

Macro Outlook

Navigating through the woods

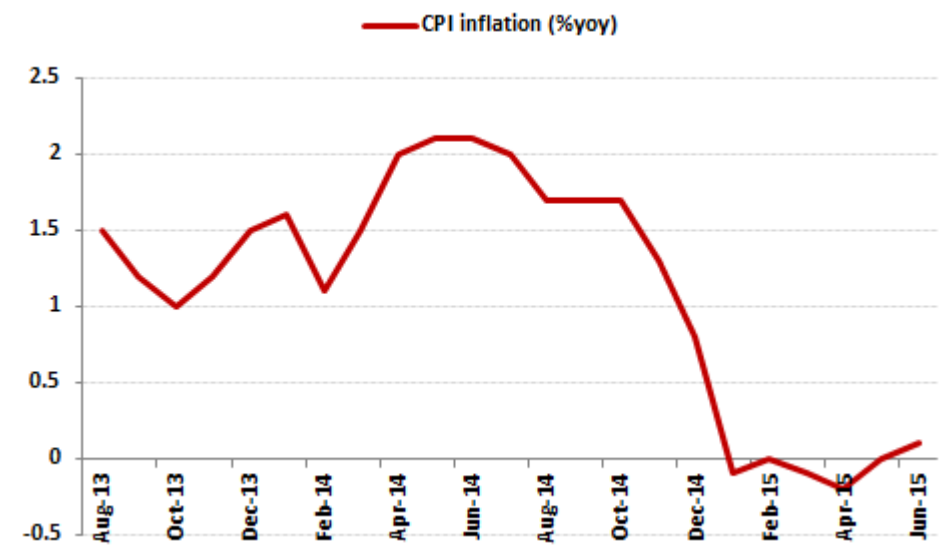
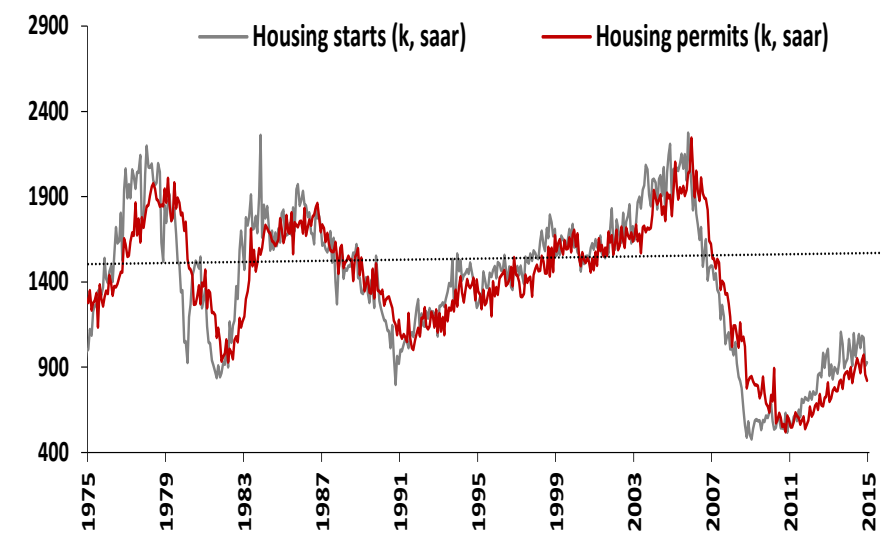
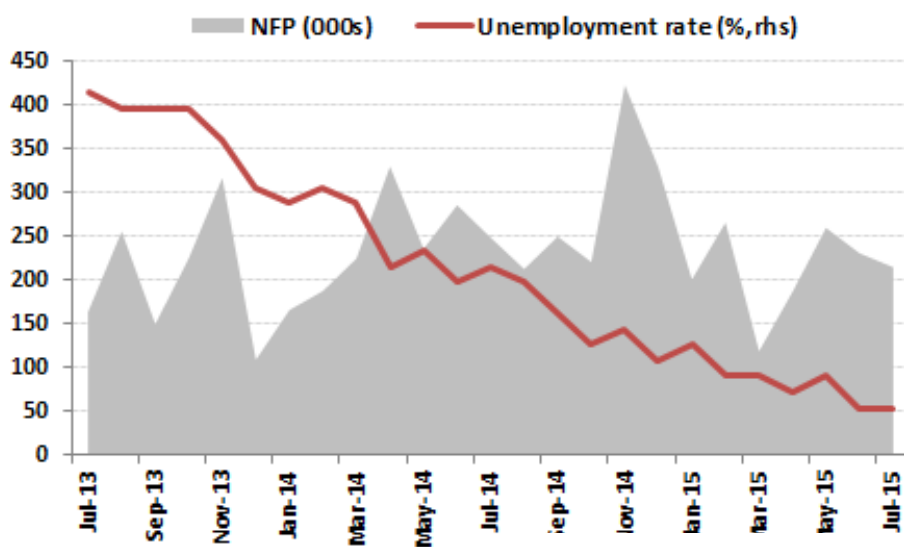
Shekhar Bhandari
Kotak Mahindra Bank

Aug, 2015

1. Unsynchronized global monetary policies



US economy picking up momentum though inflation still a concern





Policy divergence across major central banks

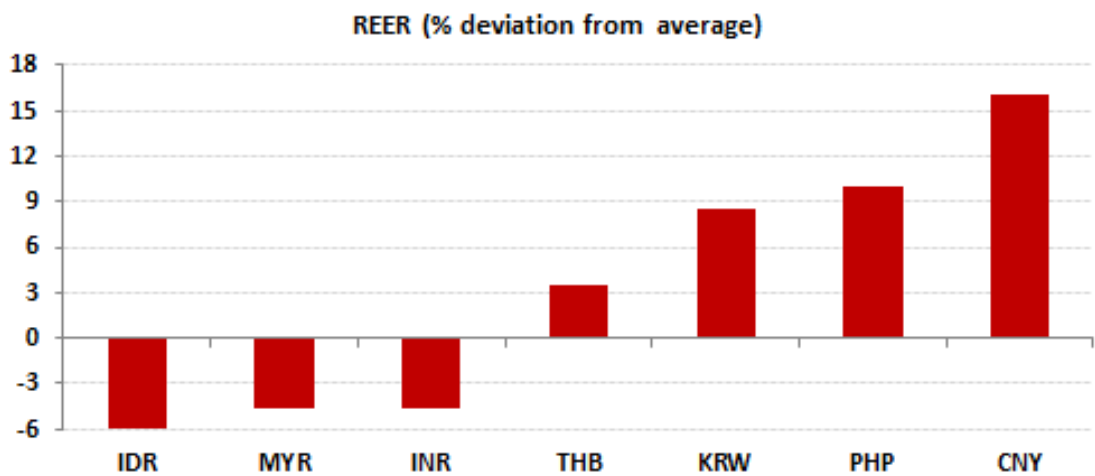
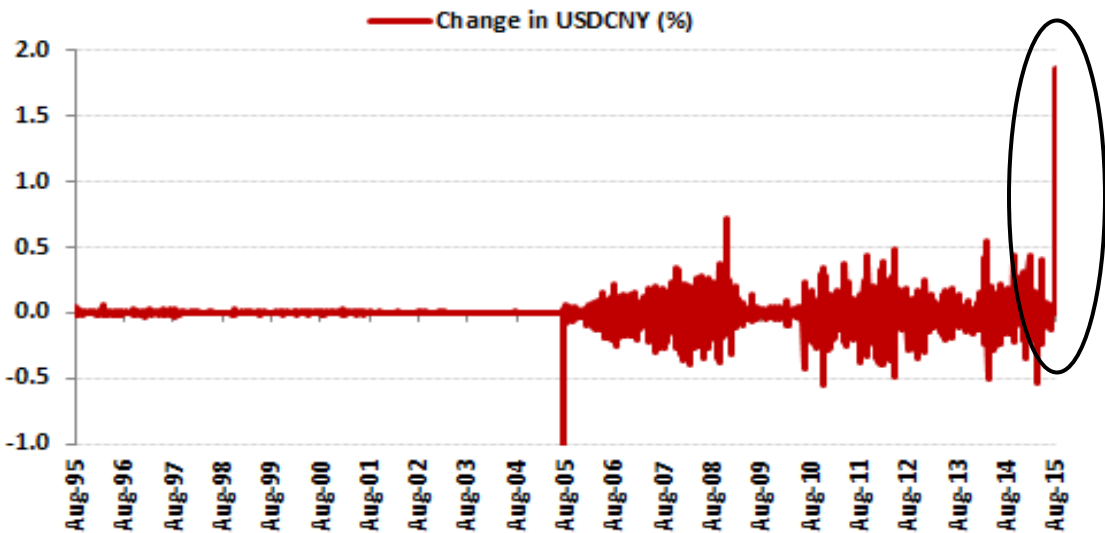
- **US & UK poised to raise rates in 2015/early 2016**
 - ✓ With rapidly tightening labor markets, both Fed (and BoE) will likely normalise policy even in the absence of wage and price pressures
 - ✓ Pace of tightening, whenever it starts, likely to be slow and measured
 - ✓ However, the balance sheets of both central banks unlikely to contract any sooner

- **ECB & BoJ will lean towards more monetary accommodation**
 - ✓ Both central banks keen to reflate their economies and avoid deflation
 - ✓ The ECB intends to expand its balance-sheet to early 2012 levels (~EUR 3tn)
 - ✓ The BoJ to expand its balance-sheet by 16-17% of GDP annually

- **China will continue to ease monetary policy with fading economic momentum**
 - ✓ Rate cuts by 75-100bps
 - ✓ Yuan devaluation

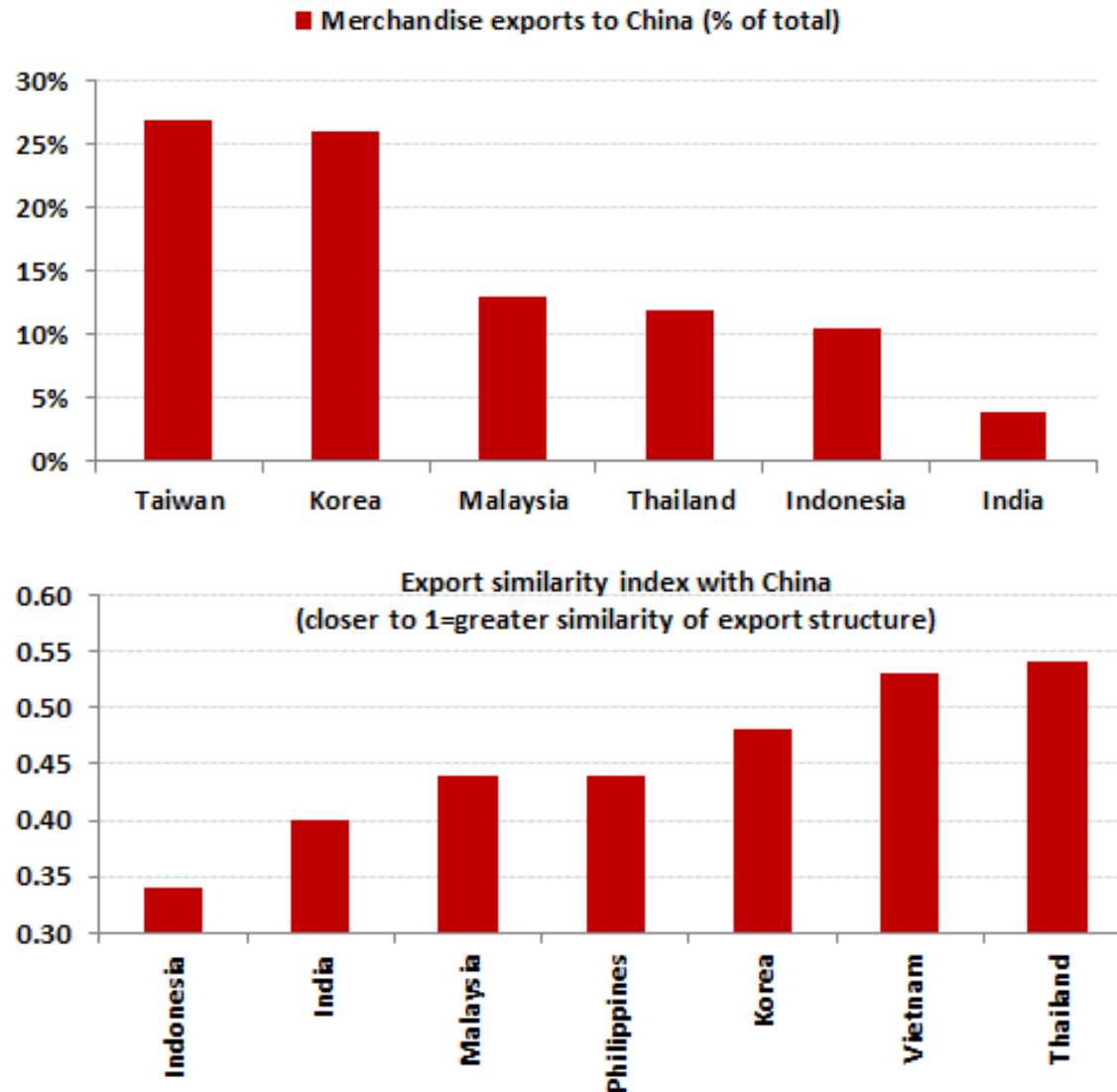


PBoC shocks markets with CNY devaluation



- China devalues Yuan by most in 2 decades
- Asian currencies tumble sharply, with MYR and IDR hitting lows unseen since the East Asian Crisis in 1998.
- Poses risk of currency wars to keep the export market shares intact
- But unless CNY devaluation continues we do not this is as a big threat given the overvalued currency

Exposure to China- India has limited exposure but indirect impact remains





Competitive currency devaluation: by-product of policy divergence

- **All want a cure for disinflation**
 - ✓ Policy directions by BoJ and ECB have provided the natural bias for their currencies to weaken
 - ✓ This will help them import inflation and gain global trade share
 - ✓ The (trade-weighted) currency weakness will help them export deflation to their trading partners – primary one being the US (and Asia)

- **US Fed unlikely to remain unperturbed**
 - ✓ This could potentially have implications for US monetary policy (i.e. delay policy normalization)

- **Yuan devaluation may result in the race to the bottom –covert currency wars**
 - ✓ Can lead to unfortunate consequences
 - Increased protectionism and trade barriers
 - Increased cost of essential imports
 - Fall in global productivity



2. Is global growth structural this time?



Winds of divergent global growth impulses

	2013	2014	2015E	2016E
World	3.3	3.3	3.5	3.7
Advanced economies	1.3	1.8	2.4	2.4
US	2.2	2.4	2.5	3.0
Euro area	(0.5)	0.8	1.2	1.4
Japan	1.6	0.1	0.6	0.8
UK	1.7	2.6	2.7	2.4
Emerging Economies	5.0	4.6	4.3	4.7
EM Asia	7.0	6.8	6.6	6.4
China	7.8	7.4	6.8	6.3
India	6.9	7.2	7.5	7.5
EM Latam	2.9	1.3	0.9	2.0
EM Europe	2.9	2.8	2.9	3.2

Source: IMF, Kotak Economic Research

- ✓ US recovery will be mild, to lead the DM space, helped by stronger domestic demand, healthier housing and labor market and strengthening household balance-sheet
- ✓ Euro area recovery to remain anemic and uneven in the region; core region to slow
- ✓ Japan to remain stagnant, even with delay in Vat hike and continued monetary support
- ✓ China structural rebalancing will likely to keep its growth muted, while excess capacity and financial imbalances continue to weigh

China's economic rebalancing conundrum

China Slowdown

Policy induced factors

- Policymakers conscious effort and reforms to correct
 - ✓ The poor growth mix (move from export oriented to domestic demand model)
 - ✓ Loss of capital productivity due to excess investment capacity

Non-policy driven factors

- Trade as engine of growth losing steam due to sluggish global demand
- Corporate deleveraging
- Unfolding China's shadow banking issues

A hard landing could risk policy intervention to reverse gear and prop growth/weaken Yuan

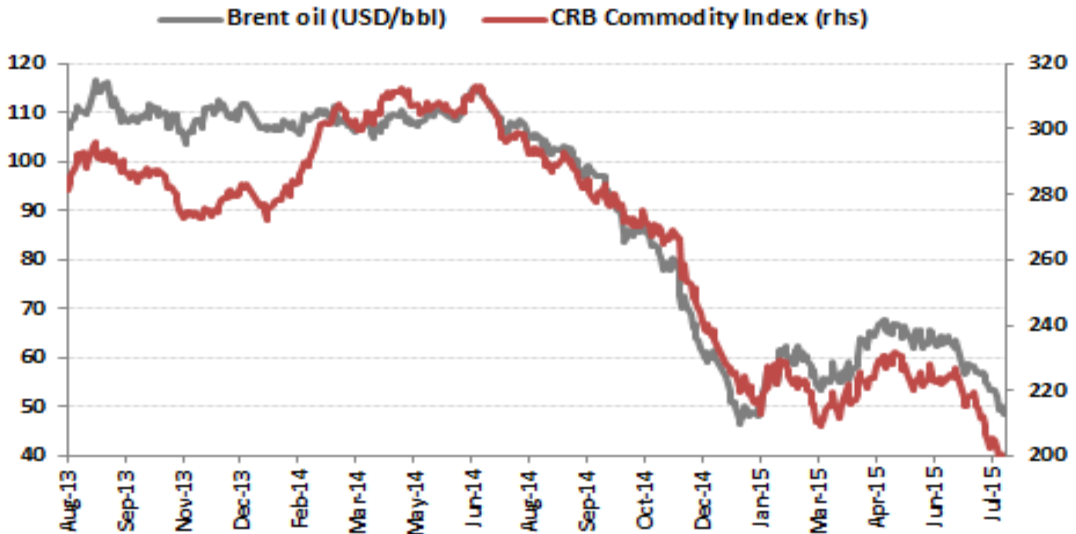




3. Benign commodity cycle, but how much more?

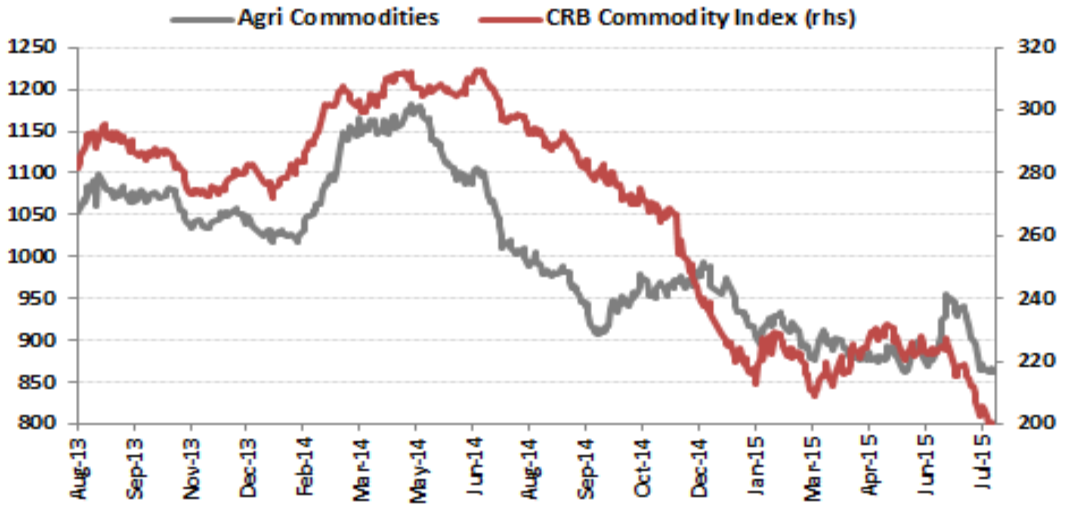


Multiple cross-currents impacting the commodity cycle



Significant commodities correction

- Diminishing global demand
- Strong US Dollar
- Oil supply glut

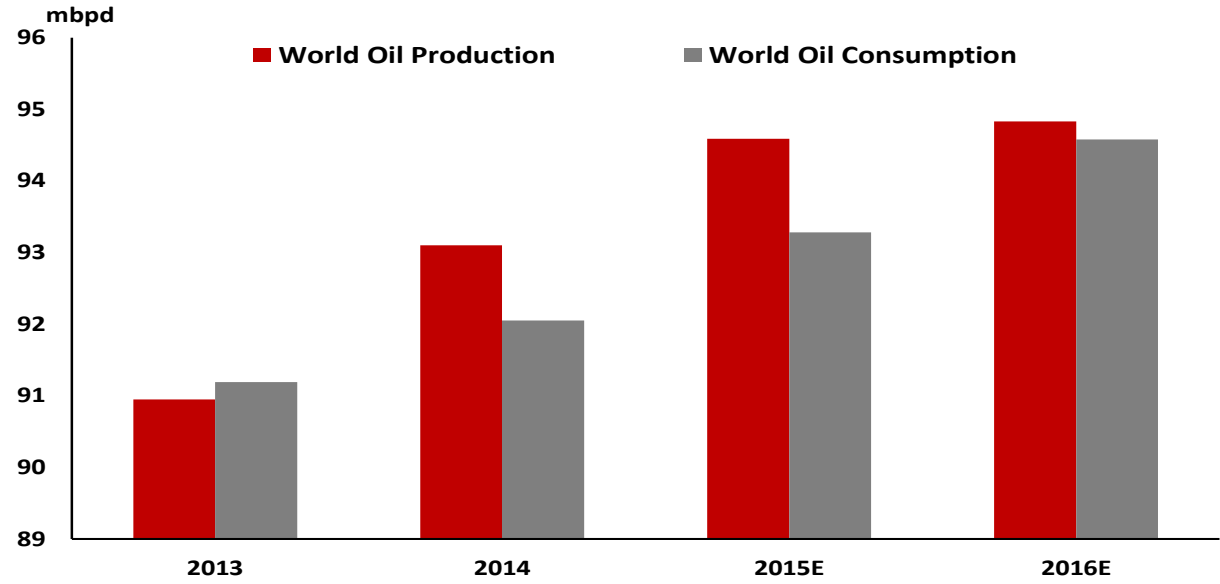




Global commodities unlikely to see significant upside

Further fall unlikely but expect enough factors to offset the upside risks

- Strong dollar and sluggish global demand, particularly of China to keep commodities upside capped
- Oil outlook looks soft
 - ✓ World supply of oil to outpace demand/Iran the next trigger on increasing supply
 - ✓ Geopolitics alone not enough to reverse the cycle significantly

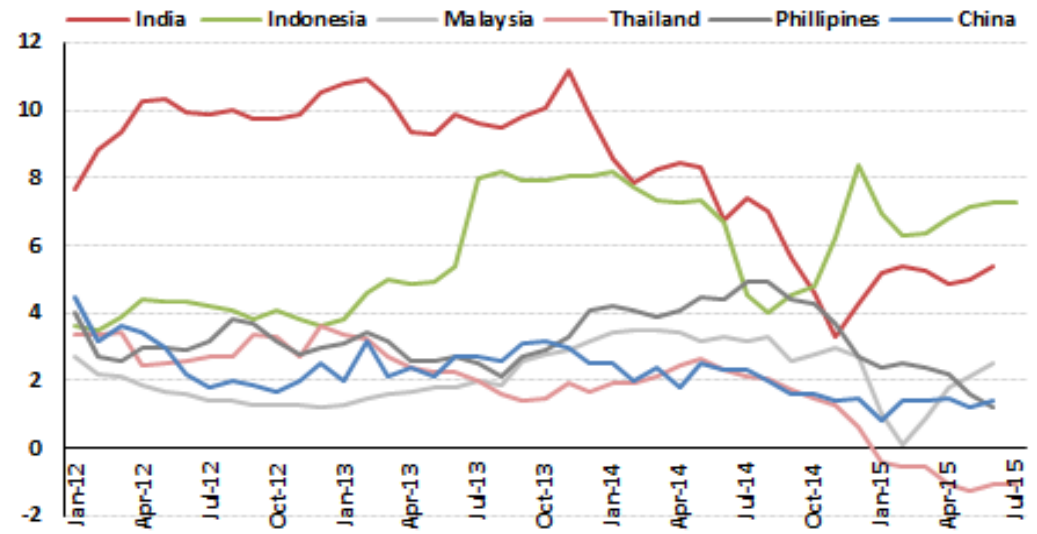
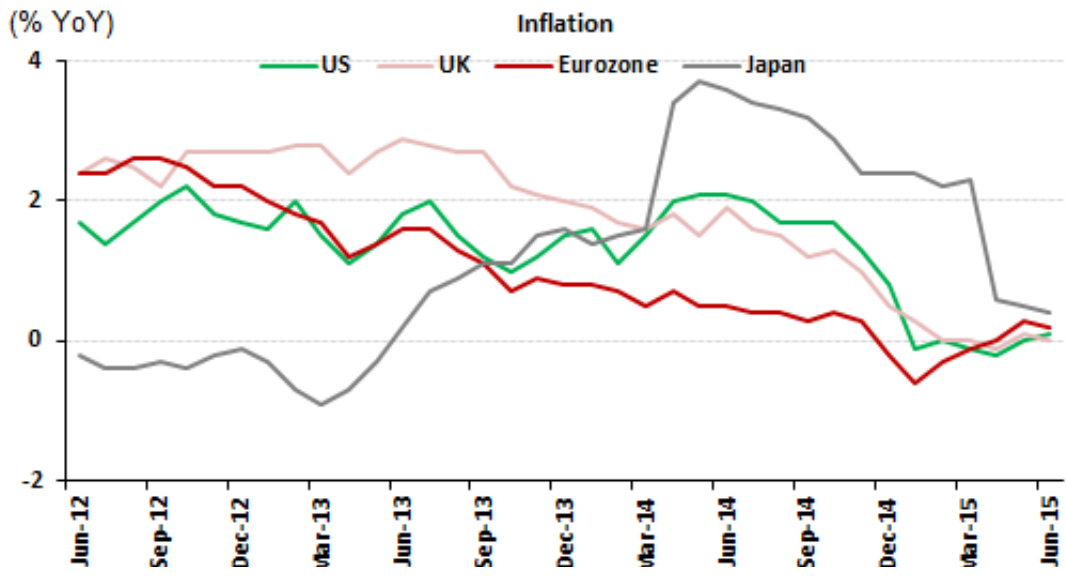


Source: EIA estimates, Kotak Economic Research



4. Deflationary risks persist

Sliding commodity prices keeps disinflationary pressures intact



SOURCE: BLOOMBERG, KOTAK ECONOMIC RESEARCH



India: Glass half full



India: Glass half full

- **Stable Macro fundamentals**
 - ✓ External sector stability
 - ✓ Gradual economic recovery underway
 - ✓ Anchored inflation

- **Coordinated policy initiatives improve medium term prospects**
 - ✓ Targeted monetary policy
 - ✓ Commitment to fiscal consolidation
 - ✓ Easing of policy hurdles

- **Challenges immense**
 - ✓ Politiconomics
 - ✓ Factor productivity
 - ✓ Competitiveness

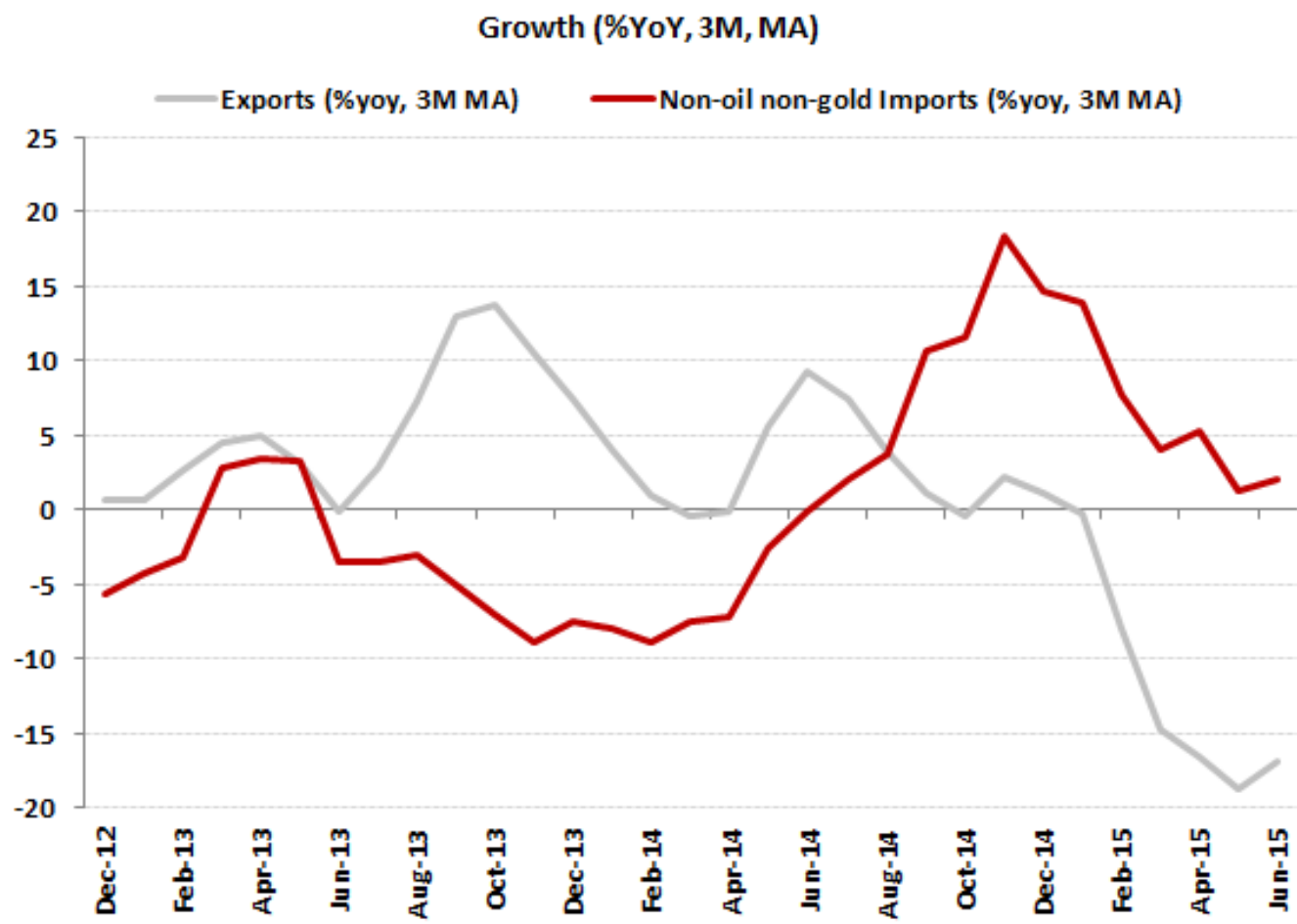
CAD to be comfortably funded despite uncertain external environment

	2013	2014	2015	2016E		
				Oil@57.5	Oil@62.5	Oil@67.5
Current account	(88.2)	(32.4)	(27.9)	(9.4)	(14.8)	(20.2)
GDP	1,836	1,877	2,049	2,163	2,163	2,163
CAD/GDP (%)	(4.8)	(1.7)	(1.4)	(0.4)	(0.7)	(0.9)
Trade balance	-196	-148	-144	-133	-138	-143
Trade balance/GDP (%)	(10.6)	(7.9)	(7.0)	(6.1)	(6.4)	(6.6)
- Exports	307	319	317	301	304	306
- oil exports	61	63	56	44	47	50
- non-oil exports	246	255	261	257	257	257
- Imports	502	466	461	434	442	450
- oil imports	164	165	138	99	108	116
- non-oil imports	338	301	323	334	334	334
- gold imports	54	29	34	35	35	35
Invisibles (net)	107	115	116	123	123	123
- Services	65	73	76	82	82	82
- software	64	67	70	75	75	75
- Transfers	64	65	66	67	67	67
Capital account	89.4	48.8	90.0	51.0	51.0	51.0
Percentage of GDP	4.9	2.6	4.4	2.4	2.4	2.4
Foreign investment	47	26	74	44	44	44
- FDI	20	22	33	34	34	34
- FPI	27	5	41	10	10	10
Banking capital	17	25	12	10	10	10
- NRI deposits	15	39	14	12	12	12
Short-term credit	22	(5.0)	(0.9)	(3.0)	(3.0)	(3.0)
ECBs	8.5	11.8	2.7	7.0	7.0	7.0
Overall balance	3.9	15.6	61.5	41.6	36.2	30.8

Source: CEIC, Kotak Bank Research



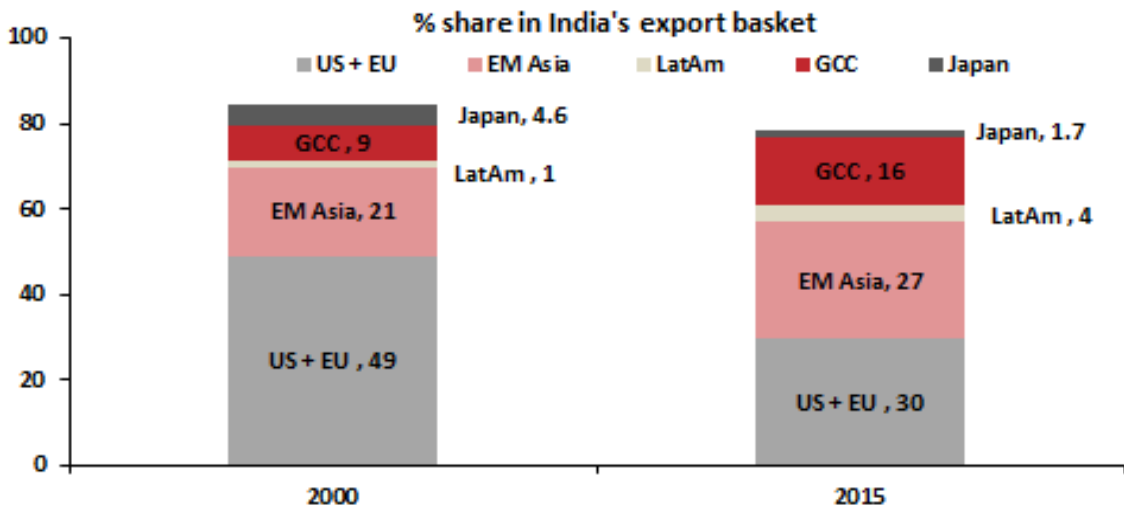
Exports and imports growth continue to decline



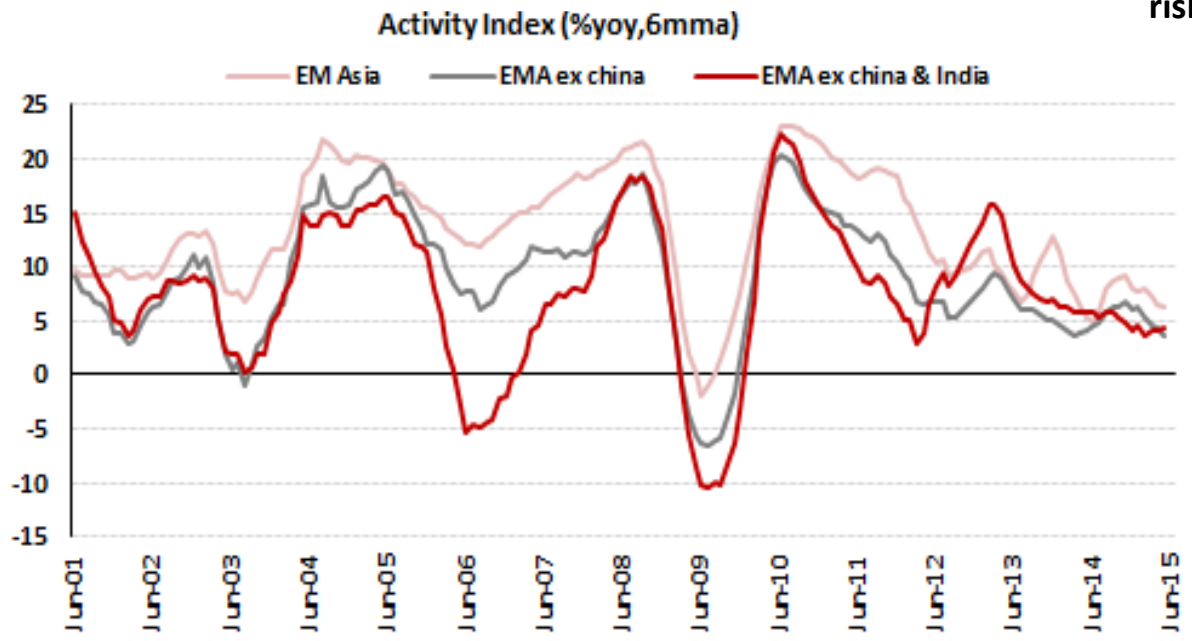
Source: CEIC, Kotak Bank Research



EM slowdown poses big risk to Indian exports



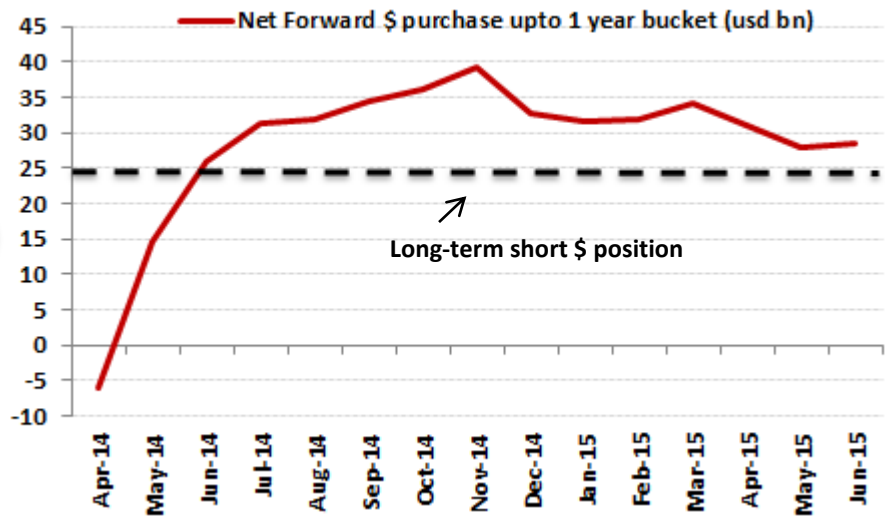
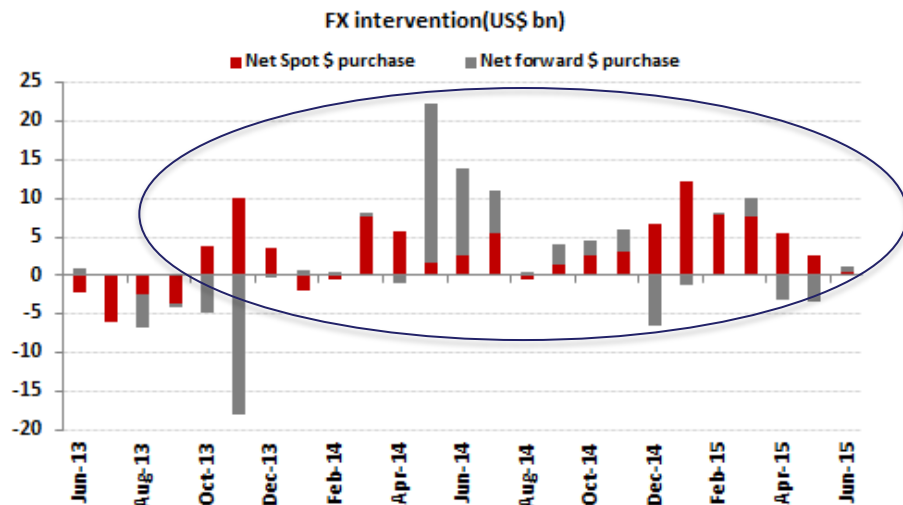
- ✓ EM Asia's share in India's exports basket has increased
- ✓ Persistence of weak growth poses significant risk to exports



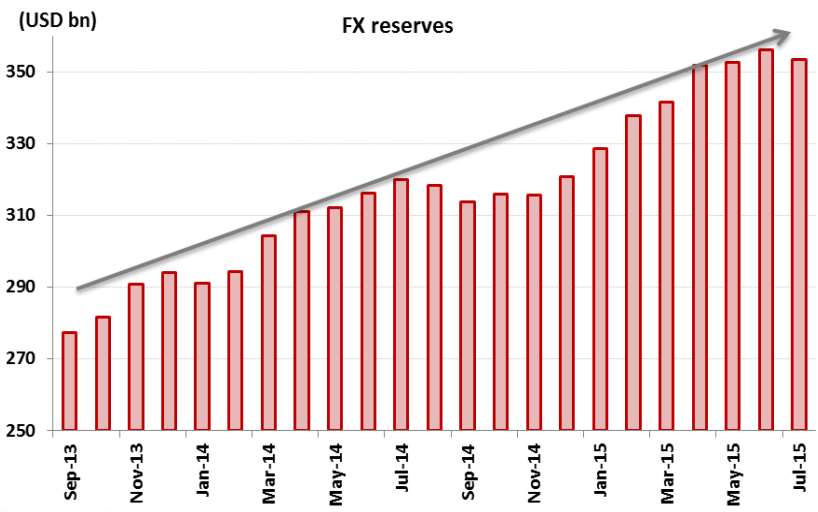


Cushion being built for external shocks...

RBI's invisible hand builds coffers



FX accretion has outdone the post Lehman loss

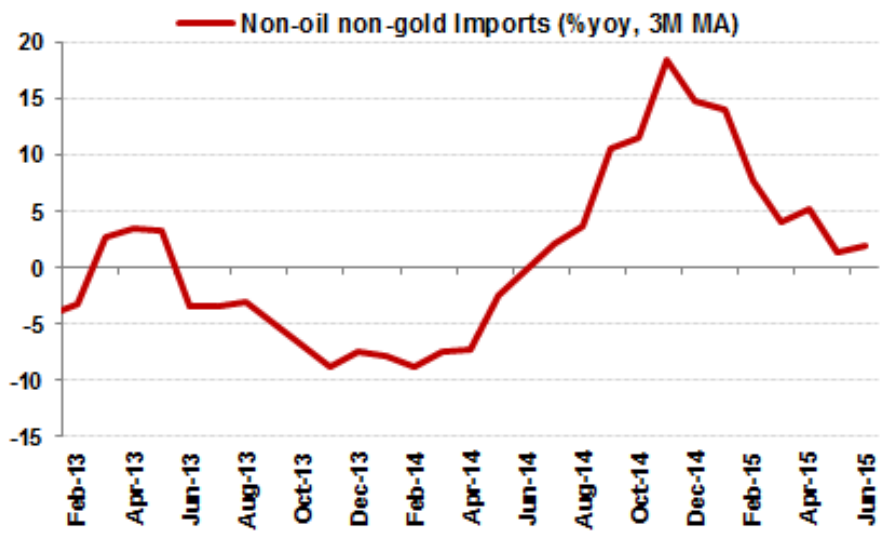
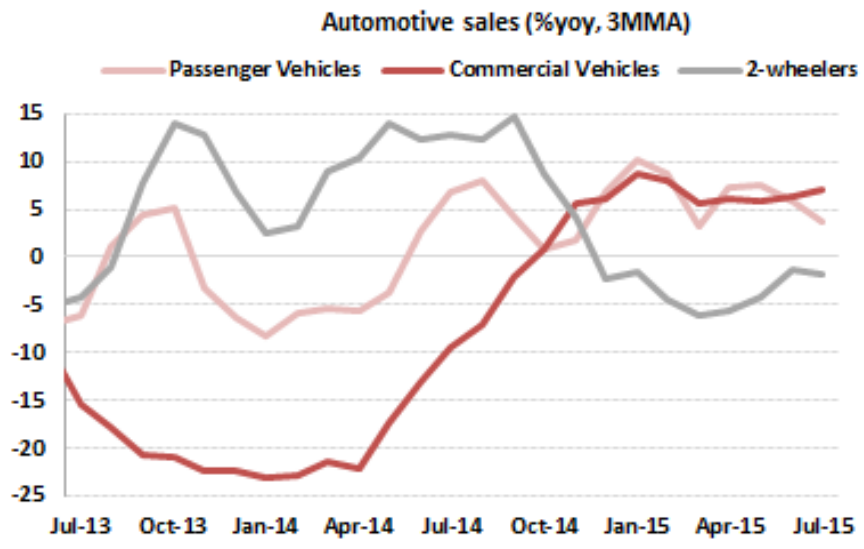
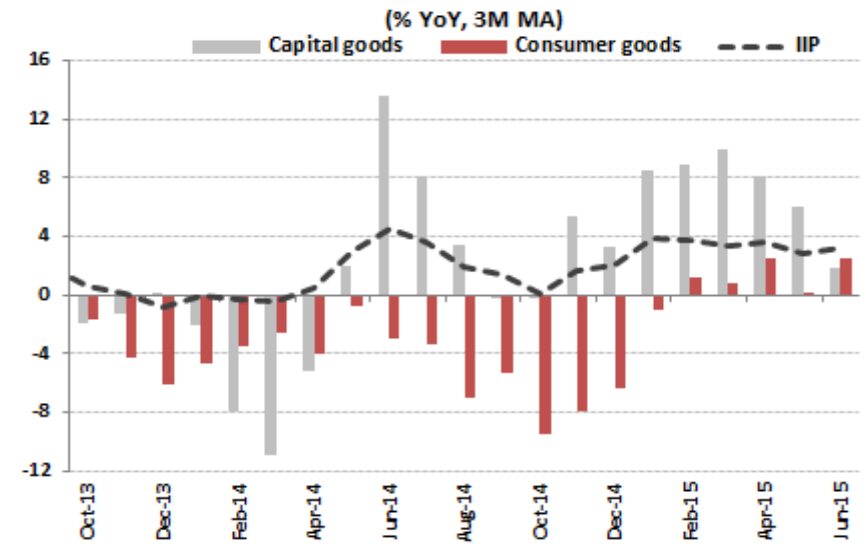
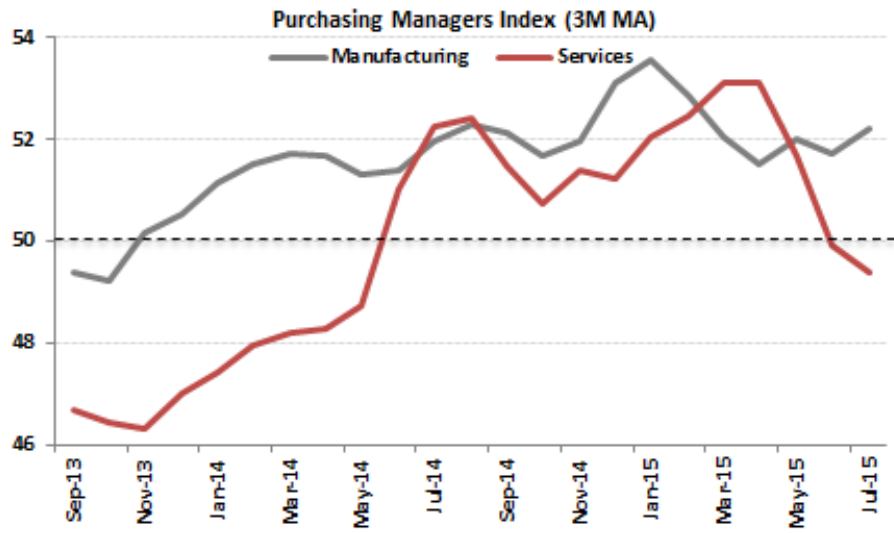


	Spot FX intervention (USD bn)
FY08	78.2
FY09	(34.9)
FY10	(2.5)
FY11	1.7
FY12	(20.1)
FY13	(2.6)
FY14	8.9
FY15	56.8
Loss in FX reserves (FY09-FY13)	(60.1)
Reserve accretion (Sep'13-Jul'15)	80.0



India's real sector: slow and steady

Mixed activity indicators

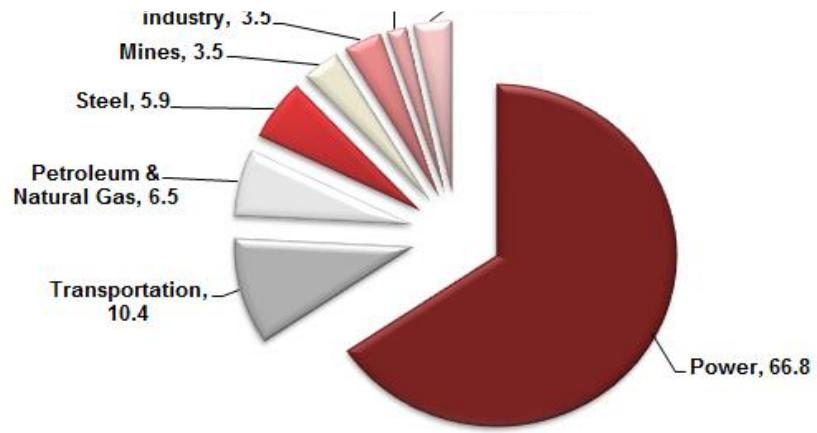




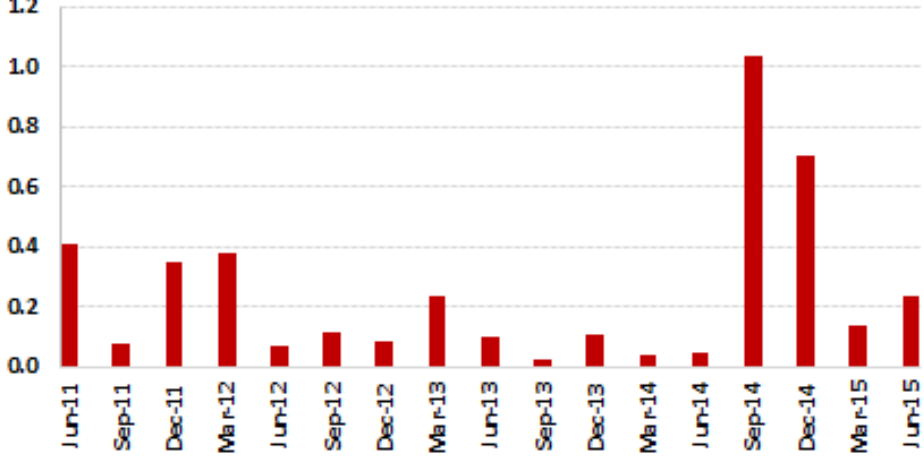
Project approvals continue to gain traction, but execution remain key

Projects referred and resolved by the PMG	
Number of Projects Referred	506
Number of Projects Resolved	205
Value of the Projects Referred (INR tn)	25
Value of the Projects Resolved (INR tn)	7
% of projects resolved	28

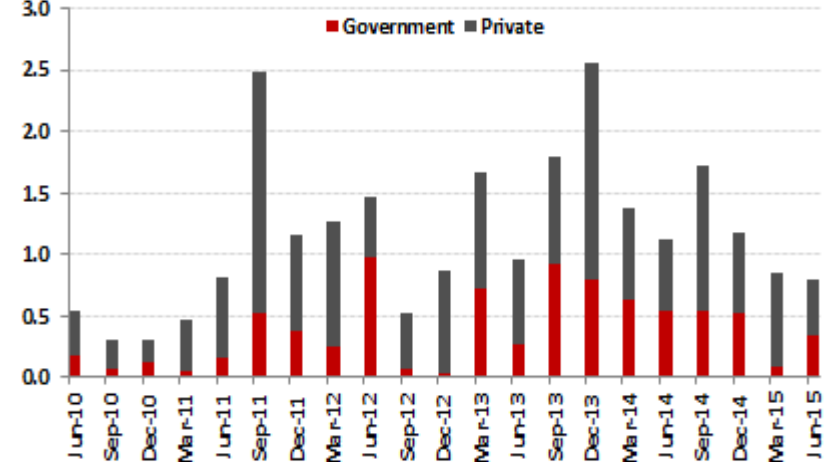
Sectoral composition of projects resolved (% of total value)



Projects revived (Rs trillion)



Projects abandoned/shelved/stalled (Rs trillion)





Slow but steady recovery underway

	2013	2014	2015	2016E
Real GDP (GVA)	4.9	6.6	7.2	7.5
Agriculture and allied	1.2	3.7	0.2	2.0
Industry	2.4	4.5	6.1	6.1
Mining	(0.2)	5.4	2.4	3.7
Manufacturing	6.2	5.3	7.1	7.1
Electricity	4.0	4.8	7.9	6.8
Construction	(4.3)	2.5	4.8	4.2
Services	8.0	9.1	10.2	10.1
Trade, hotel, transport, comm	9.6	11.1	10.7	9.8
Financial, real estate, etc	8.8	7.9	11.5	11.1
Public admin, defence, etc	4.7	7.9	7.2	9.0

Source: CEIC, Kotak Economic Research estimates

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