ArthaYantra

Newsletter

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Geopolitics and the Global Economy.

Political tensions are inducing volatility in the world economy

Inside Story

Monetary Policy

Geopolitical events are affecting the market that could affect the already weak economic growth

There is a rise in geopolitical tensions across the world in recent times. The war of words between the United States and North Korea, border stand-offs between China, Bhutan and India, the isolation of Qatar from the Gulf cooperation council, and the separation of the United Kingdom from the European Union- have all influenced the world economy in the past month and a half. Political tensions tend to raise the inflation of a nation due to various reasons- conflicts raise commodity prices which in turn has an effect on the consumer's basket. Conflicts lead to reduced trade creating a shortage of goods that an economy typically imports. The currencies of countries that are engaged in conflict weaken, which in turn make import of goods costlier.

Inflation is the primary parameter to determine interest rates of the economy. Most of the developed economies pegged their inflation target at 2%, however very few are able to achieve it. The United Kingdom on the other hand, achieved an inflation rate of 2.6%. But this inflation can be due to the depreciation of the British pound owing to Brexit. Because of the weakening of British currency in the international markets Britain, which largely imports its goods, will find it even more expensive to buy which in turn drives inflation in the UK. Post the snap elections which PM Theresa May called for last month, the United Kingdom's ruling party split three ways on the Brexit: one group favouring a hard exit from the union, the second group favoring a gradual exit and the third group - which includes the prime minister, opting for a pragmatic approach where the primary objective is to exit from European Union and at the same time avoiding an economic cliff edge. The UK's GDP grew by 0.3% in the previous quarter. However, there are risks that the UK will be heading towards a recession.

The European Union on the other hand has been performing quite well. The economic performance as measured by the PMI indicate a strong growth. The Unemployment rate of EU is 7.7% which is the lowest since 2009. But the EU's inflation for the month of July is 1.4% whereas the European Central Bank (ECB) would like to maintain the inflation at 2%. The EU's GDP grew by 0.6% in the last quarter.

The economy of Japan is facing a different problem in terms of inflation. The Japanese economy has faced chronic deflation since the 1990s. So the core Inflation becomes a critical measure for the Japanese economy. For the month of July, the core inflation remained positive at 0.4%. For the fifth month in a row, the core inflation has remained positive indicating that the policies taken by the Japanese Government and the Bank of Japan are yielding. The Japanese Yen is considered to be a safe haven similar to the US dollar and Gold. The political tensions from the US with President Trump's "fire and fury" statements, meant the Yen became one of the most preferred currencies for investment. This strengthened the yen thereby made Japanese imports cheaper. The Bank of Japan has lowered the forecast of inflation for the coming year, but has increased the expectations of GDP growth. The Q2 GDP growth of Japan stood at 0.3%. Considering how Japan faced deflation and stagnation since the mid 90s, a 0.3% growth is very much welcome.

The US economy continues to perform well in terms of economic activity. The unemployment rate and wage growth continues to be low, and a robust 209,000 jobs were added in the month of July. In the last Federal Reserve policy meeting, the Federal Reserve kept interest rates unchanged because there are other indicators suggesting that US economy might not be performing well. The inflation rate (Retail) stood at 1.7% for the month of July, while the wholesale price index surprisingly fell by 1%, which means that US economy's inflation is not stable. The United states is also involved in Geopolitical tensions primarily with North Korea, which could affect its performance in the third quarter. On August 9th, when President Trump suggested aggressive action against North Korea, the US dollar index fell, indices fell and investors moved their money to much safer haven like Gold or Yen. US imports may now become costlier with the weakening dollar.

In the Asia pacific region, growth is primarily driven by China. The Q2 GDP of China grew by 6.9%, which is much better than expected. However, this growth is primarily fueled by debt. Although the forecast for China's GDP growth has been raised for this year, the long term forecast is low. The manufacturing PMI of China has a spillover effect on the ASEAN economies primarily because, the South-East Asian economies have a large dependency on China. Due to the political tensions between USA and North Korea the dollar value slipped, consequently the Chinese Yuan grew against the dollar. China is engaged in border standoffs with a few of its neighbors, the latest standoff being with India and Bhutan. Unless the border standoff situation between China and India are subdued, trade wars between the two fast growing emerging markets may ensue.

The Latin American economies are primarily commodity driven and their biggest trading partner is China. In June, the Chinese manufacturing PMI declined compared to the month of May, which in turn had an effect on the Latin American economy as well. Which is why the PMI of Brazil, which just got out of recession, declined. The GDP of Brazil expanded in the first quarter by an annualized 1%. The GDP of Brazil is forecasted to grow by 0.4% in the coming year. The whole of Latin America is expected to grow by 1.1% in the coming year. With the growth in Chinese economy, Latin American economy is also expected to grow. However, there are political tensions in Latin America as well which could hamper the growth.

The CPI of India for the month of July is 1.54%, which is less than the 2% mark which the RBI has kept as the lower bound. The WPI inflation stood low at 0.9%. The Economic activity of India sank in the month of July. The primary reason for this drop is attributed to the introduction of GST, which caused uncertainty in corporates and businesses. However, this is expected to be a one time event and positive effects of GST will be seen in the longer term.

Manufacturing PMI saw an eight year low, whereas services PMI hit a 4 year low. All these suggests that India is going through a transition in its growth. With the low inflation measured by CPI and WPI, the RBI reduced its interest rates by 25 bps. The current repo rate is 6%. The monsoons which are the primary source of water for the agricultural sector in India stood at an excess of 1% as on 1st August 2017. However the distribution of monsoon has been erratic leading to the prices of vegetables shooting up, in turn leading to rising inflation. This indicates that the opportunities for the RBI to reduce key interest rates have reduced.

Commodities

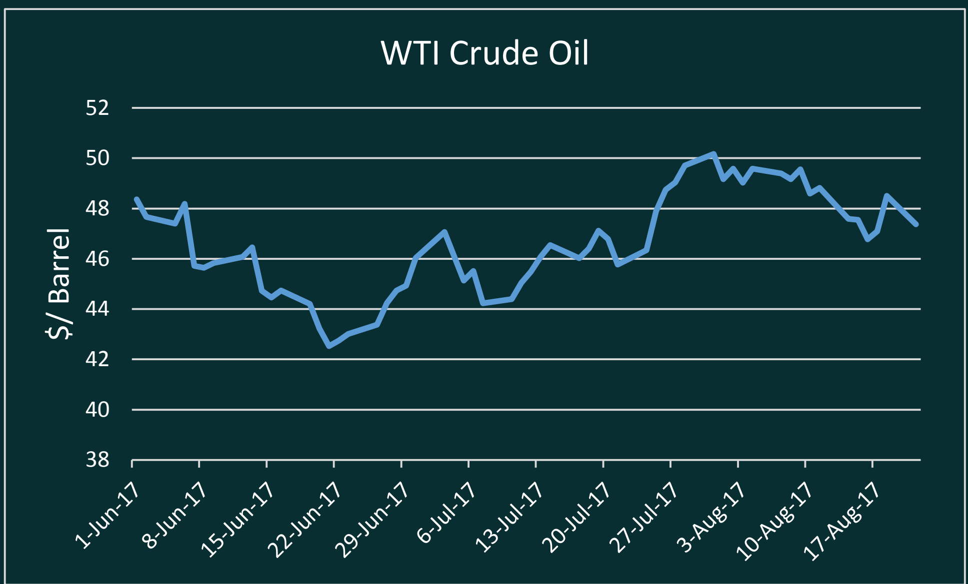

Fig 1: WTI Crude prices over the past 3 months

Oil prices were volatile for the month of July 2017. Oil prices fell on 7th July to 44.23 $/ Barrel as global supplies and inventories remained high despite the Opec extending its output cuts for another nine months. The US rig count continued to increase and its oil production is now near the highest since August 2015.

Despite OPEC's attempts to lift prices, oil prices declined as supply continued to outpace demand. With the Qatar-GCC rift, OPEC's crude oil production is expected to increase by another 145,000 barrels per day driven by higher production in Saudi Arabia, Nigeria, and the UAE.

Oil prices then rallied to 47.12 $/ Barrel on 19th July, as the dollar weakened and global demand forecasts were revised higher by the IEA.

In the beginning of August, prices rebounded with reports of large inventory draws, falling U.S. rig count and strong demand. Europe, U.S., India and China were driving the consumption and this strong demand growth is expected to remain in place through the second half of the year.

Table 1: Commodity prices as on 21st august 2017

Commodity (quantity)	Price (USD)	Projection (fortnight)
Copper (tonne)	6,513.50	Upwards
Nickel (tonne)	11,210	Upwards
WTI Crude Oil 1 month futures (barrel)	47.37	Ranged to upwards
Natural Gas (MBTU)	2.96	Ranged
Zinc (tonne)	3,143	Ranged

Equity

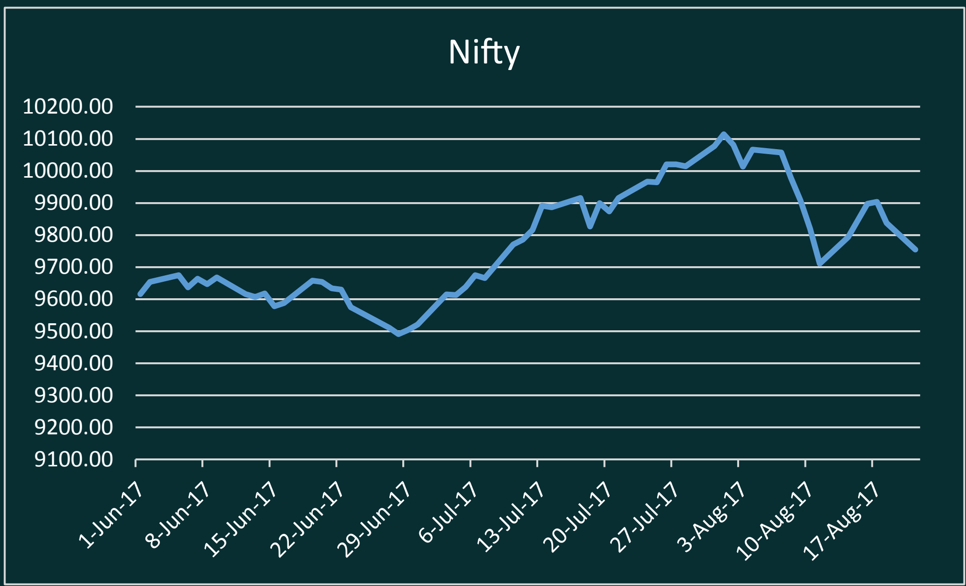

Fig 2: Nifty over the past 3 months

Equity markets continued to rally to through the month of July. With inflation hitting a record low, the market's expected the RBI to lower the policy rates. This in turn fuelled the rally with Nifty crossing the 10,000 mark for the first time in its history. The markets were boosted with the US Federal Reserve keeping its benchmark interest rate unchanged after the conclusion of a two-day policy meeting.

On 2nd August 2017, The Reserve Bank of India (RBI) slashed repo rates by 25 bps and maintained an accommodative stance as was expected. The markets factored the rate cut and corrected.

However, the Indian markets along with its Asian peers corrected in August with rising geopolitical concerns after the U.S. and North Korea exchanged threats.

Bullion

Gold prices fell in beginning of July reaching to $1207.55/tr.oz. on 10th July as central banks around the world hinted at tightening of monetary policy and higher interest rates. However, Gold prices recovered in mid-July after Janet Yellen's testimony, where she hinted at slower than expected interest rate hikes in the coming year.

The gold prices further rallied reaching upto 1247 $/ tr.oz on 21st July with the announcements made by the European Central Bank’s (ECB), which indicated a gradual shift towards policy "normalization".

However a decline in gold prices was seen in the first week of August after the job reports in the USA suggested that more jobs were added in the month of July than expected. This means that the Federal Reserve is likely to continue the rate raising cycle. This strengthened the US dollar and weakened gold.

However Geopolitical tensions induced volatility in the global markets thereby boosting the price of gold. Gold prices rose to 1267.95 $/ tr.oz on 9th August amid rising tensions between the United States and North Korea after the former responded to warnings from US President Donald Trump with a threat to strike the US territory of Guam.

Table 2: Precious Metals prices as on 21st August 2017

Commodity (quantity)	Price (USD)	Projection (fortnight)
Gold (tr.oz.)	1,287.60	Ranged to upwards
Silver (tr. Oz.)	17.02	Ranged
Platinum (tr. Oz.)	973.50	Ranged

Investment Strategy

In the last few weeks, equity markets have corrected due to political tensions. With the weakness in the Asian markets and Political uncertainty, markets will be volatile. With the introduction of GST, corporate earnings saw a decline in the previous quarter. However, Indian economy are poised to grow for long term. With the geo-political tensions, there will be volatility in the immediate term. Therefore, it is best to hold equity for long term rather than short or immediate term.

With the lowering of key interest rates by the RBI, bonds of longer duration will become attractive. Additionally, the introduction of GST, e-governance and more key initiatives led to an increase in the realised revenue by the government. This will enable the bond market to rally. It is therefore best to hold bonds with longer Duration.

Political Uncertainty still persists with tensions between US and North Korea, China and India and the Qatar- GCC countries. Political uncertainty also persists in the UK and EU with Brexit. These will contribute to the uncertainty in the global markets. Gold will attract more investment as safe-haven leading to the rallying of gold. It is therefore best to hold gold as a hedge with an exposure not more than 5-10% of the portfolio

Global Economy

A quick look at the economic events that are taking place across the world and the likely outcome.

Country/Region	Event	Impact(Projected)
USA	US Federal Reserve Holds interest rates steady	• Dollar Weakens • Gold Strengthens
European Union/UK	ECB indicates normalization of policy	• Euro strengthens • British Pound weakens
Asia Pacific	North Korea- US tensions	• Asian Indices crash • US Dollar weakens • Gold Strengthens
India	RBI lowers interest rates	• Rupee strengthens

Blog

5 Common Money Mistakes Middle Class Should Avoid

Middle-class families are almost always under financial pressure due to limited income yet too many responsibilities. Eventually, families do not have enough saved to pay for kids' college and even to retire at 60. To relieve the stress and to improve the financial situation, it is imperative to avoid the below listed common money mistakes they usually commit.

Loose Spending and Impulse Purchasing: Many times we neglect to compare or find better options for a product we intend to buy. We hesitate to bargain at showrooms with grand ambiance. But, it is always better to research a lot before making any buying decisions. Not having a tight fist while spending the hard earned money makes us remain broke all through the life.

So, be wise in avoiding impulse shopping and loose spending habits. In simple, think twice or thrice before making any purchase. Ask yourself if you really need that item you wanted to buy and then take a well-informed decision.

Not Having an Insurance kit: No insurance means no cover or protection against unforeseen events like a medical emergency, an accident, a lay off etc. What if you are laid off, all of a sudden? Can you meet the heavy hospital expenses, if any of your family members gets hospitalized on emergency? Don't your family shatter both emotionally and financially if you die due to an accident? Most middle-class families struggle to recover if they experience any such unexpected financial emergencies.

Thus, it makes sense to pay little insurance premiums on a regular basis to keep you and your family covered. Also, create an emergency fund worth 3 to 6 month of family income to sustain an emergency.

Dependence on Single Income Source: Depending on a single income source is the most common drawback for 90% middle class. Even if both wife and husband work, most of the times their earnings are enough just to make ends meet. Thus, they are more prone to debts, loans or borrowings, after which their earnings are diverted to interest payments.

It is always better to create multiple income sources. We should look out for more and more opportunities to earn. Extra earnings in free time drastically help reduce financial pressures and push savings.

Having No Proper Financial Plan: Every household needs to have a proper financial plan to lead a self-sufficient life till the end. To build a plan, one has to first identify all the financial goals of life, prioritize them and estimate the corpus required to meet each goal. Then dedicate savings for every goal.

Making Wrong Investments: Simple savings may not be enough to beat the inflation and build required corpus in the given time to reach money goals. Thus, investments in mutual funds are the best way to let savings grow with time. After considering all the factors like risk appetite, assets, liabilities, etc., a well-diversified portfolio has to be created and then mutual fund investments are to be made, for which an expert advice comes handy.

If you love to improve your financial quotient and get your family to an improved financial status, approach online advisories like ArthaYantra – World's Full-Service Robo Advisory. Maximize your savings and lead a wholesome life!

About ArthaYantra

ArthaYantra was founded with the mission to make high quality financial advice available to everyone irrespective of their wealth status. Our award winning platform, Arthos, uses artificial intelligence based system and complex neural networks to generate advice across Investments, Expense management, Insurance, Loans, Estate planning, and Taxes. The advice itself is explained by a certified personal advisor. We are the only fintech startup globally to have been recognised by Gartner for digital innovation. Winner of Red Herring Global Top 100 startup award; Among the top 35 Fintech company in Asia as per Finovate, and NASSCOM emerge 50 Award. Since our launch, we have helped more than 130,000 customers across 650+ cities and 30+ countries.

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