Trade wars actualize

Since June, trade wars have actualized with US enforcing tariffs on steel and aluminum imports on various countries along with targeted duties worth USD 34 bn on specific Chinese imports. Meanwhile, US trading partners have started to enforce retaliatory tariffs. EU imposed tariffs on US imports worth USD 3.4 bn, Canada imposed tariffs on imports worth USD 12.6 bn and China imposed tariffs on imports worth USD 34 bn. Statements from the US president provide no indication of trade tensions abating, with US looking into imposing tariffs on EU cars and additional tariffs on Chinese imports worth USD 500 bn. The rising trade protectionist rhetoric from the US, is resulting in other countries presenting a more united front in support of free trade, with China announcing cuts in import tariffs from countries under Asia Pacific Trade Agreement.

On the monetary policy front, key central banks indicated that monetary policy would continue to diverge over the next year with a more hawkish Fed at one end of the spectrum and a relatively more dovish ECB and BoJ at the other end. While the Fed hiked rate by 25 bps in June, in line with consensus expectation, it sounded more confident on growth and indicated two more rate hikes by the end of 2018 vs. one rate hike previously. On the other hand, ECB, BoJ and BoE held rates steady. ECB outlined ending its asset purchase program by Dec 2018 and commitment to keep policy rates on hold till summer of 2019, which was interpreted as dovish by the markets. Meanwhile, BoE sounded more hawkish, with MPC members agreeing that "future rate hikes are likely to be at a gradual pace and to a limited extent" amidst likelihood of buildup in domestic inflationary pressure.

On global macro data front, cues remain mixed. Global manufacturing PMI eased to an eleven-month low on the back of slower growth output and new orders. Data emerging out of the Eurozone continued to remain weak, reflected in real-activity indicators such as PMI manufacturing (eased to 1.5 years low), economic sentiment and industrial production (at one-year low). However, on the positive side, composite PMI rose aided by service sector activity and German industrial orders that came stronger. For US, data was mixed, with downward revision of Q1 2018 GDP by 20 bps to 2% YoY and fall in consumer confidence, while on the positive side, manufacturing activity surged and factory goods rose aided by strong demand for machinery.

In India, lead domestic indicators released for the months of May-June mostly fared better, pointing towards continued normalization of growth conditions post GST implementation. Both Manufacturing and Services PMI rose in Jun-18 on the back of stronger pace of expansion in new orders amidst robust demand conditions. Meanwhile, core sector growth and IIP moderated in May, while auto sales remained robust in June, indicating continuing strong momentum in consumption.

We expect FY19 GDP growth to pick up pace at 7.3% (vs. 6.7% in FY18) with incremental growth likely to be supported by twin-engines of consumption and gradual capex recovery. Consumption growth is supported by Government's focus on reviving rural economy, projected normal monsoon along with urban consumption that remains supported by upward wage revisions by both Centre and State governments. Meanwhile, gradual capex recovery is expected with rising capacity utilization rates, PSU bank recapitalization and resolution of stressed assets. In addition, continued external demand recovery with exports supported by a weaker rupee should provide additional support.

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Global Macro Developments

- US CPI inflation rose by 2.9% YoY in June (previous: 2.8%) hitting highest level since Feb-12 amid tighter labour market. Core CPI rose by 2.3% YoY in June vs. 2.2% in previous month.
- Eurozone Commission revised down euro zone's economic growth forecast by 20 bps to 2.1% amid trade tensions with the US and rising oil prices.
- US President Donald Trump said a free trade deal with Britain might be impossible if it went ahead with Prime Minister Theresa May's proposals for post-Brexit ties with the EU.
- As per ECB policy minutes for June, the central bank will keep rates at a record low for as long as needed to raise inflation, and its interest rate guidance should be seen as "open-ended".
- UK seeks to strike new trade deals for services around the world as part of a Brexit plan that will place its goods under EU rules in a bid to preserve open customs borders with the bloc.
- The Trump administration in US raised the stakes in its trade war with China on Tuesday by saying it would slap 10% tariffs on an extra USD 200 bn worth of Chinese imports. US officials released a list of thousands of Chinese imports the administration wants to hit with the tariffs, including hundreds of food products as well as tobacco, chemicals, coal, steel and aluminum. It also includes consumer goods ranging from car tires, furniture, wood products, handbags and suitcases, to dog and cat food, baseball gloves, carpets, doors, bicycles, skis, golf bags, toilet paper and beauty products.
- UK's GDP grew by 0.3% MoM in May, recovering from a slowdown at the start of the year, aided by services sector. On YoY basis, the economy grew by 1.5%. Industrial output fell by 0.4% MoM in May, hit by the shutdown of the Sullom Voe oil and gas terminal.
- US economy created more jobs than expected in June, but steady wage gains pointed to moderate inflation pressure. Nonfarm payrolls rose by 213,000 jobs last month as manufacturers stepped up hiring. The economy added 37,000 more jobs in April and May than previously reported.

Events and Data Calendar

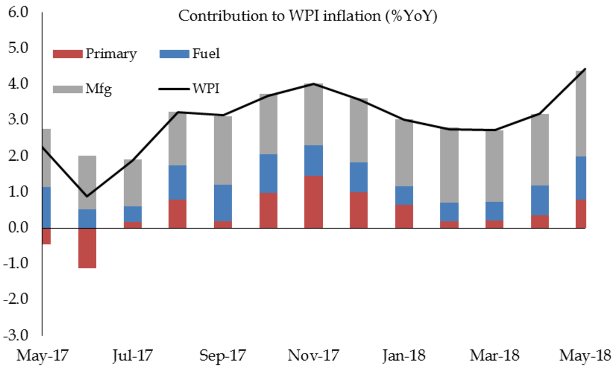
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	22-Jun-2018	National CPI (YoY)	(JUN)	0.60%	0.70%	0.60%	⇧
	15-Jun-2018	BoJ Interest Rate Decision	(JUN)	-0.10%	-0.10%	-0.10%	⇨
US	12-Jul-2018	CPI Inflation (YoY)	(JUN)	2.90%	2.90%	2.80%	⇧
	13-Jun-2018	Fed Interest Rate Decision	(JUN)	2.00%	2.00%	1.75%	⇧
	28-Jun-2018	GDP annualized QoQ	(1QF)	2.20%	2.00%	2.20%	⇩
UK	13-Jun-2018	RPI (YoY)	(JUN)	3.40%	3.30%	3.40%	⇩
	29-Jun-2018	GDP (YoY)	(1QF)	1.20%	1.20%	1.20%	⇨
	21-Jun-2018	BoE Interest Rate Decision	(JUN)	0.50%	0.50%	0.50%	⇨
China	4-Jul-2018	Caixin PMI Composite	(JUN)	-	53.00	52.30	⇧
	10-Jul-2018	Consumer Price Index (YoY)	(JUN)	1.90%	1.90%	1.80%	⇧

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

COMMODITY

- Gold prices decreased by 1.62% MoM in June vs. a decline of 2.35% MoM in May amid surging US bond yields and a stronger dollar.
- Brent prices decreased by 1.8% MoM in June vs. a rise of 7.18% MoM in May as traders assessed the impact of supply of crude entering the market following OPEC's decision to raise output. Rise in Russia's oil production early in June weighed on Brent prices.

Domestic Market Macro Economics



India May WPI

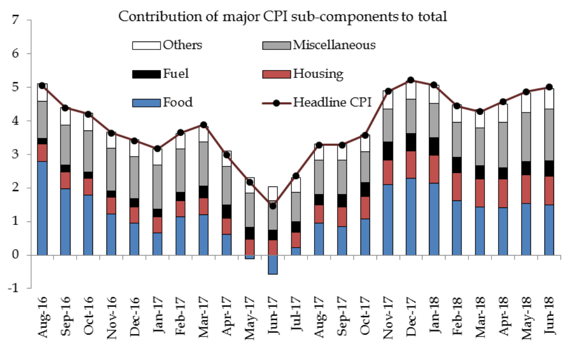
%YoY	Weights(%)	Apr-18	May-18
IIP	100	4.8	3.2
Sectoral Classification			
Mining	14.4	4.0	5.7
Manufacturing	77.6	5.3	2.8
Electricity	8.0	2.1	4.2
Use Based Classification			
Primary goods	34.0	2.8	5.7
Capital goods	8.2	11.9	7.6
Intermediate goods	17.2	1.7	0.9
Infrastructure/constructio	12.3	7.0	4.9
Consumer durables	12.8	4.5	4.3
Consumer non-durables	15.3	7.9	-2.6

May IIP: A short term blip

- Manufacturing PMI rose to a seven month high of 53.1 in June (Previous: 51.2), marking eleventh consecutive month of expansion, led by a stronger pace of expansion in output and new orders.
- The PMI services index bounced back to expansion territory in June from a contraction in the previous month to 52.6 (Previous: 49.6), hitting a one-year high. The expansion in the service activity was led by new orders that rose further in June amidst strong demand conditions.
- Core sector growth moderated to 3.6% YoY in May-18 (Apr-18: 4.6%) driven by a waning favourable base effect.
- As per RBI's latest data, non-food credit growth is 12.3%YoY as of 8th June-18, slight moderation from 25th May figure of 13.2%. Looking at the sectoral deployment of bank credit data for May-18, uptick in credit growth was broad based, as all sub-categories - agriculture, industry, services and personal loans, recorded an improvement in credit growth compared to previous month.
- India's merchandise trade deficit deteriorated to USD 14.6 bn in May-18 from USD 13.7 bn in the previous month. Exports registered a growth a 20.2%, up sharply from a modest 5.2% growth seen in the previous month and growth in imports also accelerated to 14.9% from 4.6% in the previous month.
- June CPI Inflation came below our expectations (YBL: 5.30%, consensus: 5.28%) at 5.0%YoY from 4.87%YoY in May, driven by muted food inflation. Indeed, food inflation has remained consistently softer than seasonal, with back-to-back normal monsoon. The marginal rise in headline inflation is due to fuel and miscellaneous, in addition to an adverse base. Core inflation accelerated to 6.35%YoY (vs. 6.12% in May), near a four-year high.

%YoY	May-17	Mar-18	Apr-18	May-18
Overall	**3.9**	**4.5**	**4.6**	**3.6**
Coal	-3.1	9.1	16.0	12.1
Crude Oil	0.8	-1.6	-0.8	-2.9
Natural Gas	4.5	1.0	5.8	-1.4
Refinery Products	5.4	1.1	2.7	4.9
Fertilizers	-5.9	3.2	4.6	8.4
Steel	3.9	4.8	3.8	0.5
Cement	-1.4	13.0	16.5	5.2
Electricity	8.2	6.0	2.1	3.5

CORE – Growth moderates



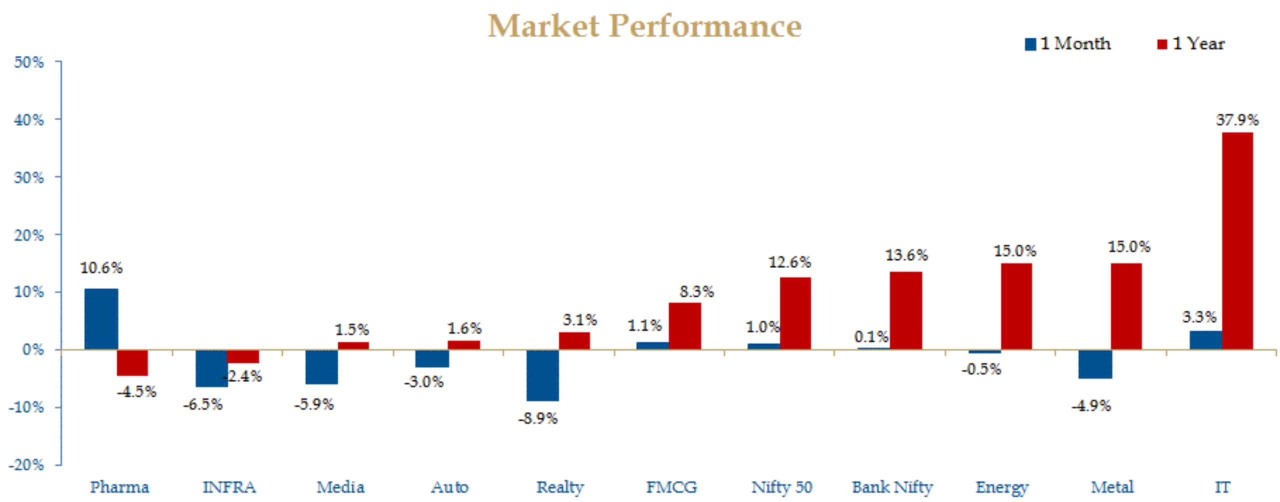
India June CPI - Food inflation delivers a positive surprise

We expect:

- FY19 GDP growth to accelerate to 7.3% 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.
- FY19 CPI inflation at 4.9% assuming normal monsoon, average crude oil price at USD 75 per barrel and recalibration of Kharif MSP. Upside risk to inflation from elevated crude oil prices capped at 20 basis point with oil @ USD 80 per barrel.

Equity Market Insights

- June 2018 was a mixed month for global indices. Within the US, the S&P 500 declined marginally on a month on month basis. In Asia, weakness was seen in China, while Japan and India ended marginally higher. In the calendar year till date, the Sensex is up by 4%.
- Small and midcap stocks were under pressure in the month gone by with benchmark indices - Nifty Smallcap 100 and Nifty Midcap 100 down by as much as 8.3% and 3.8% respectively. On the other hand, the Sensex and Nifty 50 held their ground, with 1.5% and 1% returns, respectively.
- Foreign investors continued to be net sellers for the third consecutive month. While domestic funds were net buyers, the additional amount invested was the lowest seen in past seven months and the second lowest amount since April 2017. Domestic institutions invested a net amount of ~INR 65 bn in June 2018. Foreign investors remained net sellers with a net outflow of ~INR 19 bn during the month.

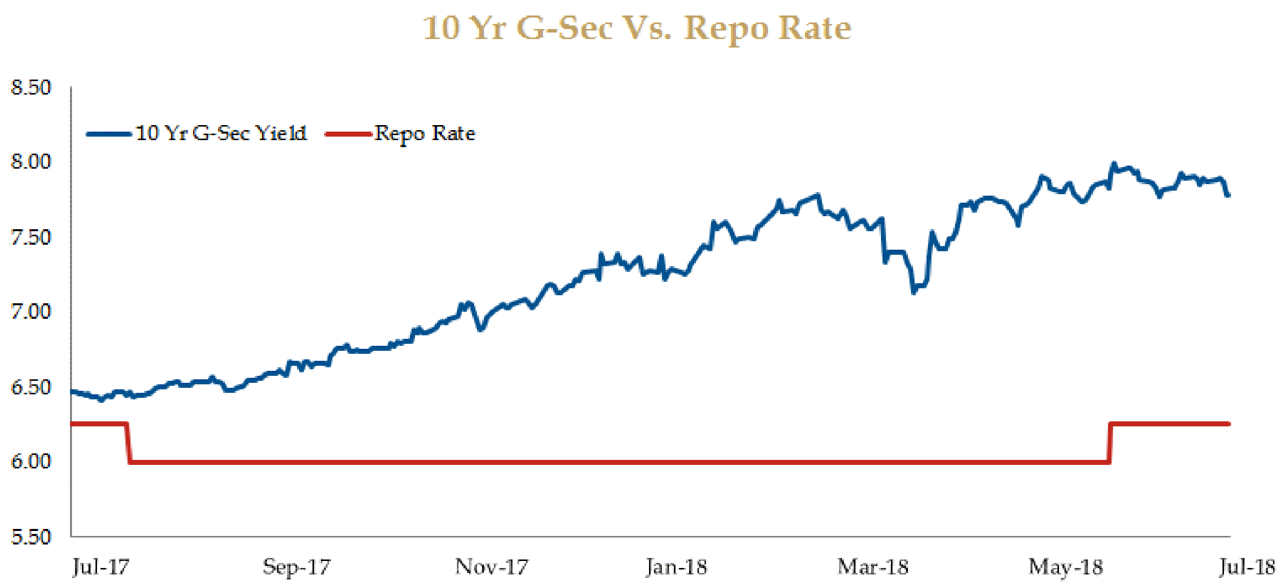


Outlook & Expectations

- A key reason for the sharp decline seen in the mid and small cap stocks since the start of the year has been the valuation and earnings growth remaining out of sync. For instance, the trailing 12-month price to earnings ratio of the midcap index expanded by more than 2x over the past three years, eventually leading to a sharp divergence between the earnings growth and index movement. Such situations rarely turn out to have favourable outcomes.
- The lack of investment options and abundance of liquidity in the system (post demonetization) have been one of the main factors driving the broader markets over past few years. But while one may believe this is a structural change, we would instead like to believe that its human nature that came out on top.
- A busy political calendar (state elections) towards the end of the year as well as the news related sentiments leading up to the general elections will also keep the market on its toes; the stock market is bound to swing to developments and news flow emanating from the political arena. In the interim, all eyes will be on the results for the quarter ended June 2018 which have already started to flow in.
- As has been our view since the start of the year, the aim for equity participants (read long term investors and not speculators) is to build wealth. And to do so, one would essentially need to do as well or better than the broader market in both, a rising or falling environment.
- Notwithstanding the dull market sentiments in the past two quarters, we believe this should be the game plan for investors over the short to medium term.

Debt Market Insights

- The average systemic liquidity surplus increased in June to INR 134 bn from INR 129 bn in May.
- While the average 10Y G-sec bond yield during June remained elevated at 7.9% vs. 7.8% in May, with crude oil prices avg. at USD 76 per barrel and depreciation pressures on the INR.
- The divergent trend in fuel and core inflation vis-à-vis food inflation is likely to complicate inter-temporal policy choices for the RBI. Hardening of fuel and core inflation argues for another round of rate hike in the immediate future (August policy review). This is offset by the current solace provided by food inflation that reduces the urgency for any incremental tightening. However, implementation of Kharif MSPs from H2 FY19 could once again tilt the balance in favor of a rate hike. Taking into account the fluidity in inflation drivers and their changing inter-temporal impact, we retain the risk of another 25 bps rate hike from the RBI by Oct-18.



Outlook and Expectations

- On the monetary policy front, the neutral tone of the June RBI statement indicates that future policy action will be data dependent. We see the risk of another 25bps hike by Oct, depending on the future trajectory of oil and food prices.
- FY19 10Y G-sec yield trading range maintained at 7.5-8.2%. Elevated yields being driven by run-up in crude oil prices and rise in UST yields.

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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