Global geopolitics take center stage

The last few weeks have been marked by resurgence of political gyrations in the Eurozone, with the ousting of Spanish PM Rajoy and coming together of two Euro sceptic parties in Italy; along with furthering of trade war concerns. In retaliation to US imposed tariffs on steel and aluminum on EU, Canada and Mexico which came in to effect from 1st June, all the three trade partners reacted swiftly. Canada announced tariffs on US imports worth USD 12.8 bn, Mexico is targeting farm and industrial products, while European Commission is planning to set higher duties (25%) on US imports worth USD 3.4 bn.

On global macro data, cues remain mixed. While US recovery remains on a firm ground, reflected in the recent robust payroll additions, economic data emerging out of the Euro zone remains weak, reflected in GDP growth and real economic activity indicators such as PMI (Composite PMI hitting 18-month low in May) and industrial production. Against the backdrop of domestic political uncertainty, global trade war concerns and weaker economic data (suggesting monetary policy normalization could be delayed by the ECB), Euro depreciated by 4.0% in May against the USD.

Despite these global undercurrents, the World Bank reinforced its optimism on global growth prospects for 2018 as it retained its global growth projection at 3.1% in 2018 and 3.0% in 2019, in its June Global Economic Prospects report. However, it did acknowledge downside risks to global growth emanating from a broad-based increase in tariffs worldwide.

On the domestic front, leading domestic indicators released for the months of Apr-May mostly fared better. PMI manufacturing remained in the expansion zone for the 10th consecutive month, but moderated marginally in May due to slower output and new orders growth. On the hard data front auto sales posted a robust growth aided by improved spending in rural and semi-urban areas on the back of expectations of normal monsoon. The growth was led by Passenger Vehicles, Utility Vehicles and 2-Wheelers in particular. Core sector growth improved marginally driven by robust output of coal, cement and natural gas and a favorable base effect. GST revenue collection in May-18 (paid for month of April) was robust at Rs 940 bn indicating improvement in compliance post implementation of e-way bills.

Q4 FY18 GDP accelerated to 7.7%, driven by consumption and investment, aided by base effects. For the full year FY19, we expect GDP growth to pick up to 7.3% (up from 6.7% in FY18) with incremental growth likely to be consumption led on account of Government's focus on reviving rural economy, and projected normal monsoon 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.

On the monetary policy front, RBI hiked rates by 25 bps in its June meeting, this is the first rate hike since 2014 and was contrary to consensus expectations of a status quo. Overall tone of the statement was neutral with the central bank acknowledging both upside and downside risks to inflation, given the volatility in crude oil prices and expectations of normal monsoon, which could keep food inflation momentum benign. The neutral tone indicates that the future policy course remains data dependent.

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Global Macro Developments

- US and North Korea pledged to work toward complete denuclearization of the Korean peninsula with President Trump making concession to North Korean leader Kim Jong Un about halting military exercises.
- China's PPI inflation rose to 4.1%YoY in May vs. 3.4% in April, bolstered by a recent jump in commodity prices along with base effect, beating consensus estimate of 3.9%. Meanwhile, CPI inflation held steady at 1.8%YoY in May. On the trade front, trade surplus narrowed to USD 24.9 bn in May vs. USD 28.38 bn previously, coming significantly below consensus estimates of USD 31.9 bn. Export growth slowed to 12.6%YoY (vs. 12.7% previously) and import growth accelerated to 26% vs. 21.5% previously.
- Japan's GDP contracted by 0.6% YoY in Q1 2018, unchanged from preliminary estimate released last month. On a quarterly basis, GDP fell by 0.2%.
- Eurozone GDP growth slowed to 2.5% YoY in Q1 2018 vs. 2.8% in Q4 2017 due to reduced trade contribution amidst lingering trade war concerns. In Q1 2018, Eurozone exports fell by 0.4% QoQ (Previous: 2.2%) and imports fell by 0.1% QoQ (Previous: 1.5%). That said, trade losses were offset by growing consumer spending and increase in investments.
- US trade deficit fell to a seven-month low in April to USD 46.2 bn due to rise in exports driven by rise in shipments of soybeans and industrial materials. Data for March's trade deficit was revised to USD 47.2 bn.
- US unemployment rate dropped to 3.8% YoY, hitting 18-year low, pointing to tightening labour market conditions. Nonfarm payrolls surged by 223,000 jobs in May-18 aided by hiring at construction sites amid warm weather conditions.
- Eurozone CPI inflation came significantly above consensus expectation at 1.9%YoY vs. expectation of 1.6%, driven by rise in oil prices. Core CPI rose to 1.1% in May vs. 0.7% in Apr. Meanwhile unemployment rate moderated to 8.5% in April vs. 8.6% previously.

Events and Data Calendar

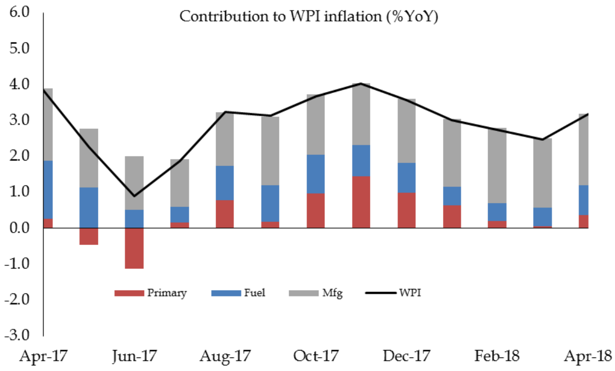
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	20-May-2018	Jobless Rate	(APR)	2.50%	2.50%	2.50%	⇨
	8-Jun-2018	GDP Annualized SA (QoQ)	1QF	-0.40%	-0.60%	-0.60%	⇨
US	30-May-2018	GDP Annualized (QoQ)	1QS	2.30%	2.20%	2.30%	⇩
	1-Jun-2018	Change in Nonfarm Payrolls	(MAY)	190K	178K	204K	⇩
	12-Jun-2018	CPI (YoY)	(MAY)	2.80%	2.80%	2.50%	⇧
UK	23-May-2018	CPI, YoY	APR	2.50%	2.40%	2.50%	⇩
	25-Apr-2018	GDP (YoY)	1QP	1.20%	1.20%	1.20%	⇨
China	10-May-2018	Caixin PMI Manufacturing	(MAY)	51.20	51.10	51.10	⇨
	9-Jun-2018	CPI (YoY)	(MAY)	1.80%	1.80%	1.80%	⇨

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

COMMODITY

- Gold prices decreased by 2.35% MoM in May (vs. a rise of 0.57% MoM in April) amid surging US bond yields and a stronger dollar.
- Brent prices increased by 7.18% MoM in May (vs. an increase of 7.63% MoM in April) on the back of 1) worries that Venezuela's crude output could drop further following a disputed presidential election in the country and with potential sanctions 2) supply concerns amid Middle East tensions and 3) decline in crude oil inventories in the US.

Domestic Market Macro Economics



India April WPI

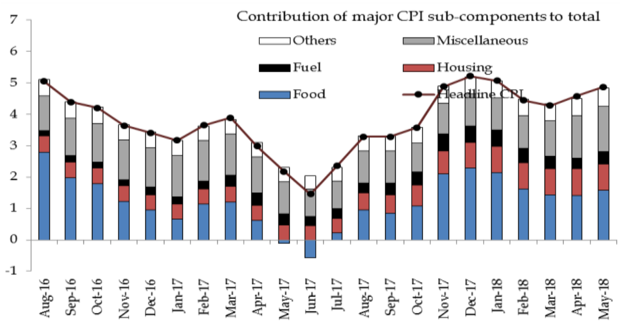
%YoY	Weights(%)	Feb-18	Mar-18	Apr-18
IIP	100.0	7.0	4.6	4.9
Sectoral Classification				
Mining	14.4	-0.4	3.1	5.1
Manufacturing	77.6	8.5	4.7	5.2
Electricity	8.0	4.5	5.9	2.1
Use Based Classification				
Primary goods	34.0	3.7	3.0	3.1
Capital goods	8.2	19.5	-5.7	13.0
Intermediate goods	17.2	3.2	2.3	1.6
Infrastructure/construction goods	12.3	12.6	8.9	7.5
Consumer durables	12.8	7.5	4.1	4.3
Consumer non-durables	15.3	7.3	12.7	7.0

April IIP: Manufacturing activity getting broadbased

- GDP growth for Q4 FY18 printed at an annualized growth rate of 7.7% (Q3 FY18: 7.0%), higher than market expectations (Bloomberg consensus: 7.4%, YBL estimate: 7.5%). The acceleration was anticipated on account of the favorable impact from the demonetization led subdued base in the comparable quarter of last year.
- Manufacturing PMI continued to remain in the expansion zone for the tenth consecutive month, however it moderated to 51.2 in May-18 (Previous: 51.6) due to slower pace of expansion in output and new orders.
- The PMI services index contracted to 49.6 in May-18 (Previous: 51.4). The contraction in service activity was led by decline in output amidst competitive demand conditions and stagnation in new orders.
- Core sector growth improved marginally to 4.6% YoY in Apr-18 (Mar-18: 4.5%) driven by robust output of coal, cement and natural gas and favorable base effect.
- Non-food credit growth rose further to 13.3% YoY as of 11th May-18, from 11.8% as of 13th Apr-18. The growth rate is buoyed by the demonetization afflicted base (which has gradually started to wane) aided by a gradual recovery in economic activity.
- India's industrial production expanded by 4.9% YoY in Apr-18 vs. an upwardly revised 4.6% in March-18 (previous: 4.4%). On the use based side, growth was led by a favourable base in capital goods supported by CV production which was severely impacted last year on account of stricter emission norms. On sectoral basis, while electricity growth slipped to 10 month low, growth in mining and manufacturing improved, with the latter becoming more broad-based. The expansion was broad based with 16 out of the 23 manufacturing groups registering positive growth as compared to 11 in the previous month.
- India's merchandise trade deficit remained unchanged at USD 13.7 bn in Apr-18, belying expectations of a deterioration. Exports registered a growth a 5.2%, up from a contraction of 0.7% seen in the previous month and growth in imports moderated to a 16-month low of 4.6% vis-à-vis 7.1% in the previous month.

%YoY	Feb-18	Mar-18	Apr-18
Overall	**5.4**	**4.5**	**4.6**
Coal	1.3	9.1	16.0
Crude Oil	-2.3	-1.6	-0.9
Natural Gas	-1.4	1.0	7.2
Refinery Products	7.9	1.1	2.7
Fertilizers	5.1	3.3	4.6
Steel	5.0	4.8	3.5
Cement	23.0	13.0	16.6
Electricity	4.5	5.9	2.2

CORE – Growth improves marginally in April



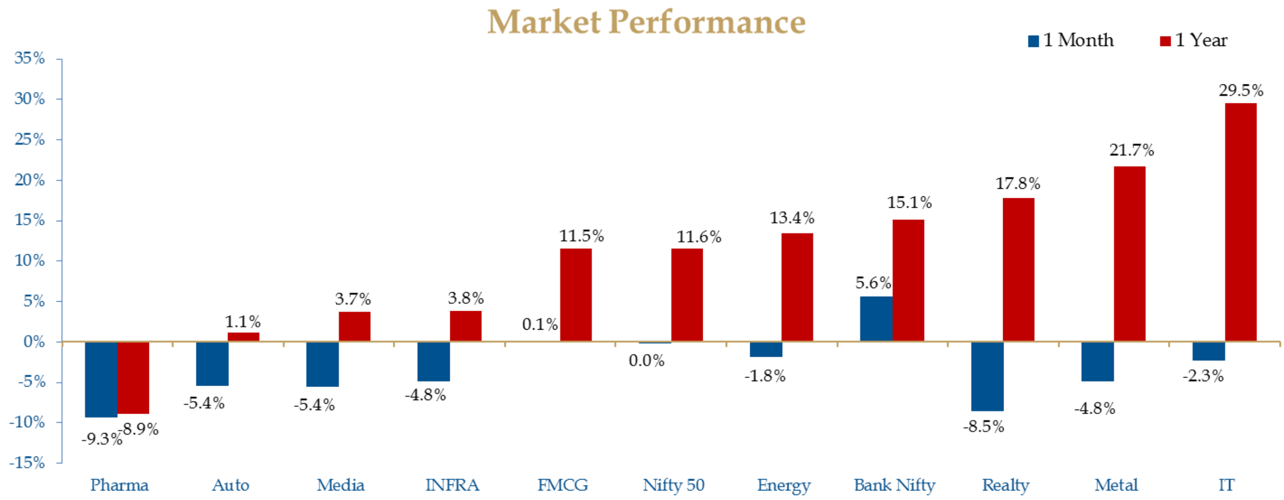
India May CPI - A seasonally soft increase

We expect:

- FY19 GDP growth is expected 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 bps with oil @ USD 80 per barrel.

Equity Market Insights

- May 2018 saw a mixed performance for global markets with Asian stocks underperforming their developed peers. On a YoY basis however, nearly all the major markets were higher, rising in the range of ~2% to 20%. In the calendar year till date, the Sensex is up by ~3.7%.
- The Sensex and Nifty 50 indices were broadly flat or marginally higher in the month gone by while the Nifty Midcap 100 and Nifty Smallcap 100 were down 6.7% and 6.8%, respectively.
- Capital continues to be poured into equities by domestic institutions who invested a net amount of ~INR 136 bn in May 2018. Foreign investors remained net sellers with a net outflow of ~INR 50 bn during the month. In the calendar year till date, DII's invested INR ~590 bn versus the INR ~34 bn amount invested by FPIs.

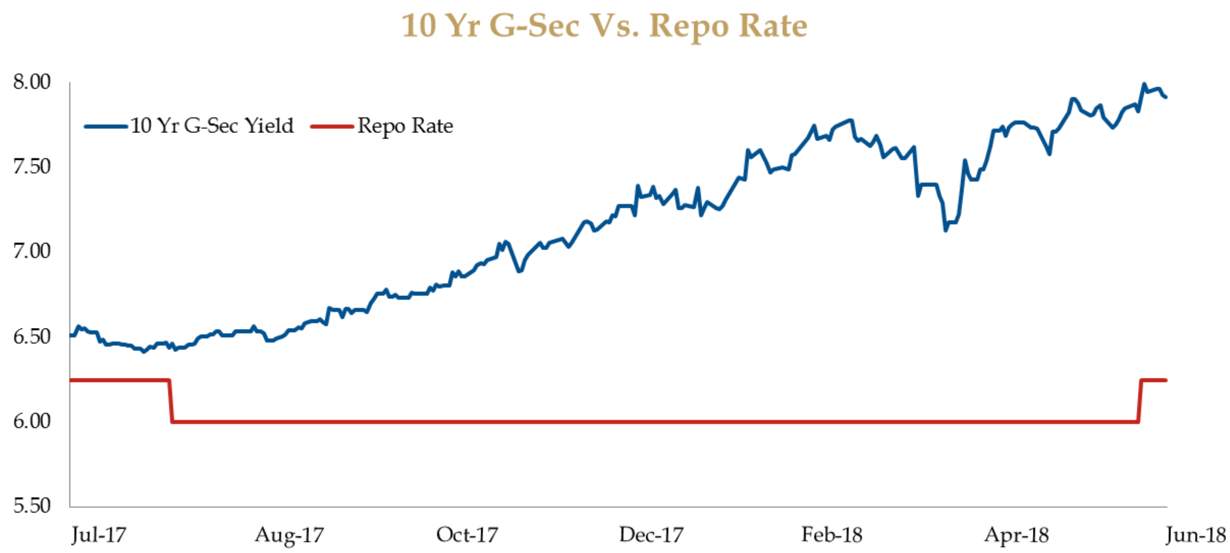


Outlook & Expectations

- Domestic fund flows into equities have had a strong role to play in keeping the markets firm over the past few quarters. Developments such as demonetization and RERA implementation have discouraged investments towards other asset classes; these have played a key role in funds flowing towards equities. Also, interest rates being at their lowest in many years, not enticing savers enough to park their money in debt instruments. This becomes a big factor to take into consideration as about two-third of India's gross household savings are parked in physical assets (real estate and gold); leaving low exposure to equities.
- For market bulls, the key argument remains is lack of alternative for investments. And thus, a slight change in allocation towards equities (from physical assets) will turn out to be a substantial figure in absolute terms (given the low base). And this trend is expected to continue for many years to come, thereby making a strong case for equities. On the other hand, market bears would view valuations as less enticing to see any upside.
- Having said that, it may be pointed out that retail money in India has historically flown into equities in line with market sentiments and that too usually with a lag effect. As and when the markets continue to perform better as time goes by, the money inflows only goes up. However, the same holds true for downturns as well. When stocks begin to underperform due to valuations or a crisis situation - it is only a matter of time before fund flows towards equities start drying up, thus adversely impacting the equity markets.
- We believe that a host of factors will play their parts in testing market sentiments and the endurance levels of market participants; some of which include the busy political calendar (state elections and the noise leading up to general elections), the emerging inflationary concerns and the expected impact on interest rates, discussion revolving rural income and farmer wages, and the monsoons, amongst others.
- To conclude, we'd like to reiterate, it would be wise to keep expectations in check in the short to medium term - especially for investors new to the equity investments. Be assured that we remain bullish on India and believe that there is no match to equities as a wealth creating asset class. But this view is over the longer term. Short term blips are bound to make the markets move in a volatile manner, which is something that the new investors should consider before investing.

Debt Market Insights

- The average systemic liquidity surplus reduced in May to INR 129 bn from INR 504 bn in April.
- The average 10 yr G-sec bond yield during May remained elevated at 7.8% vs. 7.5% in April with continuing surge in crude oil prices and US yields averaging ~ 3%.
- RBI hiked rates by 25 bps in its June meeting, first rate hike since 2014 and was contrary to consensus expectations of a status quo. Overall tone of the statement was neutral with the central bank acknowledging both upside and downside risks to inflation, given the volatility in crude oil prices and expectations of normal monsoon, which could keep food inflation momentum benign. The neutral tone indicates that the future policy course remains data dependent.
- May CPI inflation came marginally below our expectations (YBL: 4.95%, consensus: 4.90%) at 4.87%YoY from 4.58%YoY in April, led by higher food, core (6.07%YoY in May vs. 5.80%YoY in Apr), fuel inflation and adverse base effect. Core-core inflation which is a more trimmed version of core inflation (excluding gold, silver and other ornaments) and a better gauge of underlying inflation pressures rose to 5.96%YoY in May vs. 5.84% in April.



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 25 bps hike depending on the future trajectory of oil and food prices.
- We maintain the FY19 10 Yr G-sec yield trading range at 7.5-8.2%. Yields are expected to remain elevated due to recent run-up seen 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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