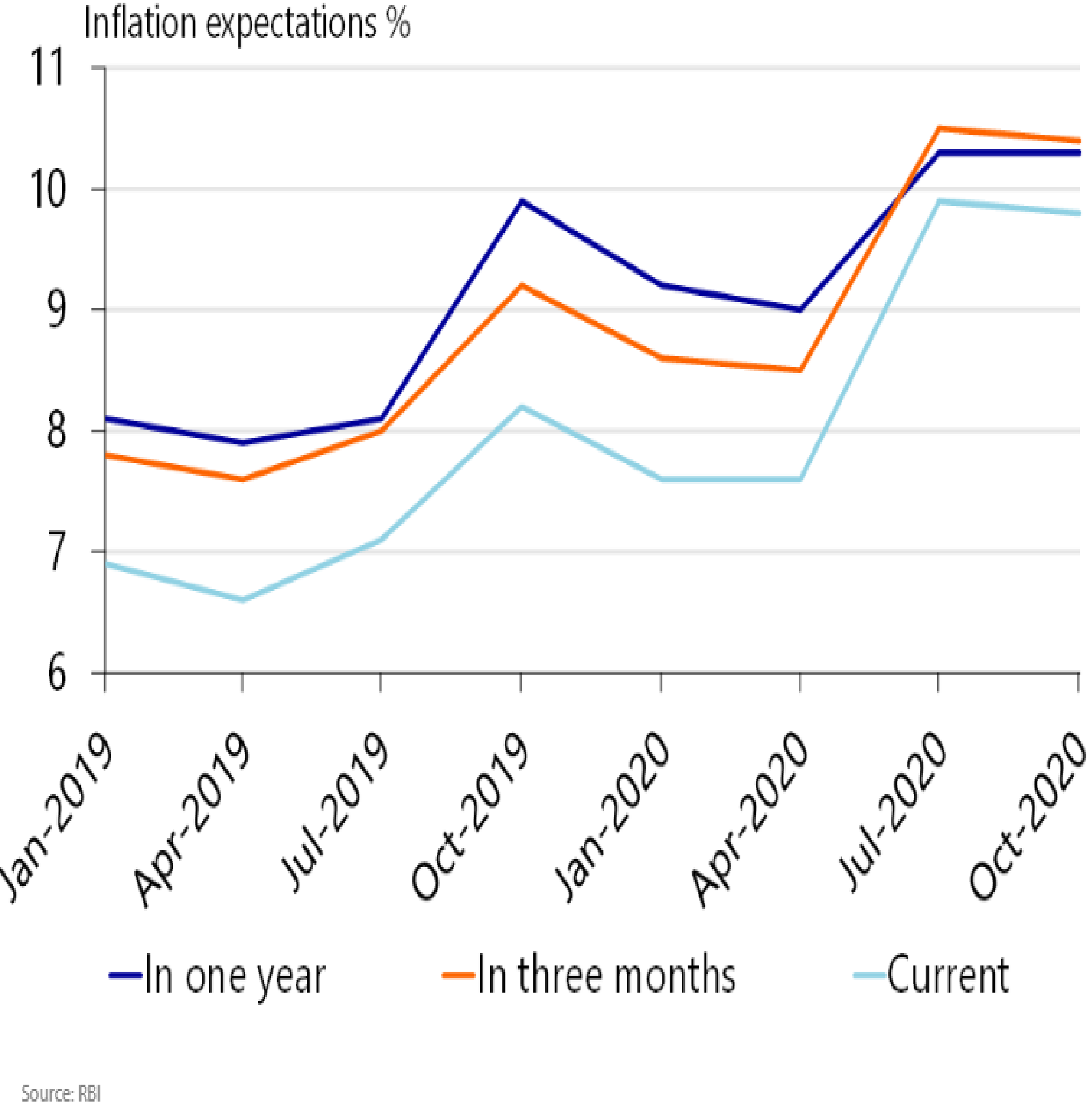
- Emerging markets against both EUR and USD has been a roller-coaster ride in 2020 but things have brightened substantially of late and FX prices reflect this.
- Stimulus from China has propelled EM optimism through demand and commodities.
- With the economy on a stronger footing and risks more balanced, China is set to return to a strategy of deleveraging and focus on reforms and longer term goals. A slowdown in infrastructure and construction growth is set to dampen commodity price inflation and is likely to weigh on emerging markets.
- The tailwind of 2020 from China is likely to fade during the course of 2021 and this could be the reason that the markets had seen the better part of the emerging market story.
- The stress in EM is likely to re emerge especially in countries where the rate differential has narrowed, where the currency has strengthened since March and where commodities or inflation are a key theme in the economy and FX

India : Data highlights

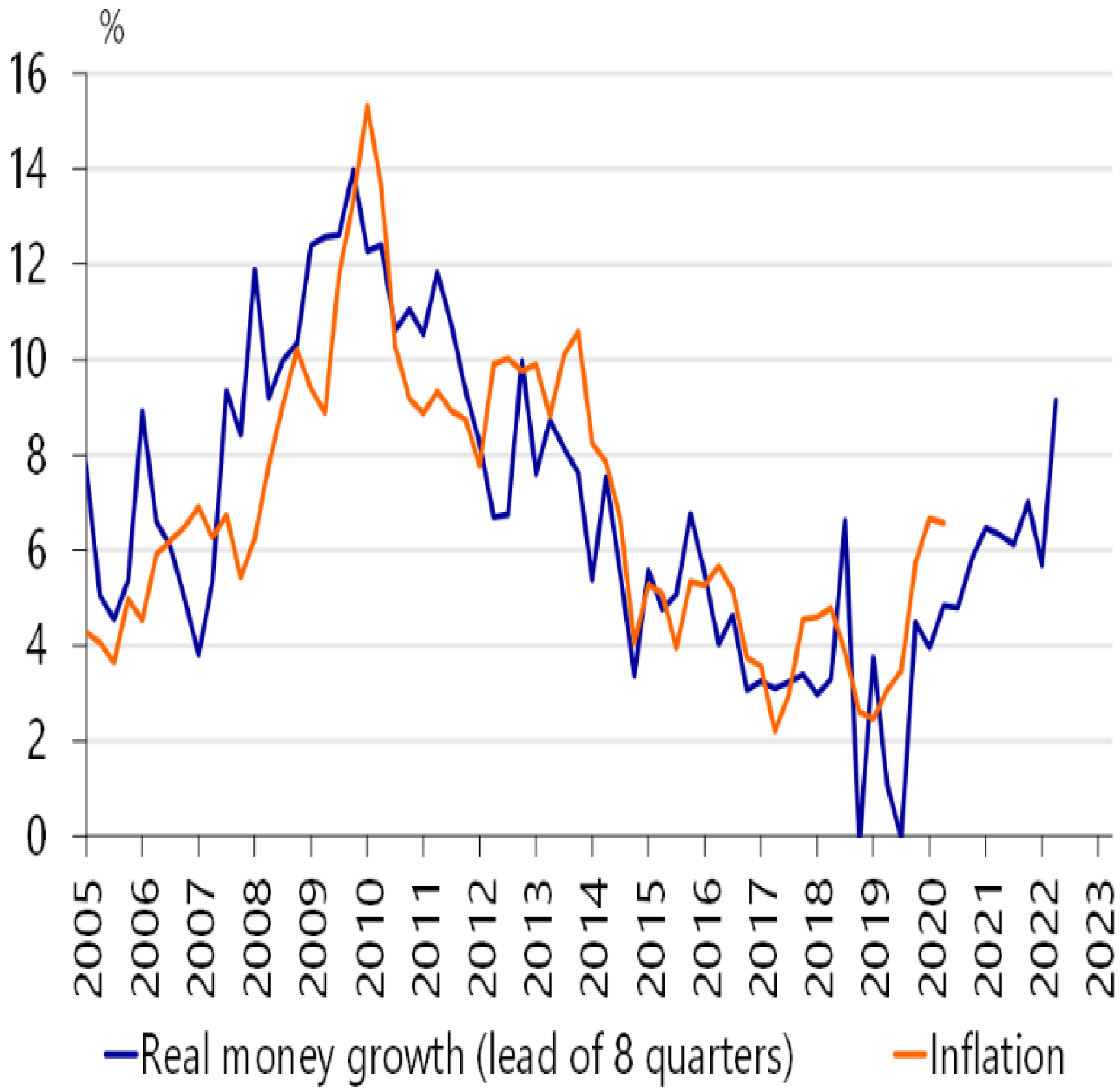
- Contracting for the eighth consecutive month, the output of the eight core infrastructure sectors dropped 2.5 % per cent in October, mainly due to decline in production of crude oil, natural gas, refinery products, and steel. The fall was sharper than September's 0.1 %.
- Overall, on a year-on-year basis, non-food bank credit growth decelerated to 5.6 % in October 2020 from 8.3 % a year ago –credit to industry contracted by 1.7 % in October, and personal loan growth decelerated.
- The revised Budget estimate for gross tax collection in 2019-20 was 21.63 trln rupees. If the total tax collections in 2020-21 reach the revised estimate level of last year, it will be a growth of 7.6% on year from 20.10 trln rupees raised in 2019-20. The government's tax collections in Apr-Sep, the first half of 2020-21, contracted 21.6% on year to 7.21 trln rupees.
- RBI is likely to keep the rates unchanged in its monetary policy review on 4 Dec

	Apr-Oct 2020-21	Apr-Oct 2019-20	Year-on-year % change	Budget estimates	% of actuals to Budget estimates 2020-21	2019-20
Revenue receipt	6,919.03	9,076.34	(-)23.8	20,209.26	34.2	46.2
Net tax revenue	5,756.97	6,834.86	(-)15.8	16,359.09	35.2	41.4
Non-tax revenue	1,162.06	2,241.48	(-)48.2	3,850.17	30.2	71.6
Recovery of loans	102.18	94.61	8.0	149.67	68.3	63.8
Other receipts	61.79	173.65	(-)64.4	2,100.00	2.9	16.5
Total receipts	7,083.00	9,344.60	(-)24.2	22,458.93	31.5	44.9
Revenue expenditure	14,640.99	14,536.32	0.7	26,301.45	55.7	59.4
Capital expenditure	1,973.55	2,012.73	(-)1.9	4,120.85	47.9	59.5
Total expenditure	16,614.54	16,549.05	0.4	30,422.30	54.6	59.4
Fiscal deficit	9,531.54	7,204.45	32.3	7,963.37	119.7	102.4
Revenue deficit	7,721.96	5,459.98	41.4	6,092.95	126.7	112.5

Inflation expectations have been trending higher



and Growth of real money supply to keep inflation high going forward



India Q2 FY 21 – Rebound

- Economic surprises and better than anticipated recovery reflected on Q2FY21 GDP coming at -7.5% y/y against the broad consensus at -8.5%. Improvement in rural demand and restocking ahead of the festive season has supported .

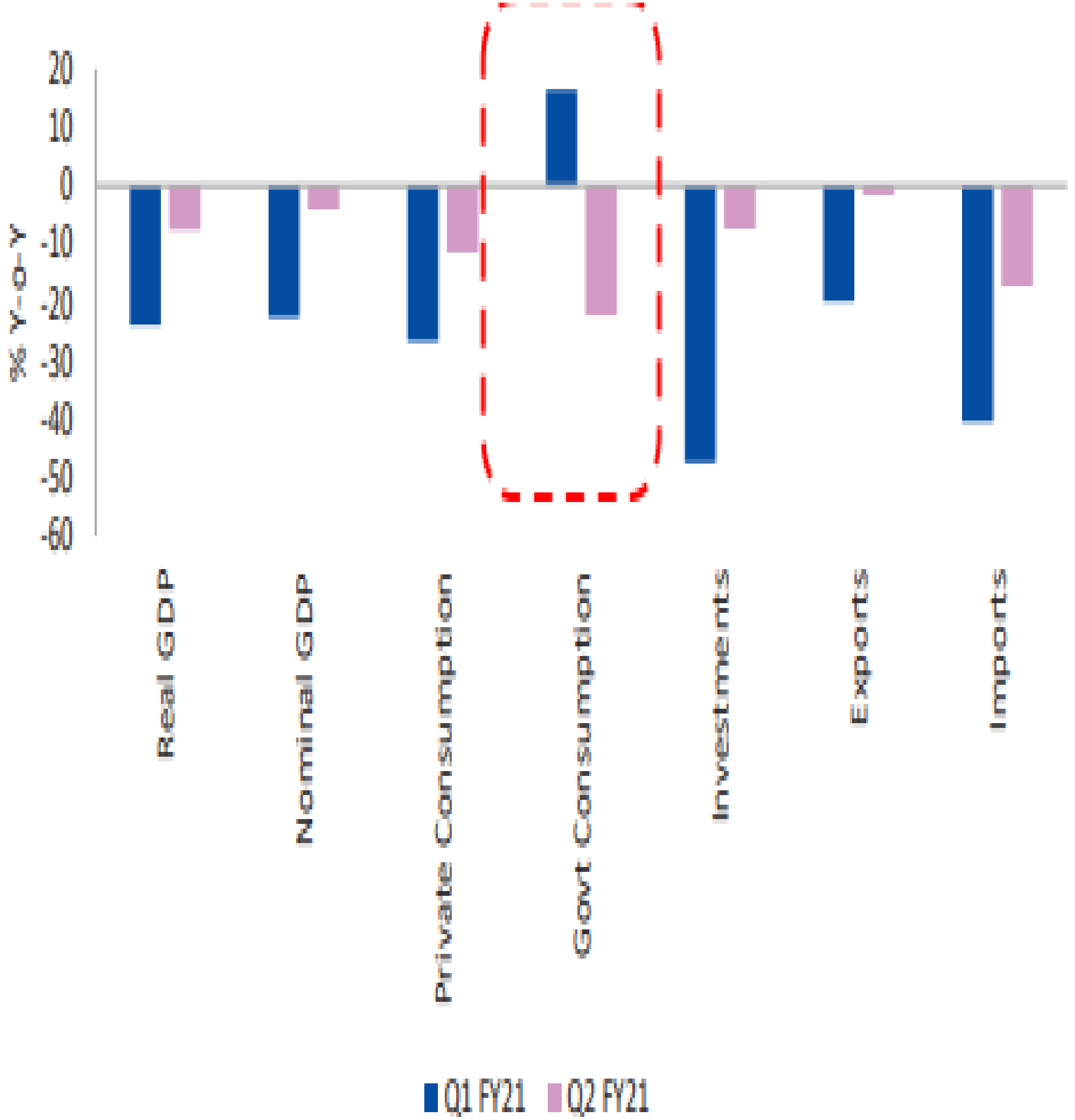
- The rebound was primarily led by a strong recovery in investments (-7.3% YoY) and exports (-1.5%), partly compensating for a sharp contraction in public (-22.2% YoY) and private (-11.3% YoY) consumption

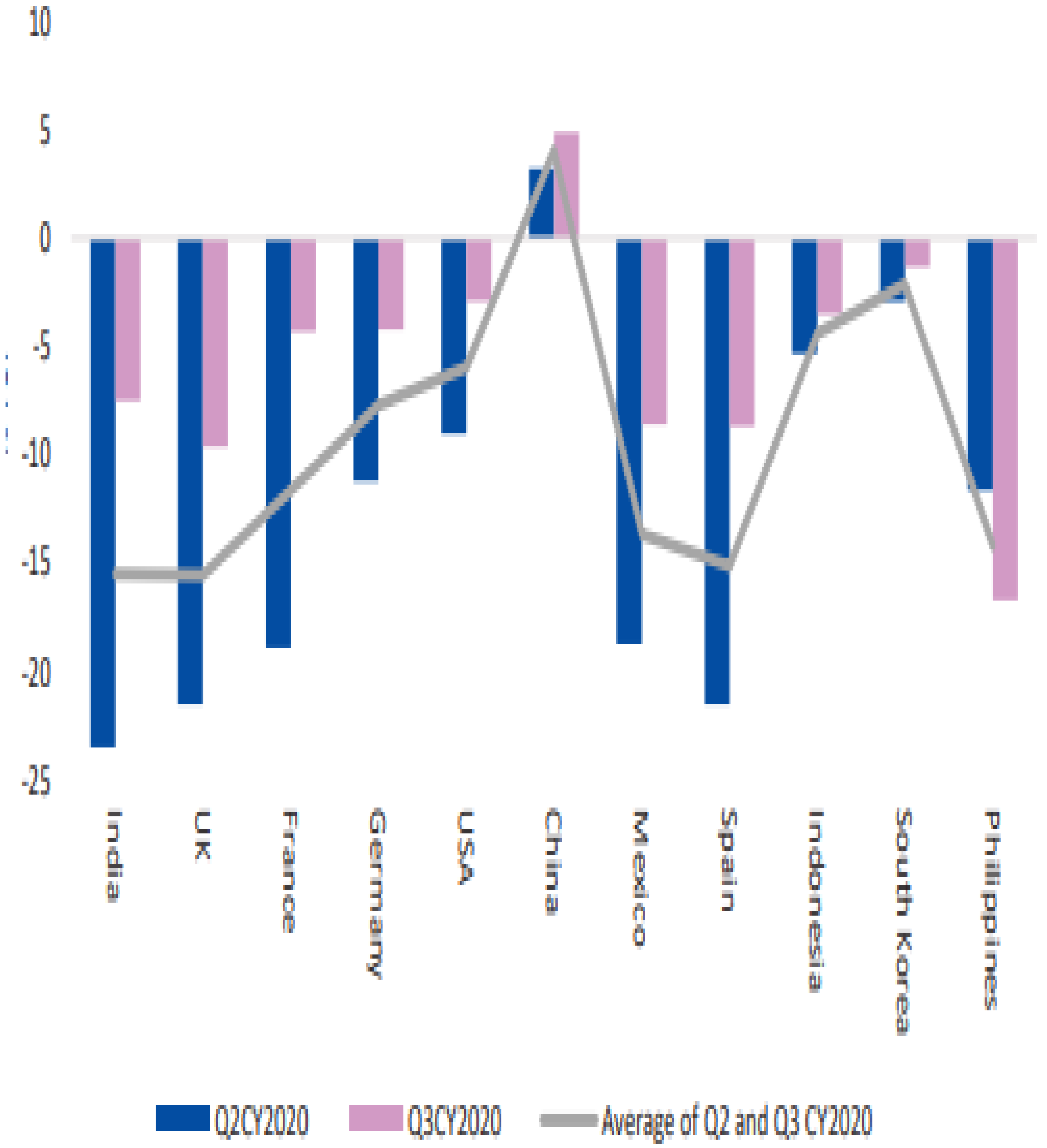
- Manufacturing was a clear outlier moving to a growth of 60bps while most other sectors witnessed a slower pace of contraction

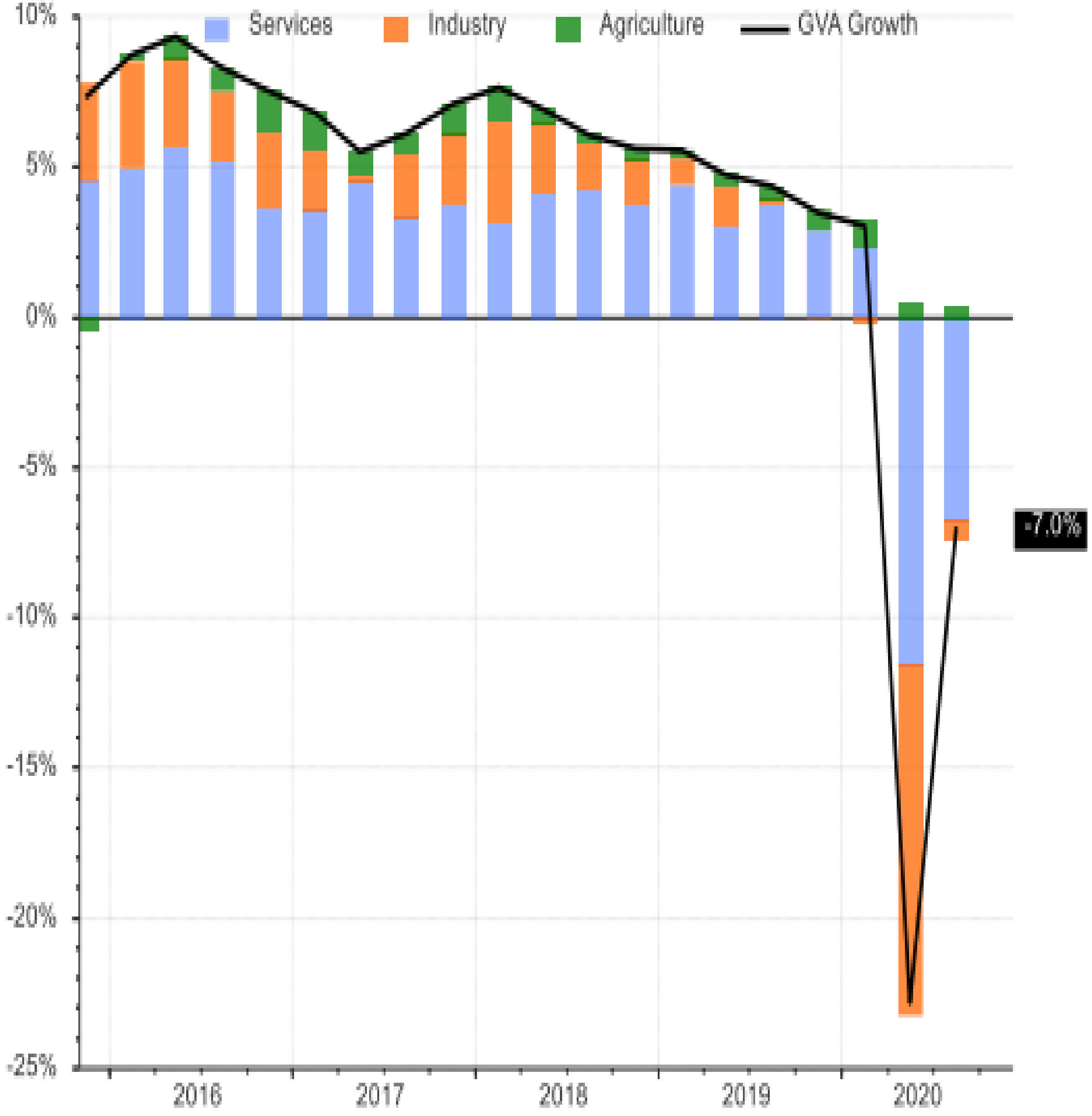
- That said, the national accounts data in Q2 mainly captures the organised corporate sector where the recovery has been robust. The impact of lockdown has been far more severe on the informal sector which has got hit by aggressive cost rationalisation by the formal sector which does not reflect in the GDP data yet. Q2 data face over-estimation bias, and are susceptible to downward revisions.

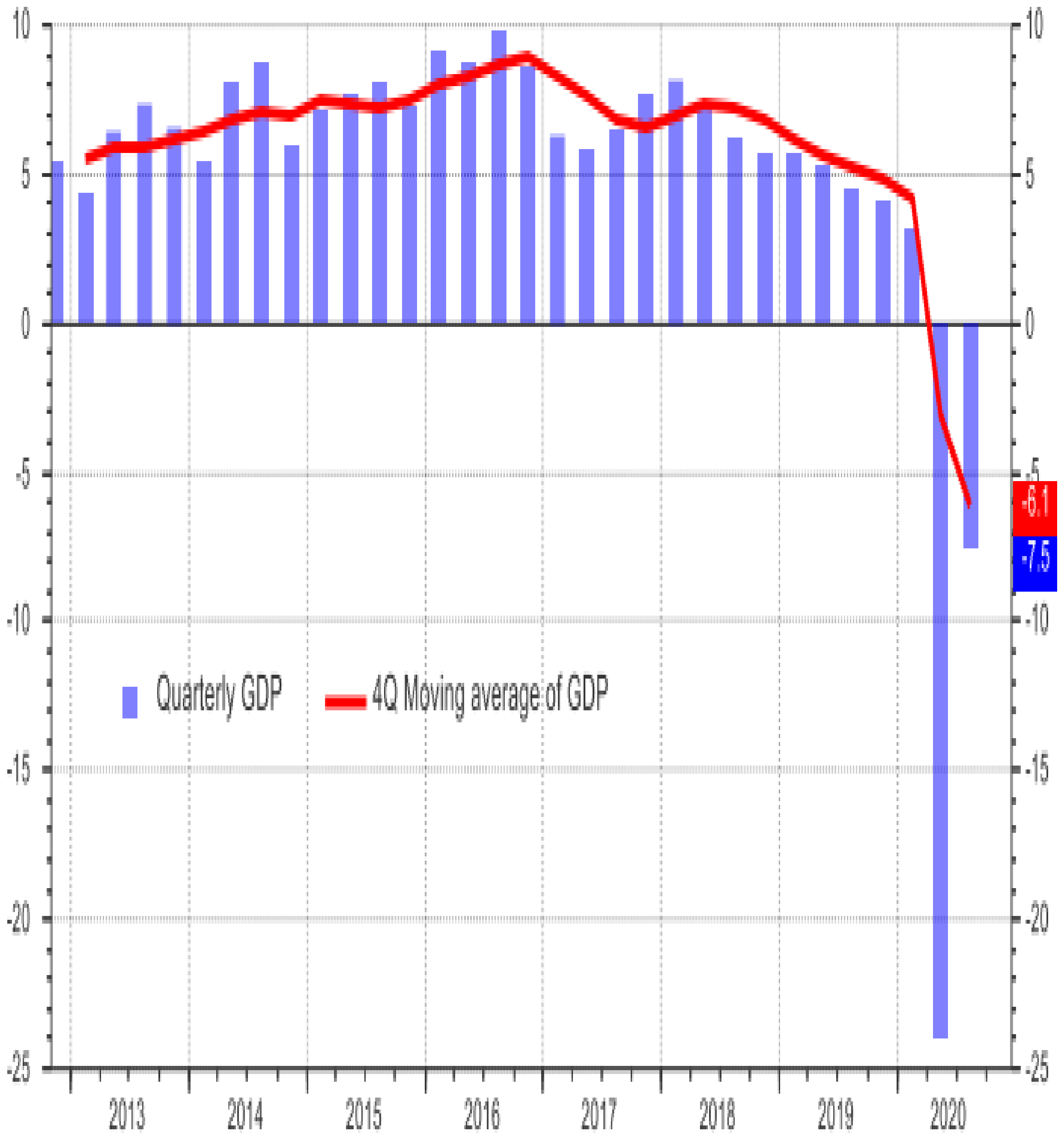
- Contraction in fiscal expenditure, albeit negative for Q2FY21, could translate into higher expenditure in H2 with October data of central government's expenditure showing 9% increase in total expenditure (vs -12% Y-o-Y in Q2FY21).

- Overall, H1FY21 GDP stands at -15.7%, FY21 GDP contraction is now expected closer to 7.5%, better than the previous expectation of -9.5%


20
10
0
-10
-20
-30
-40
-50
-60
% Y-o-Y
Real GDP
Nominal GDP
Private Consumption
Govt Consumption
Investments
Exports
Imports
Q1 FY21
Q2 FY21


10
5
0
-5
-10
-15
-20
-25
India
UK
France
Germany
USA
China
Mexico
Spain
Indonesia
South Korea
Philippines
Q2CY2020
Q3CY2020
Average of Q2 and Q3 CY2020

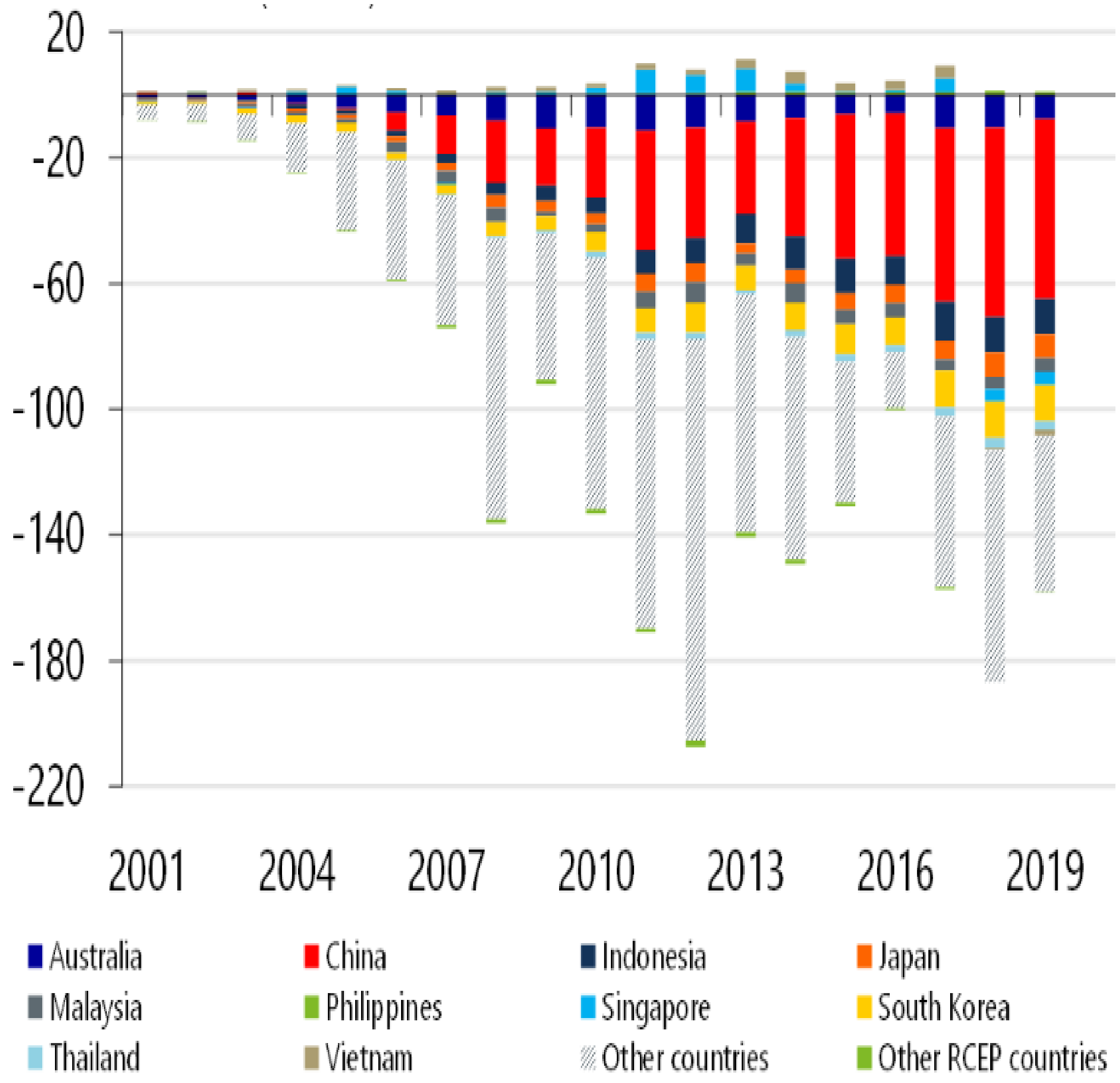

Services
Industry
Agriculture
GVA Growth
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-7.0%
2016
2017
2018
2019
2020

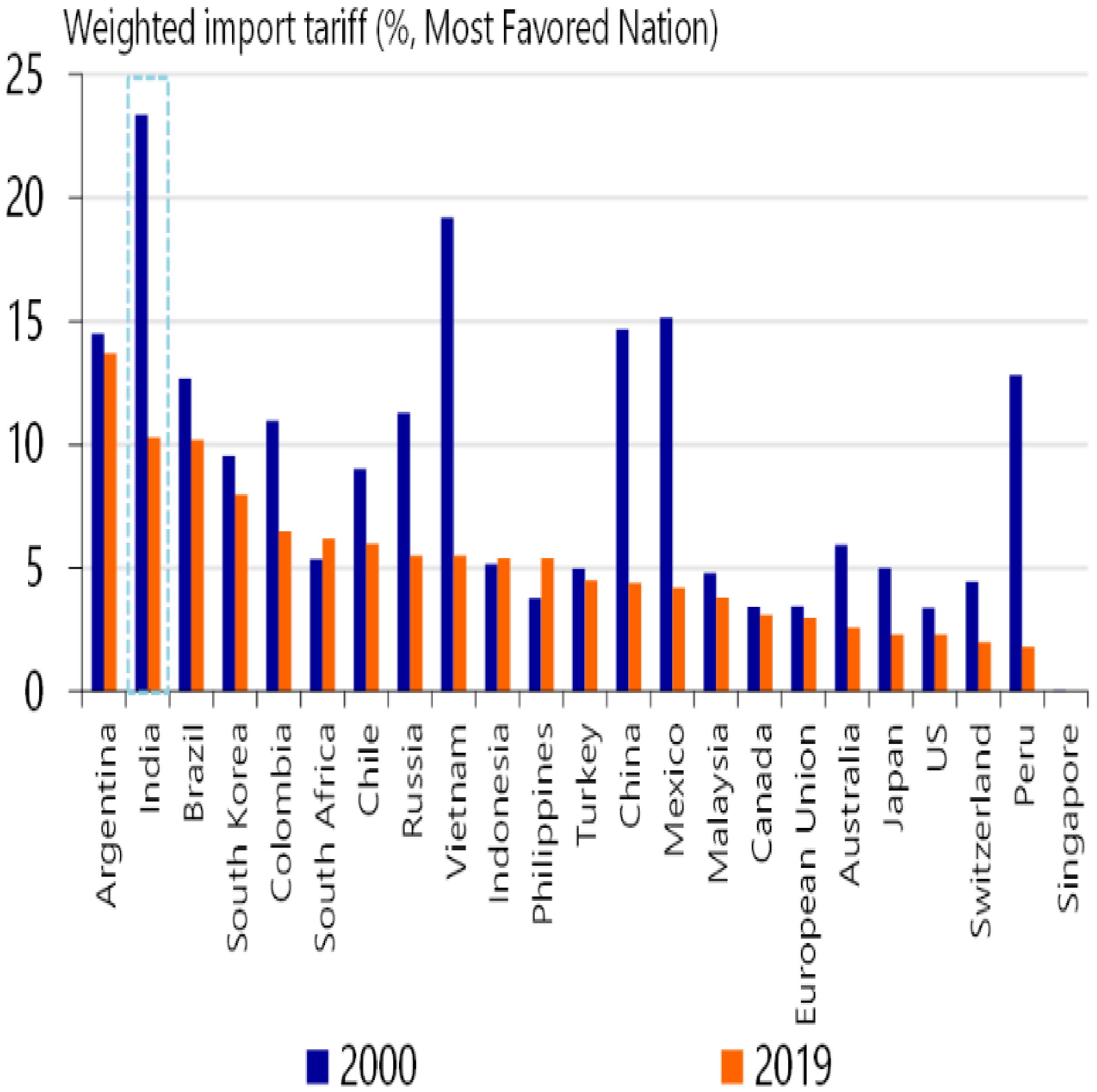

10
5
0
-5
-10
-15
-20
-25
-6.1
-7.5
Quarterly GDP
4Q Moving average of GDP
2013
2014
2015
2016
2017
2018
2019
2020

RCEP : India’s concerns – 1/2

- The Regional Comprehensive Economic Partnership (RCEP) is a free trade agreement signed in November, 2020 between fifteen countries: all ten ASEAN countries, Australia, China, Japan, South Korea and New Zealand.
- India was a member of the drafting committee from its inception in 2011, but in November 2019 decided to opt out, saying that some of its main concerns were not being addressed.
- India’s main argument not to join RCEP is its large trade deficit with many RCEP countries. Over the last 5 years, RCEP members were on average responsible for almost 70% of India’s trade deficit .
- India’s net international investment position deteriorated from -1.2% of GDP in 2008 to almost -5% at this moment. This has implications for India’s financial conditions and creditworthiness.
- India’s worsening trade balance explains why it is still among one of the most protectionist countries in terms of tariffs

India’s trade balance deteriorated heavily over the last two decades (Trade balance in USD bio)





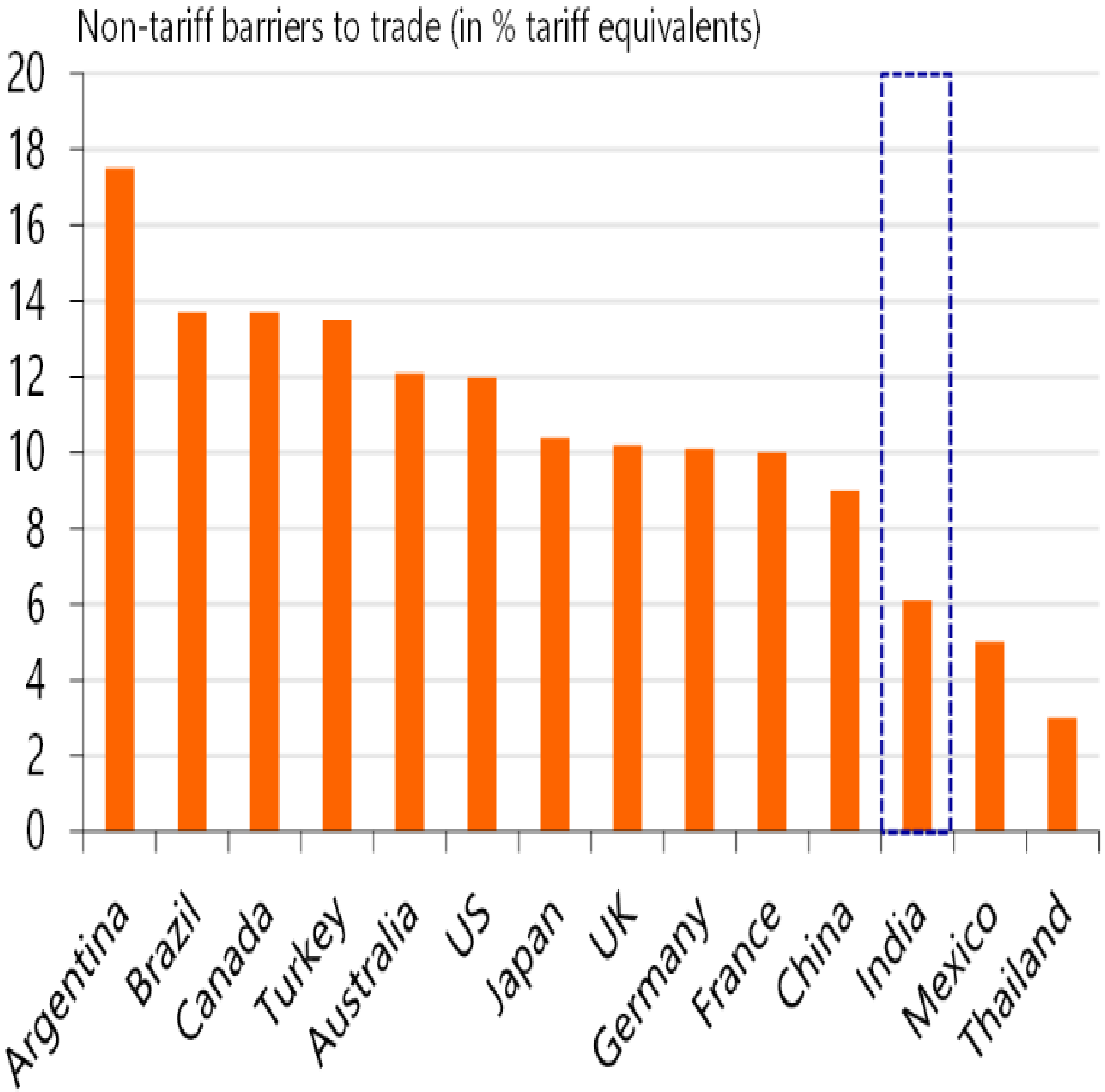
Source: World Bank, WTO, RaboResearch, Macrobond

RCEP : India's concerns – 2/2

- It is easy to see why signing members have still left the door open for India to join and have even included some chapters safeguarding India's interests in the final version.
- India joining RCEP would have resulted in a substantial decrease of India's tariffs, which will enable RCEP members to more easily access it's large market.
- India is currently insistent that it will not join the partnership. But a few agreements on import exclusion in sensitive sectors and a phased-out liberalization might push India to rethink, as RCEP is currently one of the easiest large FTAs which concentrates solely on trade.
- There is no emphasis on issues like environment, labour or state-owned enterprises, which are contentious in getting a trade deal with the likes of EU and US.

Non Tariff Barriers

- So from the perspective of external weakness, India opting out of RCEP makes sense.
- But reality is even more nuanced.
- Trade barriers are not only about tariff levels.
- Non-tariff barriers (NTBs) to trade, ranging from administrative burdens to outright quantitative restrictions, have become increasingly important.
- Looking at OECD data on NTBs, India is not the most protectionist country by an arm's length, being outflanked by RCEP members Australia, Japan and China
- RCEP has not made any arrangements on lowering NTBs.



India :Equity markets

- By scrutinizing monthly FPI flows for this year we can see that FPIs furiously sold equities to the net tune of Rs. 65,817 Crs in March which happens to be the market bottom., whereas in November FPIs pumped in over Rs. 57,500 Crs in equities near all-time high.
- MSCI Global Standard Index rejig with varied additions and deletions is wef 30th November and this month's inflows can be majorly attributed to the rejig and possible increase in India's weight in the global index, that many global fund houses would have had to follow
- DIIs on the other hand continue to be sellers on this : FPIs might not aggressively buy going forward since the MSCI index rejig event would get over. Hence Institutional activity will offer an important clue going forward.
- 12430 12930 should hold for now