FIRST Insights

It's all dovish in here!

The year 2019 has started on a subdued note from a macroeconomics perspective. Global demand continues to show signs of moderation, across emerging and developed markets, as corroborated by both soft data indicators like manufacturing PMI and hard data like the industrial production and exports. In the US, corporate earnings for the last quarter of 2018 disappointed, but the focus more so has been on 2019 outlook which appears less optimistic. US corporates have slashed sales and revenue forecasts citing lagged impact of US-China trade tensions and reduced Chinese demand, while the domestic economy battled the 35 day Government shutdown.

Across the Atlantic, Eurozone is at the cusp of slipping into a recession with all major economies of Germany, France and Italy reporting contraction in industrial production. The deterioration in the manufacturing data, which also takes a blow from the Brexit related uncertainty in the region and civil protests in France, is consistent with the ECB's recent remarks that pointed towards growing risks to the Eurozone growth outlook. In addition, Brexit deadlock remains unresolved as PM Theresa May's Plan B got rejected by the UK Parliament amidst the impasse over the Irish border continuing to hold. China also reported a weak GDP growth of 6.4%YoY for Q4 2018, the lowest annualized growth since 2009.

Validating the loss in global growth momentum, IMF cut its world GDP growth forecast to 3.5% and 3.6% for 2019 and 2020 respectively; lower by 0.2 and 0.1 percentage points versus previous estimates. Along with the ECB and the IMF, Bank of Japan (BoJ), the US Fed and BOE have also turned more dovish and patient in their approach towards balance sheet management and interest rate hikes.

However with a "Powell put" (A term used to refer to the confidence that the Fed will lower interest rates or loosen financial conditions to prevent sustained drop in stock market and other asset prices) and increased optimism over the US and China trade deal truce supported risk appetite of investors. Investor demand in Jan-19 shifted from safe haven assets of gold, JPY and the US Treasury to equity markets, especially in the US. The S&P 500 (+7.8%) and the MSCI World indices posted a sharp rally in the month of Jan-19. Similarly, crude oil paced up by 16% on CYTD basis as OPEC oil production cuts started, the US reported decline in its oil rigs and imposed sanctions on Venezuelan oil exports. However, the upside is likely to be capped owing to still uncertain US-China trade pact which faces a deadline of March 1 along with continuing Brexit impasse.

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Global Macro Developments

- UK PM expressed her confidence of reaching a Brexit deal that parliament could support, allowing the UK to leave the EU on March 29. Meanwhile, as per media reports, more than 40 former British ambassadors have called on PM Theresa May to extend Britain's stay in the EU. The diplomats said it would be best to delay Brexit in order to clarify the terms of the future relationship between Britain and the EU or allow for a second referendum.
- On expected lines, the BoE voted unanimously to keep the bank rate unchanged at 0.75%. The central bank said that Britain faces its weakest economic growth in a decade this year as uncertainty over Brexit mounts and the global economy slows, but interest rates will eventually rise if Brexit deal passes through.
- The European Commission sharply cut its forecasts for euro zone economic growth in 2019 to 1.3% from 1.9% in 2018 and 1.6% in 2020 as it expects the bloc's largest countries to be held back by global trade tensions and an array of domestic challenges.
- China's National Bureau of Statistics trimmed the final 2017 GDP growth to 6.8% (previous : 6.9%) as the initial estimates of industrial and services sector were reduced. 2018 GDP growth slowed to 6.6%.
- Japan pushed up its projection of achieving primary budget surplus of 0.1 % of GDP in fiscal 2026 (previous 2027) on the expectations of less welfare expenditure and surge in tax revenue. However the concerns of ballooning debt burden and aging population still weighed on the economy even as the government forecasts 1.3% GDP growth in 2019 vis-à-vis 0.9% in 2018.

Events and Data Calendar

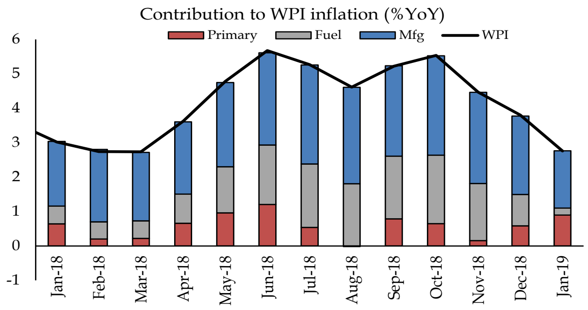
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	31-Jan-2019	Manufacturing PMI	Jan	49.30	49.50	49.40	⇧
	15-Feb-2019	CPI YoY	Jan	1.90%	1.70%	1.90%	⇩
UK	11-Feb-2019	GDP QoQ	4Q P	0.30%	0.20%	0.60%	⇩
	11-Feb-2019	Industrial Production YoY	Dec	-0.50%	-0.90%	-1.50%	⇧
	13-Feb-2019	CPI YoY	Jan	1.90%	1.80%	2.10%	⇩
US	1-Feb-2019	Unemployment Rate	Jan	3.90%	4.00%	3.90%	⇧
	13-Feb-2019	CPI YoY	Jan	1.50%	1.60%	1.90%	⇩
Japan	15-Feb-2019	Industrial Production YoY	Dec F	--	-1.90%	-1.90%	⇨

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

COMMODITY

- Gold prices increased by 2.9% MoM in January vs. an increase of 2.4% MoM in December due to safe haven asset demand amid rising global uncertainty and a weaker dollar.
- Brent prices increased by 4.6% MoM in January vs. a contraction of 13.56% MoM in December due to OPEC led supply cuts and US sanctions on Venezuela and Iran.

Domestic Market Macro Economics



India January WPI

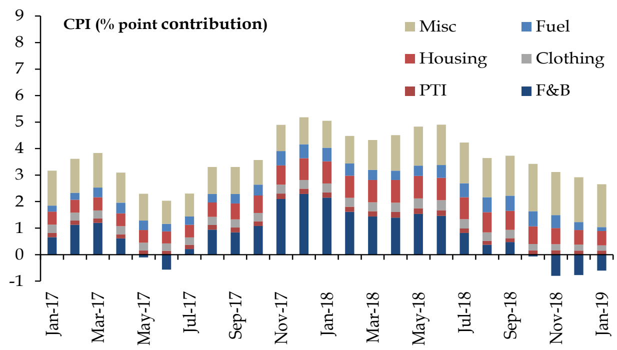
%YoY	Weights(%)	Sep-18	Oct-18	Nov-18	Dec-18
IIP	100	4.6	8.4	0.3	2.4
Sectoral Classification					
Mining	14.4	0.1	7.2	2.7	-1.0
Manufacturing	77.6	4.8	8.2	-0.6	2.7
Electricity	8.0	8.2	10.8	5.1	4.4
Use Based Classification					
Primary goods	113.1	2.6	6.1	3.2	-1.2
Capital goods	93.4	6.9	17.0	-3.1	5.9
Intermediate goods	115.4	1.5	2.0	-4.9	-1.5
Infrastructure/construction goods	119.6	9.5	8.9	5.0	10.1
Consumer durables	120.6	5.4	18.0	-2.1	2.9
Consumer non-durables	113.5	6.4	8.8	-0.6	5.3

Dec IIP

- Both PMI manufacturing and services continued to remain in the expansion zone for the 18th and 8th month in succession, respectively. That said, upturn in manufacturing sector was offset by moderation in service sector activity. As such, the composite PMI remained unchanged in Jan-19 (from Dec-18) at 53.6
- Core sector growth slipped to an 18-month low of 2.6% YoY in Dec-18 (Nov: 3.5%). The overall performance was weighed down by a decline in output of crude oil, refinery and fertilizers, along with subdued growth in heavyweights like electricity.
- GST collection for Jan-19 crossed INR 1 tn mark (INR 1.02 tn vs. INR 947 bn in Dec), despite various tax cut on 23 items (effective Jan-19). GST collections average run rate for FYTD19 stands at INR 973 bn
- Non-food credit growth continued to remain strong at 14.6%YoY as of 18th Jan-19 compared to 15.1% as of 21st Dec-18. Growth in bank credit off late, has been supported not only by some shift in market share to banks from NBFCs but also higher on-lending to NBFCs, some of which are facing tight financing conditions.
- India's industrial production picked up in Dec-18, clocking a growth of 2.4% YoY compared to a downwardly revised 0.3% YoY in Nov-18 (from 0.5% earlier).
- India's retail inflation moderated in January, falling to its lowest level in 19-months with the headline CPI inflation printing at 2.05% on annualized basis from a downwardly revised print of 2.11% (from 2.19%) in December. This now happens to be the ninth consecutive downward surprise (vis-à-vis market expectations) in inflation and the sixth consecutive month of undershooting with respect to RBI's medium term target of 4%.

%YoY	Sep-18	Oct-18	Nov-18	Dec-18
Overall	4.3	4.7	**3.5**	2.6
Coal	6.5	11.3	**3.7**	0.9
Crude Oil	-4.2	-5.0	**-3.5**	-4.2
Natural Gas	-1.9	-1.0	**0.6**	4.3
Refinery Products	2.5	1.3	**2.3**	-4.9
Fertilizers	2.6	-11.6	**-8.1**	-2.4
Steel	3.2	2.6	**6.0**	13.3
Cement	11.9	18.5	**8.9**	11.6
Electricity	8.2	10.8	**5.4**	4.0

CORE Sector



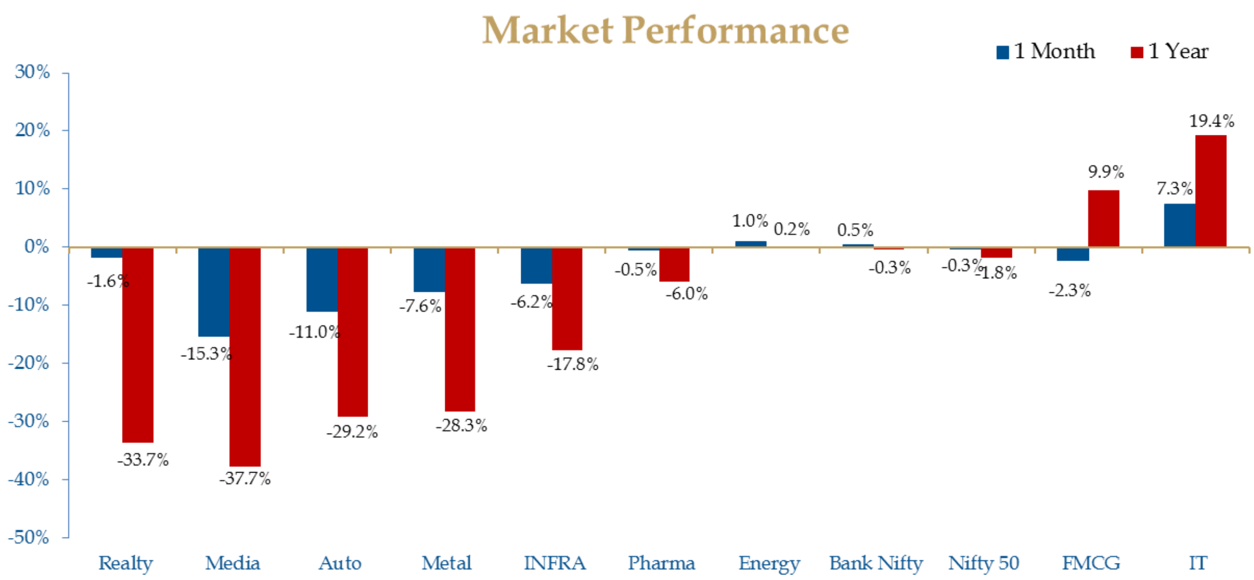
India Jan CPI - Vindicates RBI's dovish stand

We expect:

- FY19 GDP growth estimate stands revised to 7.2% (in line with CSO's estimate) from 7.3% earlier and vis-à-vis 6.7% in FY18. Downside risks to growth could emanate from lesser support from uncertainty on global trade prospects and a slowdown in NBFC lending due to tight liquidity conditions.
- On inflation outlook, we revise lower our estimated inflation trajectory to 3.5% in FY19 (from 3.7% earlier), which pulls lower the FY20 estimate to 3.8% in FY20 (from 4.1% earlier).The combination of benign food inflation, decelerating fuel inflation, and gradually moderating core inflation (with some downward stickiness) pulled headline inflation close to the lower end of RBI's inflation mandate of 4%+/-2%.

Equity Market Insights

- ✓ Rupee depreciation, higher crude oil prices possibly weighed on the sentiments and capped the upside for Indian markets. Ease in December CPI inflation to 2.19% for the month of December & strength in select index heavyweights provided respite to Indian markets.
- ✓ Indian markets underperformed major equity markets across the globe. US indices posted its best January in recent history as the Fed said it would pause its three-year interest rate rise campaign while assessing the weakening of the economy.
- ✓ While the festive season was weaker than expectations for the auto sector, the demand has not yet revived. Q3 FY19 results for most companies were below expectations impacted by weak volumes, higher discounts and rising raw material costs. Management commentary for the near-term outlook is not encouraging either. This has translated into cut in earnings estimates as well as valuation multiples leading to sharp correction in stock prices.

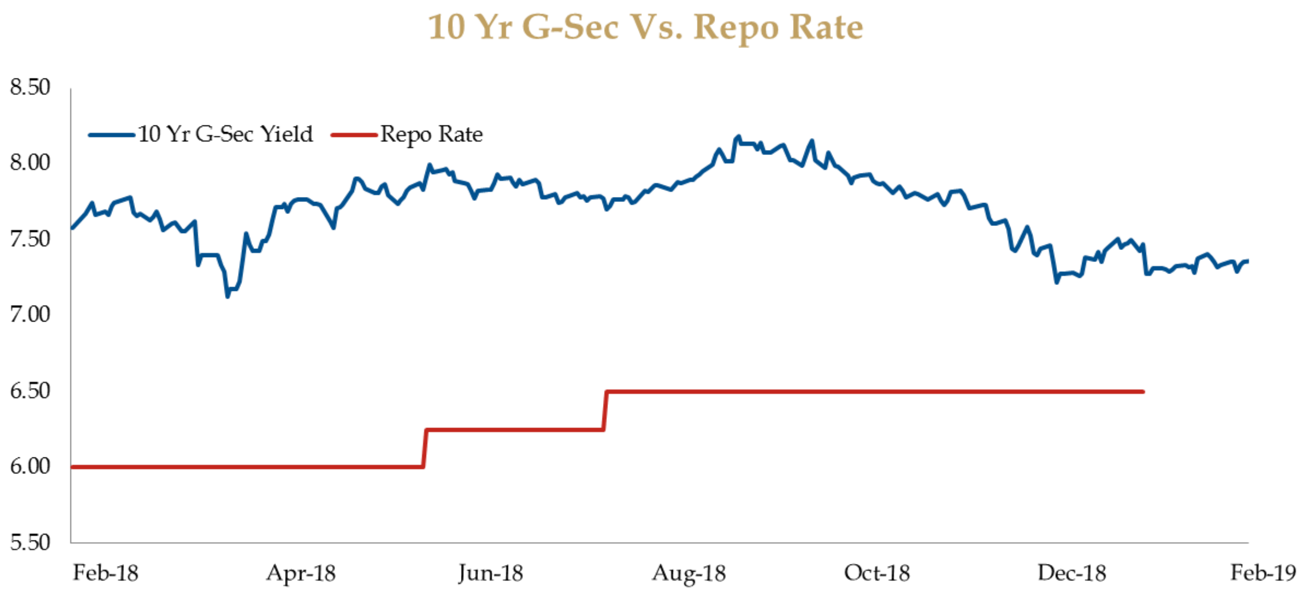


Outlook & Expectations

- ✓ Although markets remain volatile, select large caps will drive the broader indices higher. On the midcap front, bulk of the froth has dissipated after the massive retracement in 2018. However, a sustainable resumption of rally in this counter will take another 12-15 months at least.
- ✓ Uncertain times tend to be an ideal opportunity to generate significant returns, especially when the economy is amidst structural positives. Indisputably, India is going to remain fastest growing large economy in the world for some years to come, manifested by widening gap between India and China GDP rate.
- ✓ Globally, trade rift between US and China remains a concern, however, likely reversal on Fed's monetary policy tightening can prove to be a big positive for Emerging markets, in terms of capital inflows.
- ✓ Interim Union Budget has given a structural boost to Consumption in the form of direct income package for farmers and tax rebate for the small income group, TDS relief on small savings and house rent, increase in standard deduction, removal of notional rent concept for self-occupied second home and roll-over benefit in capital gain tax in property. Positive Budget reinforces our belief that the market is ripe for a pre-election rally.
- ✓ Indian equity attractiveness is high, vis-à-vis fixed income, gold and property. An investment from 3 to 4 years perspective would prove rewarding. Sectors like capital goods, chemicals, consumption oriented themes and select financials look appealing.

Debt Market Insights

- ✓ The average systemic liquidity maintained a deficit in January of INR 301 bn from a deficit of INR 944bn in December.
- ✓ The average 10Yr G-Sec bond yield during January moderated to 7.36% from 7.40% in December because of correction in oil prices from the Oct-18 peak of USD 85 per barrel, weaker than expected CPI inflation prints which aided hopes of a rate cut in Feb-19 and receding expectations of US rate hikes.
- ✓ The central bank has done INR 2,485 bn OMO purchases in FYTD 2019 with INR 250 bn OMO purchases remaining for Feb-19. As per the calendar released by RBI, Q4 FY19 state market borrowings are pegged at ~INR 2.2-2.3 tn - significantly above recent trends (last 11 quarter average stands at ~ INR 1.0 tn).



Outlook and Expectations

- ✓ We reiterate our view of a rate cut in Apr-10 RBI policy review by including it into our baseline scenario. While we maintain our call of a pause thereafter, persistence of the benign inflationary trend in the coming months could raise the risk of a subsequent rate cut in Jun-19 policy review as there is a low likelihood of headline inflation breaching the 4% mark (on a quarterly average basis) in the next 4-quarters. However, any monetary easing beyond Apr-19 would be data dependent and contingent upon the balance of caution stemming from the recent sharp acceleration in wage inflation (represented by wage heavy components within CPI), monsoon performance in 2019, unfolding of consumption led fiscal stimulus, and uncertainty on the geopolitics led oil price outlook.
- ✓ Taking into account the fiscal slippage in FY19, which is likely to have a negative sentiment impact (while G-Sec borrowings are unlikely to be interrupted), we revise up our 10Yr G-Sec yield for Mar-19 to 7.5% from 7.1-7.2% earlier. Yields to harden thereafter towards 7.50-7.75% by Mar-20.

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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About YES BANK

YES BANK, India's new age private sector Bank, is the outcome of the professional & entrepreneurial commitment of its Founder, Rana Kapoor and its top management team, to establish a high quality, customer centric, service driven, private Indian Bank catering to the future businesses of India. YES BANK has adopted international best practices, the highest standards of service quality and operational excellence, and offers comprehensive banking and financial solutions to all its valued customers.

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