FIRST Insights

Getting all tangled up

The month of July started with OPEC extending the crude oil production cuts until Mar-20 amidst easing of trade tensions between the US and China. During the month, IMF downsized 2019 global growth forecast to 3.2% from its Apr-19 estimate of 3.3% citing trade tensions and Brexit related uncertainties. Thereafter, major central bank policy meetings took center stage. The ECB maintained a dovish rhetoric amidst a deteriorating growth environment and low inflation. With limited fiscal space, the central bank hinted at the possibility of easing monetary policy in Sep-19 and a potential reintroduction of quantitative easing. The US Fed delivered an 'insurance' policy rate cut of 25 bps for the first time since the 2008 financial crisis citing low inflation, weakening global growth and heightened trade tensions. It also ceased the shrinking of its balance sheet effective 1st Aug-19. Heading into August, while BoE left interest rate unchanged at 0.75%; it slashed its GDP growth forecasts down to 1.3% for 2019 and 2020, from earlier estimates of 1.5% and 1.6% respectively; on the assumption that hard Brexit will be avoided.

While these signals sufficiently tamed market expectations on global growth momentum, it wasn't the end. In quick succession, US-China trade tensions erupted yet again in early Aug-19 in a manner that is being seen by markets as a full blown protracted trade and currency war, that will adversely impact global economy further in the coming months. After an unsuccessful meet between US and Chinese delegates in Beijing, President Trump surprised by imposing a 10% levy on USD 300 bn worth of Chinese imports starting 1st Sep-19. This move covers almost the entire US import basket from China worth USD 550 bn under a gamut of tariffs ranging from 10-25%. China responded by allowing yuan to depreciate past 7.0 per dollar level after more than a decade. Alongside, it asked its state owned companies to suspend imports of US agricultural products. This irked US to label China as an official currency manipulator. While the escalated trade tensions between the two largest world economies sees no end in the near term, another pocket of uncertainty has erupted across the Atlantic with Boris Johnson, the new UK PM, reiterating his promise of Brexit on 31st Oct-19, with or without a deal. UK's opposition Labor party is expected to raise a no-confidence motion in the parliament after it resumes following the summer recess. On the global macro data front cues remain largely weak. Global manufacturing PMI contracted for the second successive month on the back of decline in new orders, output and export orders. Eurozone's real activity indicators of PMI manufacturing and industrial production were weak along with sentiment indicators. For the US macro data was mixed. While US factory orders contracted for the second consecutive month and consumer confidence eased, nonfarm payrolls surged in June.

On the global macro data front, cues remain mixed. US GDP grew at an annualized rate of 2.1% in Q2, down from 3.1% registered in Q1. Despite the moderation, increase in consumer spending which posted its strongest quarterly performance since Q4-17 amidst moderation in business fixed investment, residential investment and net exports, offers comfort. On the other hand, not surprisingly, China's GDP growth slipped to 6.2% YoY in Q2 from 6.4% previously amidst ongoing trade tensions.

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Global Macro Developments

- China called planned US tariffs on an additional USD 300 billion of Chinese goods a violation of accords reached by Presidents Donald Trump and Xi Jinping, signaling its intention to impose retaliatory measures. Meanwhile, US President Donald Trump said that US and Chinese negotiators were holding productive trade talks over phone and expected them to meet in September.
- People's Bank of China (PBoC) took steps to slow the Yuan's descent by announcing the planned sale of Yuan-denominated bonds in Hong-Kong and by setting the daily currency fixing stronger than expected. Meanwhile, China also asked state-owned companies to suspend imports of US agricultural products.
- Japan is all set to remove South Korea from a list of trusted export destinations, which would expand the number of restricted materials used by South Korean makers of LED screens, televisions and semiconductors. This removal would have a grave impact that could hurt security ties between the two US allies.
- The IMF has cut its outlook for global growth by 10 bps for both 2019 and 2020 to 3.2% and 3.5%, respectively. For India, IMF lowered its forecast by 30 bps to 7.0% and 7.2% for FY20 and FY21 on the back of expectations of weaker domestic demand.
- Asian Development Bank (ADB) trims India's GDP growth forecast to 7% for FY20 on the back of fiscal concerns. In April earlier, ADB had lowered the GDP growth forecast for FY20 to 7.2% from 7.6% estimated previously due to moderation in global demand and likely shortfall in revenue on the domestic front.
- China is expected to impose anti-dumping duties (ranging from 18.1 - 103.1%) on some stainless steel products from EU, Japan, Indonesia and South Korea.

Events and Data Calendar

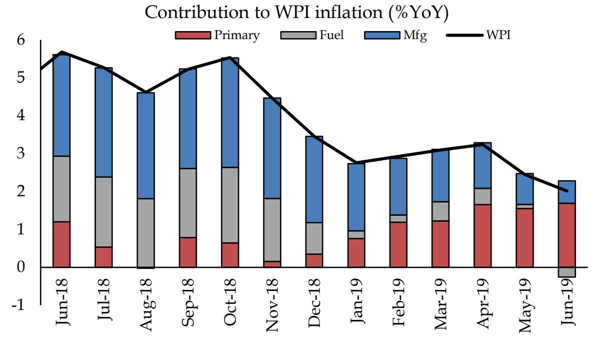
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
UK	17-Jul-2019	CPI YoY	Jun	2.00%	2.00%	2.00%	⇨
	9-Aug-2019	Industrial Production YoY	Jun	-0.30%	-0.60%	0.90%	⇩
	14-Aug-2019	CPI YoY	Jul	1.90%	2.10%	2.00%	⇧
US	26-Jul-2019	GDP Annualized QoQ	2Q A	1.80%	2.10%	3.10%	⇩
	2-Aug-2019	Unemployment Rate	Jul	3.60%	3.70%	3.70%	⇨
	13-Aug-2019	CPI YoY	Jul	1.70%	1.80%	1.60%	⇧
China	31-Jul-2019	Manufacturing PMI	Jul	49.60	49.70	49.40	⇧
	9-Aug-2019	CPI YoY	Jul	2.7%	2.8%	2.7%	⇧
	14-Aug-2019	Industrial Production YoY	Jul	6.00%	4.80%	6.30%	⇩
Japan	15-Aug-2019	Industrial Production YoY	Jun F	--	-3.80%	-4.10%	⇧

P* – Provisional Estimates F* - Final Estimates A* - Advanced Estimates T*- Third Estimates

COMMODITY

- Gold prices increased by 4% MoM in July vs. an increase of 5.3% MoM in June amidst expectations of a rate cut at the US Fed meeting, 30-31 July.
- Brent prices expanded by 3.9% MoM in July vs. a contraction of 9.7% MoM in June on the back of 1) concerns of supply related disruptions in Middle east after Iran's seizure of a British tanker in mi-July and 2) decision by OPEC to extend an output supply cut deal until Mar-20.

Domestic Market Macro Economics



India WPI Inflation

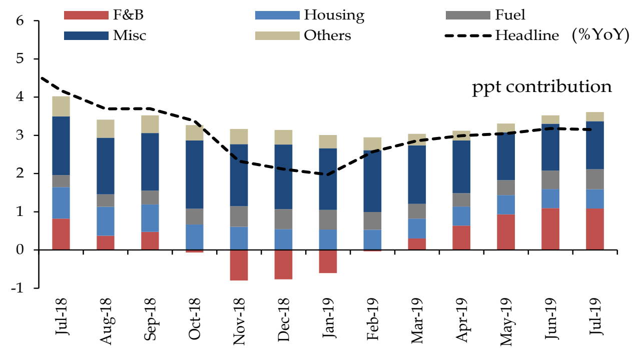
%YoY	Weights(%)	Mar-19	Apr-19	May-19	Jun-19
IIP	100	2.7	4.3	4.6	2.0
Sectoral Classification					
Mining	14.4	0.8	5.1	2.4	1.6
Manufacturing	77.6	3.1	4.0	4.5	1.2
Electricity	8.0	2.2	6.0	7.4	8.2
Use Based Classification					
Primary goods	117.6	2.6	5.1	2.2	0.5
Capital goods	101.3	-9.1	1.2	-1.4	-6.5
Intermediate goods	122.5	12.4	1.9	13.7	12.4
Infrastructure/construction goods	130.9	5.1	7.2	1.8	-1.8
Consumer durables	124.3	-3.2	2.2	0.3	-5.5
Consumer non-durables	128.4	1.4	5.9	8.1	7.8

June IIP

- ✓ Manufacturing PMI index picked up to 52.5 in Jul-19 from 52.1 in Jun-19 and services PMI index rose to near one year high of 53.8 from a contraction of 49.6 in the previous month. As such, the composite PMI output index rose to an eight-month high of 53.9 in July vs. 50.8 in June.
- ✓ Core sector growth slipped to a 3-1/2 year low of 0.2% YoY in Jun-19 compared to 4.3% in the previous month led by contraction in steel, refinery products, natural gas, cement and crude oil production. Among other sectors, production of coal, fertilizer and electricity supported at the margin.
- ✓ Auto sales plunged in Jul-19, declining for the ninth consecutive month, amidst subdued consumer sentiment, hike in registration fees for new vehicles as well as rise in renewal charges. Liquidity constraints, delay in monsoon & rise in insurance premia further weighed on sales. A gradual improvement in H2FY20 could take shape led by new launches, measures announced on reviving rural demand, festive demand.
- ✓ Gross GST revenues for the month of July stood at Rs. 1,020 bn up from Rs 999.4 bn in the previous month. Gross GST revenues on a FYTD basis (Apr-June), as a % of BE eased to 23% compared to 27.8% a year ago.
- ✓ India's industrial production growth decelerated to 2.0% YoY in Jun-19 from an upwardly revised print of 4.6% in May-19 (earlier: 4.3%). For Q1 FY20, IIP growth stands lower at 3.6% YoY compared to 5.1% recorded in Q1 FY18 adding to the host of indicators confirming the weakening economic growth momentum.
- ✓ India's retail inflation eased marginally to 3.15% YoY in July-19 from 3.18% in June-19. The reading came marginally higher than consensus expectations of 3.09%. Looking at the internals, downside in headline inflation was driven by categories of fuel. While Jul-19 CPI inflation marks the third consecutive above 3.0% print, it continues to remain well below RBI's medium term target of 4.0% for the twelfth successive month.

%YoY	Jun-18	May-19	Jun-19
Overall	**7.8**	**4.3**	**0.2**
Coal	11.5	1.9	3.2
Crude Oil	-3.4	-7.0	-6.8
Natural Gas	-2.7	0.0	-2.1
Refinery Products	12.1	-1.5	-9.3
Fertilizers	0.9	-1.0	1.6
Steel	4.2	15.3	6.9
Cement	14.2	2.8	-1.5
Electricity	8.5	7.4	7.3

CORE Sector –Records a sharp dip



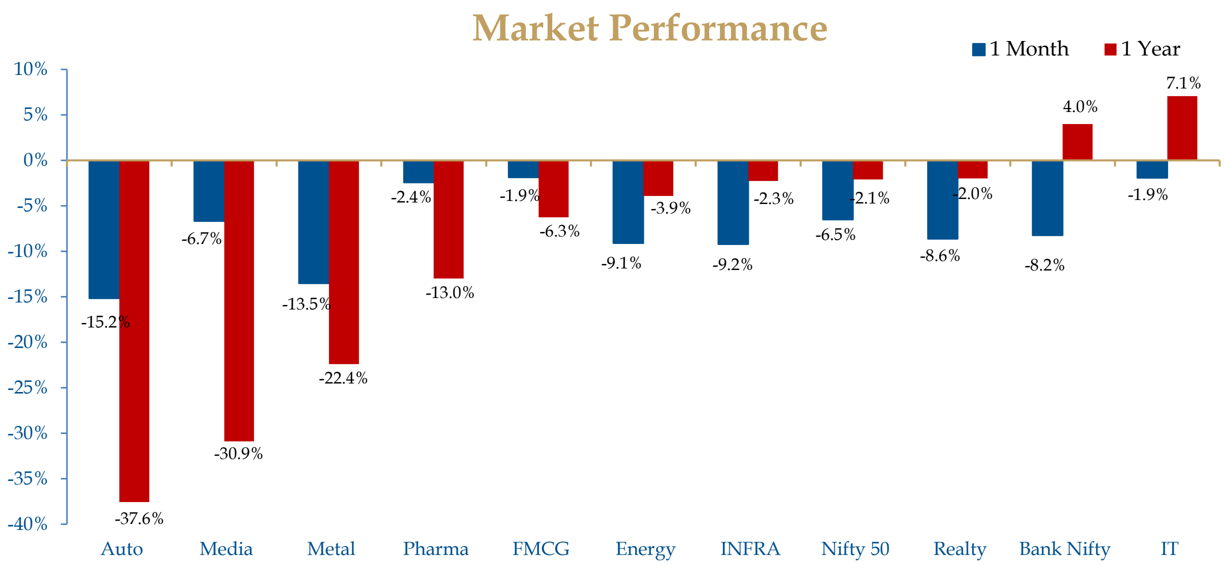
India CPI Inflation

We expect:

- ✓ We have lowered our GDP growth forecast to 6.7% (vs. 7.0% earlier). Growth momentum is expected to be back loaded in H2FY20 due to: 1) Favourable statistical base 2) PM-Kisan scheme to support rural demand 3) Sectoral initiatives for Affordable Housing, MSMEs, Roads, Aviation and Railways announced in the Union Budget and 4) Lagged moderation in real interest rates. Downside risk to growth could emanate from 1) Persistence of weak domestic demand 2) Sluggish global growth and 3) Fiscal compression spillovers.
- ✓ We expect CPI Inflation to average at 3.5% vs. 3.4% in FY19, assuming crude oil prices stay at USD 65-70 per barrel, on account of reversal of benign food inflation and moderation in core price pressures.

Equity Market Insights

- ✓ Indian equity market held up reasonably well in 1H 2019, despite moderating economic growth. FII flows, signs of bottoming in corporate profitability and strong NDA victory leading to hopes of revival in economic activity led to the NIFTY touching new highs in early June. However, these gains got eroded in July.
- ✓ Nifty 50 was down 6.5%. Whereas Nifty Midcap 150 and Nifty Smallcap 250 took a bigger hit of 9.2% and 11.3%, respectively. Sentiments have turned negative with unfavorable tax developments, lack of strong fiscal support towards growth, tight financial conditions and reduced growth visibility.
- ✓ Just as banking sector started recovering, NBFCs saw signs of stress, which has been persisting for 11 months now. The end-2018 liquidity crunch and subsequent developments are still hurting. This has percolated into other parts of the system given the connections between the real estate developers, HFCs, banks and bond markets.



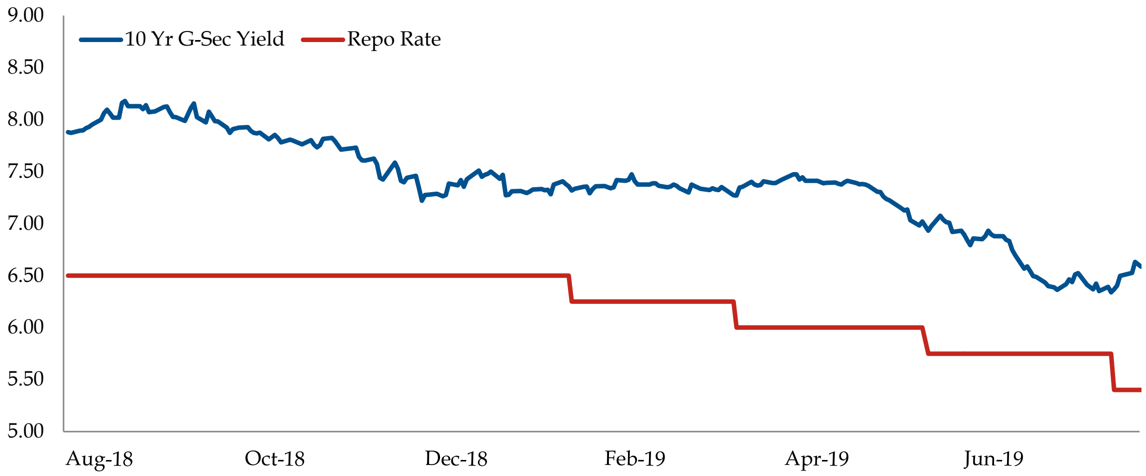
Outlook & Expectations

- ✓ We believe the market is in a consolidation phase since 2018. It has been so since early 2018 and the consolidation should last for the remainder of the year 2019 and some part of 2020. Paradoxically though, the Nifty may still inch upwards, on the strength of only a handful of blue-chip counters, during this period.
- ✓ The market support may likely come from rate cuts by RBI, enhancement in system liquidity and credit, recovery in the financial sector seen in corporate earnings, any government reforms given their strong mandate and even the US Fed cutting interest rates. Good news can also come from the likely review by Indian Government on FPI surcharge. The broader market will continue to remain lackluster, while there is scope for more pain in mid-cap/small-cap stocks.
- ✓ As the key index inches upwards, allocation to large caps makes sense at this juncture. But we also note that consumption is in a cyclical downtrend now, the economy has slowed, liquidity issues remain and the Budget didn't particularly excite either. Therefore, we believe that a systematic withdrawal (SWP) approach is equally warranted. A staggered approach to investing would be a better one, given the present state of equities.

Debt Market Insights

- ✓ The average systemic liquidity maintained a surplus of Rs 1,298 bn in July vs. a surplus of Rs 539 bn in June.
- ✓ The average 10yr G-sec bond yield moderated to 6.52% in July from 6.93% in June tracking moderation in US Treasury yields. Alongside, 1) market participates pricing in 2-3 rate cuts from the RBI in the next 1-year 2) comments from Fed chief on prospects of rate cuts and 3) positive surprise in the FY20 Union Budget and announcement of government's intent to explore the sovereign bond market.
- ✓ We continue to expect headline CPI inflation to remain moderate at 3.5% in FY20 (3.4% in FY19). This would be the third consecutive year of below target inflation outturn for the Indian economy and is likely to continue to provide comfort to RBI's Monetary Policy Committee. With near term growth appearing weak, we continue to expect 25-40 bps scope for rate cuts in the next one/two policy reviews. The rate action thereafter would get data dependent with overall monsoon outturn, global trade outlook, persistence of recent volatility in currency market, sustainability of the recent softness in global commodity prices, and last but not the least, the degree of anticipated revival in domestic growth as key variables to be watched.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- ✓ Liquidity infusion in FY20 (so far) has come about via USD 5 bn FX swap and Rs 525 bn OMO purchases. Going forward, we expect RBI to deploy both FX swaps and OMOs to infuse primary liquidity into the system.
- ✓ Gross and net market borrowing is budgeted at Rs 7,100 bn and Rs 4,731bn respectively in FY20. Adjusted for buybacks, the net supply of G-sec is expected to broadly remain unchanged at around Rs 4.2 trillion in FY19 and FY20. Budget makes INR 500 bn provision for buyback and switch of g-secs in FY20. The net SLR supply picture in FY20 could change from budgeted levels depending upon the extent of sovereign bond issuances.
- ✓ We revise our G-sec trading range to 6.00-6.50% for the rest of FY20 from 6.50-7.00% as dovish global environment (led by US rates) along with the shift in RBI's policy stance to accommodative is likely to provide further leg to the recent rally.

Glossary:

- ✓ **Consumer Price Index (CPI):** A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care.
- ✓ **Wholesale Price Index (WPI):** An index that measures and tracks the changes in price of goods in the stages before the retail level.
- ✓ **Open Market Operations (OMO's):** is the buying and selling of government securities in the open market in order to expand or contract the amount of money in the banking system. Purchases inject money into the banking system and stimulate growth while sales of securities do the opposite.
- ✓ **Cash Management Bills (CMB):** A short-term security sold by RBI to meet any temporary shortfalls.
- ✓ **Purchasing Managers Index (PMI**) is based on surveys on private sector service /manufacturing companies. An index level of 50 denotes no change since the previous month, while a level above 50 signals an increase or improvement and below 50 indicates a decrease or deterioration.
- ✓ **Net Demand and Time Liabilities (NDTL):** It is the sum of demand and time liabilities (deposits) of banks with public and other banks wherein assets with other banks is subtracted to get net liability of other banks.
- ✓ **Current Account Deficit (CAD):** A measurement of a country's trade in which the value of goods and services it imports exceeds the value of goods and services it exports. A current account deficit represents negative net sales abroad. A country can reduce its current account deficit by increasing the value of its exports relative to the value of imports.
- ✓ **West Texas Intermediate (WTI**): also known as **Texas light sweet**, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content.

For Further Information on Model Portfolios, Kindly contact your Relationship Manager.

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