Will the trade risks turn real?

Fears of escalation in global trade war accelerated further after China imposed import tariff on US goods in a retaliatory move. Looking at the recent past, after introducing additional tariff on aluminum and steel for all countries barring Canada and Mexico initially, President Trump's administration announced import tariffs of 25% on a list of 1300 Chinese goods – electronics, aerospace, industrial, medical products, etc., worth USD 50 bn. The move was designed to penalize China for alleged theft of intellectual property specific to US innovation, technology and aerospace industries. China hit back by unveiling a proposal of additional tariffs on 106 US made goods (consisting of soybeans, autos, chemical, corn products, aircrafts, etc.) worth USD 50 bn, following which President Trump threatened that his administration might levy tariffs on additional USD 100 bn worth of imports from China. With US and China aiming at each other in a tit-for-tat trade mode, risks are further escalating of a trade war between the two major economies of the world.

Meanwhile, global manufacturing PMI continued to consolidate in the expansion zone, however, the headline index moderated to 53.4 in Mar-18 from 54.1 in Feb-18 due to slower growth of output and new orders. Details suggest that growth was led by the US, UK, Brazil and Russia. Data emerging out of the Eurozone was flattish with economic sentiment turning less optimistic, PMI manufacturing sinking to an eight-month low level of 56.6 in Mar and annualized CPI inflation easing to 1.1%, remaining well below ECB's target of 2%. For US, data was mixed, with an upward revision of Q4 GDP by 40 bps to 2.9% YoY and upbeat factory goods orders aided by strong demand for transportation equipment, while ADP nonfarm payrolls surprised significantly on the downside (at 103K, much lower than market consensus).

On the global monetary policy front, US Federal Reserve, in line with market expectations, raised policy rates by 25 bps to 1.50%-1.75% and maintained its resolve to continue to trim its ~USD 4.5 tn balance sheet. FOMC maintained a neutral tone highlighting that economic conditions will evolve in a manner which will warrant a gradual pace of rate hikes. As such, market is pricing in two additional rate hikes in 2018. On the other hand, ECB kept rates unchanged and maintained its ultra-accommodative policy stance. Additionally, BoE also kept rates unchanged (7-2 vote); however the probability of a rate hike by 25 bps in May stands at 89.2%, as UK wage growth continues to gather pace in response to tight labour market conditions.

On the domestic front, lead domestic indicators released for the months of Feb-Mar mostly fared better, pointing towards continued normalization of growth conditions. PMI manufacturing expanded albeit at a slower pace while services PMI rebounded to the expansion zone. Meanwhile, India's industrial production grew at a robust pace for the third consecutive month, auto sales posted a robust growth led by UVs, CVs and 2-Wheelers.

For FY19, we expect GDP growth to pick up to 7.5% (up from 6.7% in FY18) with incremental growth likely to be consumption led on account of Government's focus on reviving rural economy along with rollout of state pay commission award; further normalization of business conditions, gradual recovery in investment climate amidst bank recapitalization and resolution of stressed assets and recovery in global demand.

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Chief Economist

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Global Macro Developments

- US Federal Reserve raised its policy rate by 25 bps in line with market expectations. It was the first meeting of the new Governor, Jerome Powell. FOMC members raised their 2018 growth projection to 2.7%, up from 2.5% in December 2017.
- US Congressional Budget Office stated that the massive tax cut undertaken in December will result in a widening of fiscal deficit in 2018, estimated at USD 804 bn (fiscal year ending in Sep) vs. USD 665 bn in 2017. The national debt is on track to approach 100% of GDP by 2028.
- US nonfarm payrolls increased by 103K in March, coming significantly lower than consensus expectations of 193K, as construction and retail sector jobs reduced. This was the smallest gain since last September and followed a 326K surge in February, which was the largest in more than two years. The unemployment rate held steady at 4.1% for a sixth straight month. Meanwhile, wage growth rose by 0.3% MoM in Mar vs. 0.1% in Feb on the back of tighter labour markets.
- BoJs quarterly Short Term Economic survey showed business sentiment worsened for the first time in two years in the three months to March, as rising raw material and labor costs weigh on an otherwise steady economic recovery. An index measuring big manufacturers' confidence fell by 2 points to 24 in March.
- Bank of England maintained its interest rates steady in its policy meeting held on 22nd March. However, two members of the rate setting committee voted for a rise in rate.
- China's central bank, PBOC, hiked its short term interest rate by 5 bps following the US FOMC meet where it raised its policy rate by 25 bps.
- Bank of Japan's board members have said that the central bank needs to stick with the quantitative easing as inflation is still well below its 2% target. They opined that further yen strength and stock declines could curb capex and consumer spending and it could delay hitting the inflation target.

Events and Data Calendar

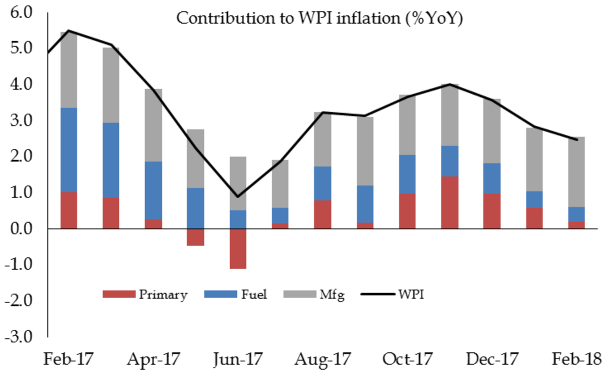
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	23-Mar-2018	National CPI (YoY)	(MAR)	1.50%	1.50%	1.40%	↑
	30-Mar-2018	Jobless Rate	(FEB)	2.60%	2.50%	2.40%	↑
US	21-Mar-2018	FOMC rate Decision	(MAR)	1.75%	1.75%	1.50%	↑
	28-Mar-2018	GDP Annualized (QoQ)	(4QT)	2.70%	2.90%	2.50%	↑
EA	6-Apr-2018	Change in Nonfarm Payrolls	(MAR)	185K	103K	313K	↓
	16-Mar-2018	CPI (YoY)	(FEB F)	1.20%	1.10%	1.30%	↓
	3-Apr-2018	Markit Eurozone Manufacturing PMI	(MAR)	56.60	56.60	56.60	→
UK	20-Mar-2018	CPI (YoY)	(FEB)	2.80%	2.70%	3.00%	↓
	22-Mar-2018	BoE Interest rate Decision	(MAR)	0.50%	0.50%	0.50%	→
	29-Mar-2018	GDP (YoY)	(4QF)	1.40%	1.40%	1.40%	→
China	2-Apr-2018	Caixin China PMI Manufacturing	(MAR)	51.70	51.00	51.60	↓
	11-Apr-2018	Consumer Price Index (YoY)	(MAR)	2.60%	2.10%	2.90%	↓

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

COMMODITY

- Gold prices decreased 0.35% MoM in March (vs. an increase of 0.08% MoM in February) amid a marginally stronger dollar.
- Brent prices increased 1.13% MoM in March (vs. a decline of 4.77% MoM in February) on the back of 1) reports of extension in OPEC led production cuts 2) supply concerns amid Middle East tensions 3) US crude inventories dropping below the five year average for the first time since 2014.

Domestic Market Macro Economics



India February WPI

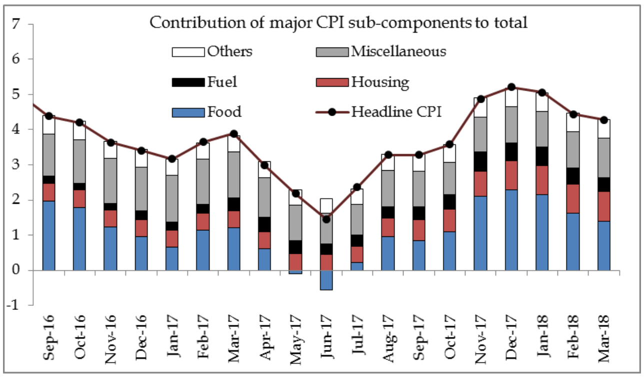
Growth in IIP (% YoY)	Weight (%)	17-Feb	18-Feb	Apr-Feb FY17	Apr-Feb FY18
IIP	**100**	**1.2**	**7.1**	**4.7**	**4.3**
Sectoral Classification					
Mining	14.4	4.6	-0.3	4.8	2.3
Manufacturing	77.6	0.7	8.7	4.4	4.6
Electricity	8	1.2	4.5	5.9	5.2
Use based Classification					
Primary Goods	34	0.8	3.7	4.8	3.8
Capital Goods	8.2	-2.4	20	2.5	5.3
Intermediate Goods	17.2	2.3	3.3	3.4	2.1
Infrastructure & Construction Goods	12.3	-1.9	12.6	4.2	5.2
Consumer Durables	12.8	-4.6	7.9	3.4	0.3
Consumer Non-durables	15.3	10.4	7.4	8	10.2

February IIP: Growth on an uptrend

- ✓ PMI for manufacturing remained in the expansion zone for the eight consecutive month in Mar-18. However, it expanded at its weakest pace since October to 51.0 (Previous Month: 52.1) led by slower rate of expansion in output and new orders at a five month low level.
- ✓ The PMI services index rebounded to positive territory in Mar-18, coming in at 50.3 (Previous Month: 47.8), indicating stabilization in business activity. The expansion in the service activity was led by new order driven by upbeat demand amidst enhanced marketing activity and discounts.
- ✓ India's industrial production growth moderated to 7.1% YoY in Feb-18 from 7.4% in Jan-18. On FYTD basis, IIP growth is currently tracking 4.3% during Apr-Feb FY18, weaker compared to the 4.7% growth seen during Apr-Feb FY17. At sectoral level, the expansion was led by capital goods, infrastructure/construction goods, and consumer goods.
- ✓ India's merchandise trade deficit widened to USD 13.7 bn in March (Bloomberg consensus: USD 12.3 bn, YBL expectation: USD 11.2 bn) from USD 12 bn in February. In sequential terms, the higher trade deficit was due to a faster pick-up in imports relative to exports. On a Y-o-Y basis, exports declined by 0.7% in March, which is partly due to base effects and imports registered a growth of 7.1% during the month of March.
- ✓ CPI inflation eased further in March for a third consecutive month to 4.28%YoY versus 4.44% in Feb-17, after hitting a 17-month high in Dec-17. However, the moderation was less than anticipated when benchmarked against our and market expectations (YBL: 3.97% and Bloomberg: 4.10%). On an aggregate basis, for Q4FY18, average headline CPI inflation now stands at 4.6%YoY, a tad higher than RBI recently downwardly revised Q4 projection of 4.5%. For full FY18, CPI inflation average stands at 3.6%, 10 bps below our estimate of 3.7%.

%YoY	Dec-17	Jan-18	Feb-18
Overall	**4.2**	**6.1**	**5.3**
Coal	-0.1	3.2	1.5
Crude Oil	-2.1	-3.2	-2.3
Natural Gas	1.2	-1.0	-1.4
Refinery Products	6.6	11.0	7.9
Fertilizers	3.0	-1.6	5.2
Steel	2.5	1.7	5.0
Cement	18.9	19.6	22.9
Electricity	4.4	7.6	4.0

CORE – Growth moderates



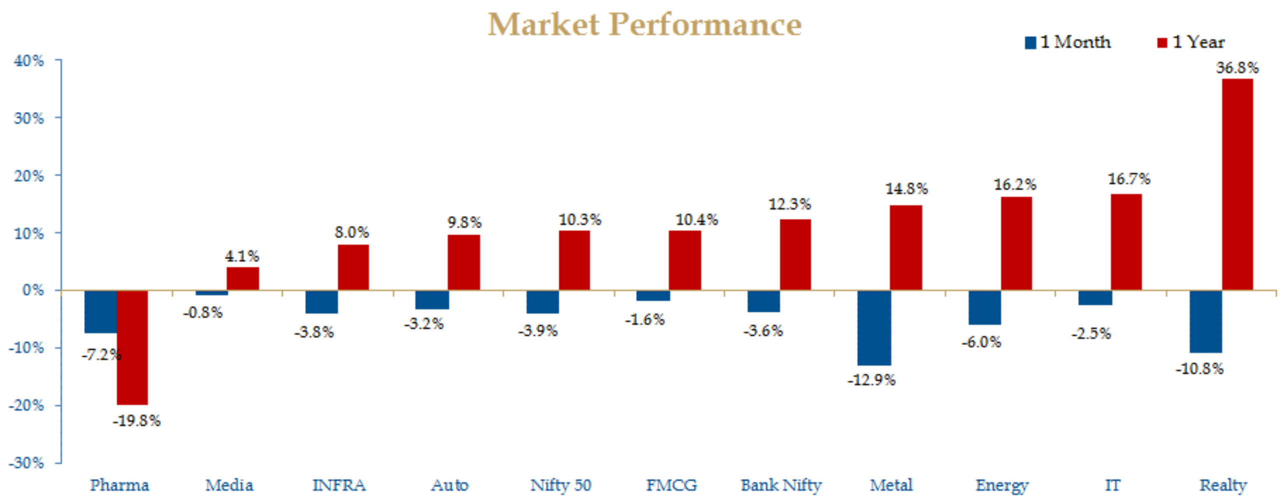
India March CPI - The last breather

We expect:

- ✓ FY19 GDP growth is expected to accelerate to 7.5% with a broad-based recovery led by consumption and modest capex cycle revival. Gains from structural reforms such as GST, insolvency resolution and bank recapitalization should begin to contribute.
- ✓ FY19 CPI inflation is expected at 4.7% assuming normal monsoon and crude oil price stays between USD 60-65 per barrel. Inflation is expected to peak in Jun-18 due to adverse base and subsequently moderate due to tapering HRA impact of 7th CPC.

Equity Market Insights

- Indian equity market delivered negative returns across sectors (for the 2nd consecutive month) in March. Small and midcap stocks continued to underperform the broader indices. While SENSEX and Nifty ended the month lower by ~3.9% each, the Nifty Freefloat Midcap 100 and Nifty Freefloat Smallcap 100 indices declined by ~4.9% and ~7.2% MoM, respectively.
- Metal, realty and pharma stocks were at the receiving end with their representative indices falling by as much as ~7% to 13% in the month of March 2018. Stocks from the FMCG, IT, and media spaces saw the least declines in the month gone by.
- Domestic institutions continued to pour in capital into equity markets and by the end of March their net investment stood at INR 92.5 bn. Foreign investors poured in a larger amount of INR 133.7 bn during the month. In FY18, the total inflow for FPIs and DIIs stood at ~INR 215 bn and ~INR 1.41 trillion.



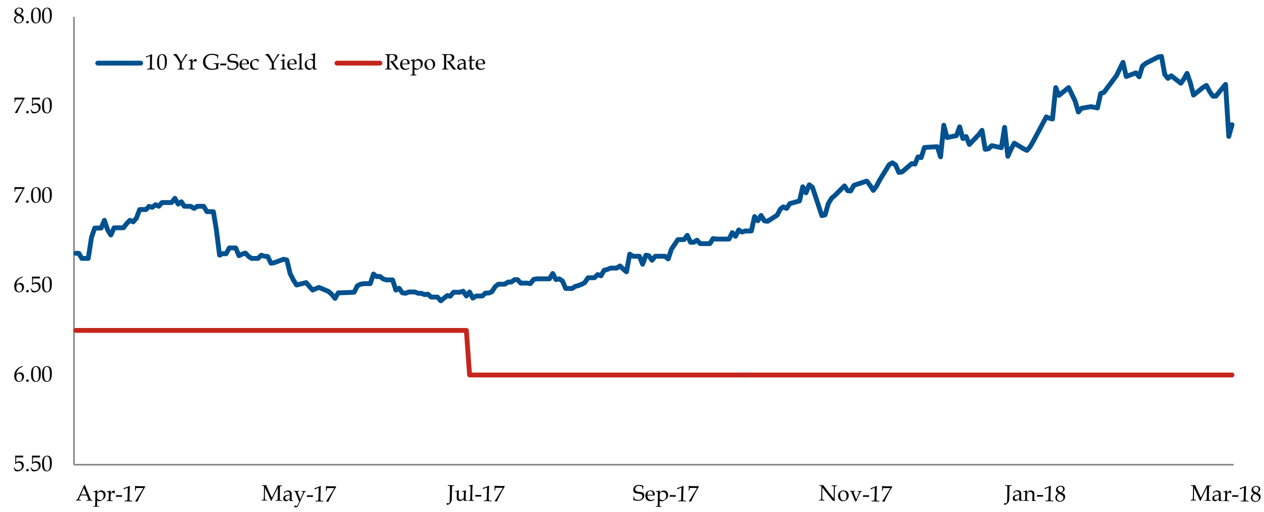
Outlook & Expectations

- In FY18, the Sensex, BSE-100, BSE-Midcap and BSE-Smallcap indices rose by 11.3%, 10.6%, 13.2% and 17.6% respectively. However, in the past six months, the returns of the Sensex, midcap and smallcap indices have been at par with the indices up by ~6%, ~6% and ~3% respectively. In fact, in the quarter gone by, the Sensex outperformed the other two indices, falling by a little over 3%, while the mid and smallcap indices fell by ~10% to ~12% each.
- Domestic fund flows into equities have had a strong role to play in keeping the market firms over the past few quarters. Going forward, this trend will depend on market performance. Poor market performance has the potential to reverse this trend as well, as has been observed in almost every previous market cycle. We believe there is no reason for this to change going ahead given the human nature. As and when equities start underperforming or when their performance does not match up to expectations of market participants, flows are bound to dry up; and this will impact equities as mutual funds as well.
- Not to mention that a lot of factors will play their part in testing market sentiments and endurance levels of market participants; some of which include the busy political calendar, the emerging inflationary concerns and the expected impact on interest rates, discussion revolving rural income and farmer wages, and the monsoons, amongst others.
- As such, it would be wise to keep expectations in check in the medium term - especially for investors new to the equity investing bandwagon.
- Having said that, we remain bullish on India over the long term. Short term blips are bound to make the markets move in a volatile manner, which is something that the investors may have to deal with.
- At the end of the day, the fact remains that there's no close competition when it comes to equities being the best asset class to invest in for wealth creation over the long term. And thus having exposure to this asset class is a must. But it goes without saying that this should be in conjunction with one's risk profile.

Debt Market Insights

- The average systemic liquidity deficit widened in March to INR 127 bn vs. a deficit of INR 25 bn in Feb due to strong growth in currency in circulation and moderation in government expenditure indicated by the build-up of government balances with RBI.
- While the average 10 yr g-sec bond yield during March held broadly steady vs. February at 7.6%, however there has been a significant moderation in yields since mid-March on the back of more moderation in inflation print, pruning of central government FY19 market borrowing target by INR 500 bn and regulatory dispensation for banks provided by the RBI to smoothen provisions for trading losses incurred in Q3-Q4 FY18. In April yields are averaging substantially lower at 7.2%. The recent expansion in FPI limits in government securities by 0.5% by FY19 and an additional 0.5% by FY20 didn't have much impact on market sentiment.
- CPI inflation eased further in March for a third consecutive month to 4.28%YoY versus 4.44% in Feb-17, after hitting a 17-month high in Dec-17. However, the moderation was less than anticipated when benchmarked against our and market expectations (YBL: 3.97% and Bloomberg: 4.10%). The moderation in March CPI inflation, was yet again driven by food prices, which corrected for the fourth consecutive month. However, the sequential pace of contraction in food prices eased significantly to 0.36% MoM vs. 1.15% MoM in Feb. The seasonal correction in food prices this year has stretched well into March, as against price hardening to the tune of 42 bps on average in March over the last 6 years.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- FY19 GDP growth to accelerate to 7.5% with a broad-based recovery led by consumption and modest capex cycle revival. Gains from structural reforms such as GST, insolvency resolution and bank recapitalization will begin to flow through.
- On the monetary policy front, we revise our monetary policy call from a 25 bps rate hike in FY19 (with risk of another 25 bps hike) to a prolonged pause. At the same time, we acknowledge the multiple moving parts on inflation, and would like to retain the risk of a 25 bps rate hike for FY19. The revised inflation trajectory in RBI's April policy and less hawkish tone of the policy statement has substantially reduced the near-term urgency for a rate hike in our view, with inflation expected to peak at 5.1% in Q1FY18 (as per RBI).
- Incorporating our change in RBI policy rate call, we revise downwards our FY19 10 yr yield trading range to 7.0 - 7.5% from 7.25% - 7.75%, previously.

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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