The naïve euphoria

The month of March had started on a positive note with the reports on the US and China finalizing a trade deal as soon as 27th March. In response to President Trump's tweet regarding postponing additional US tariffs on Chinese imports which were scheduled for 1st March, China's stocks posted a turnover of more than RMB 1 trillion, a breakthrough last seen during the country's stock market bubble in 2015. However, China's equity gains also comes amid 1) MSCI Inc. increasing the weight of China's A-share in global benchmark indices from 5% to 20% in three stage procedure beginning in May, and 2) domestic stimulus through monetary and fiscal policies. This rally in equities has also been witnessed across US, Asian and European markets as well with the MSCI World Index posting a gain of 12% YTD. Despite the US-China trade deal nearing finalization, risks remain for the auto industry across Europe, Japan and China as US continues to consider imposing of tariffs on imported cars which are seen as a threat to national security. Alongside, US plans to scrap the preferential trade status granted to India and Turkey under the Generalized System of Preferences (GSP) programme.

While the optimism on trade supported equity market buoyancy but macroeconomics data continued to paint a somber picture last month. Manufacturing PMIs for South Korea, Japan, China and Eurozone contracted in February. In addition, US ISM manufacturing weakened to a two year low of 54.2 from 56.6 in the previous month. In times of increased uncertainty, while the advance estimate of US Q4 GDP came in stronger than expected at 2.6%, momentum turned out to be weaker vis-à-vis Q3 print of 3.4%. Further, the longest US government shutdown, trade war and waning impact of fiscal stimulus is expected to dent the Q1 2019 US GDP growth as well.

Alongside, China lowered its economic growth forecast for 2019 in the range of 6.0-6.5% with the lower bound of the GDP target range being the lowest in nearly three decades. For the global economy also, OECD trimmed its 2019 growth forecasts to 3.3% from 3.5% set in November. Risks to the global outlook remain from geopolitics as 1) the Brexit uncertainty lingers, and 2) tensions have resurfaced after US President Trump and North Korea's Kim Jong Un failed to reach an agreement on denuclearization at a recent summit in Vietnam. In the backdrop of moderating global growth momentum and rising geopolitical tensions, the US Federal Reserve has turned cautious which could have an impact on other central banks'.

Looking at commodities, Brent oil prices have gained 25% in 2019 so far with the rally likely to remain intact amidst deeper production cuts by OPEC+ countries. Alongside, a trade deal between US-China is likely to add to demand side pressure on prices. Gold prices, on the other hand, have weakened coming in below the USD 1,300 per ounce level starting March as appetite for riskier assets have increased amidst trade optimism and a cautious Federal Reserve.

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Chief Economist

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Global Macro Developments

- US Fed Chairman, Jerome Powell said that the Fed is not in any hurry to change interest rates amid global risks. Powell further added that the rates are currently "appropriate" and "roughly neutral", meaning it is neither curbing nor stimulating the economy.
- According to the US FOMC meeting minutes, policymakers expressed their willingness to end balance sheet unwinding program later this year and keep rate steady amid expectations for a slower pace of US economic growth.
- UK's MPs have voted by 413-202 to seek delay to EU departure, implying that the UK may now not leave on 29 March as previously planned. PM May said that Brexit could be delayed by 3 months (Jun 30) if MPs back her deal in a vote next week.
- China's banking and insurance regulators urged banks to continue increasing lending to small firms and further cut their financing costs, as policymakers work to avert an economic slowdown.
- BoJ kept rates on hold and offered a bleak assessment of exports and output citing overseas risks that could threaten to derail a fragile economic recovery.
- OECD trimmed its global growth forecast for 2019 and 2020. For 2019, global growth forecast is revised to 3.3% from 3.5% set in November. The downward revision is due to Brexit uncertainty and trade tensions. The November forecast itself was revised lower from 3.7% earlier.
- According to a WTO statement the United Kingdom won approval to remain within the WTO's Government Procurement Agreement (GPA) post Brexit, which governs $1.7 trillion worth of annual public procurement opportunities.

Events and Data Calendar

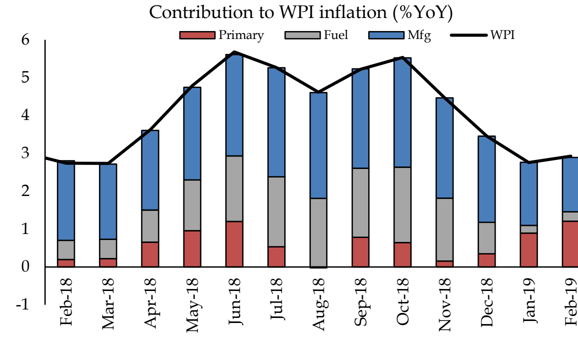
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
UK	12-Mar-2019	Industrial Production YoY	Jan	-0.01	-0.01	-0.01	⇨
US	28-Feb-2019	GDP Annualized QoQ	4Q A	2.20%	2.60%	3.40%	⇩
	8-Mar-2019	Unemployment Rate	Feb	3.90%	3.80%	4.00%	⇩
	12-Mar-2019	CPI YoY	Feb	1.60%	1.50%	1.60%	⇩
China	28-Feb-2019	Manufacturing PMI	Feb	49.50	49.20	49.50	⇩
	9-Mar-2019	CPI YoY	Feb	1.50%	1.50%	1.70%	⇩
Japan	28-Feb-2019	Industrial Production YoY	Jan P	0.01	0.00%	-1.90%	⇧

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

COMMODITY

- Gold prices increased by 2.1% MoM in February vs. an increase of 3.4% MoM in January due to a stronger dollar in Feb-19 vis-à-vis Jan-19.
- Brent prices increased by 8.13% MoM in February vs. an increase of 5.48% MoM in January due to OPEC+ led supply cuts and US sanctions on Venezuela and Iran.

Domestic Market Macro Economics



India February WPI

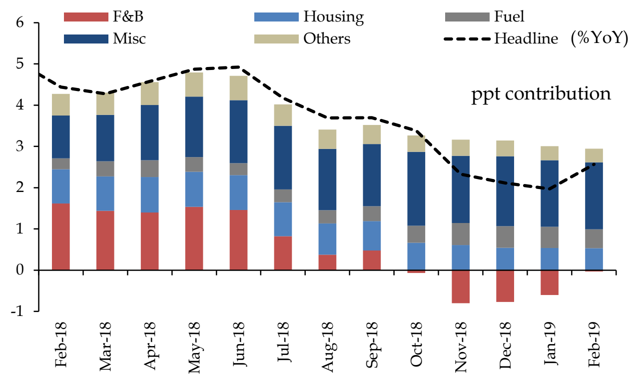
%YoY	Weights(%)	Oct-18	Nov-18	Dec-18	Jan-19
IIP	100	8.4	0.3	2.6	1.7
Sectoral Classification					
Mining	14.4	7.3	2.7	-1.0	3.9
Manufacturing	77.6	8.2	-0.6	3.0	1.3
Electricity	8.0	10.8	5.1	4.4	0.8
Use Based Classification					
Primary goods	125.2	6.1	3.2	-1.2	1.4
Capital goods	123.1	16.9	-3.1	4.9	-3.2
Intermediate goods	130.1	2.4	-4.9	-0.8	-3.0
Infrastructure/construction goods	134.1	9.0	5.0	10.0	7.9
Consumer durables	129.0	17.4	-2.1	3.9	1.8
Consumer non-durables	125.9	8.6	-0.6	5.9	3.8

January IIP

- Owing to uptick in both manufacturing and service sector activity, the composite PMI rose to 53.8 in Feb-19 from 53.6 in Jan-19.
- Core sector growth moderated to a 19 month low of 1.7% YoY in Jan-19 vs. 2.6% YoY in the previous month due to contraction in sub-sectors of crude oil, electricity and refinery products.
- GST collection moderated to Rs 972 bn in Feb-19 from Rs 1.02 tn in Jan partly reflecting the impact of rate rationalization effective from Jan-19. GST collection average run rate for FYTD19 stands at Rs 973 bn.
- Non-food credit growth posted a slight moderation coming in at 14.3% YoY as of February 15, 2019 compared to 14.6% as of January 18, 2019. For Jan-19, moderation was seen in agricultural credit growth while industry, services and housing sector loan growth remained robust.
- India's industrial production moderated to 1.7% YoY in Jan-19 vis-à-vis an upwardly revised growth of 2.6% in Dec-18 (earlier: 2.4%). On sequential basis, the headline index inched up by 0.4% MoM, which is weaker than the usual monthly momentum of 0.6% seen in the month of Jan (5 year average). Manufacturing and electricity sector acted as a drag while mining maintained strong momentum.
- India's retail inflation inched up from its 19-month low of 1.97% YoY in Jan-19 (revised lower from 2.05% earlier) to 2.57% in Feb-19. Despite higher than expected print, inflation continues to remain well below RBI's medium term target of 4% for the seventh successive month. On sequential basis, the CPI increased by 0.21% MoM in Feb-19, in contrast to the contraction of 0.37% seen in Feb-18.

%YoY	Oct-18	Dec-18	Jan-19
Overall	4.7	2.6	1.7
Coal	11.3	0.9	1.7
Crude Oil	-5.0	-4.2	-4.4
Natural Gas	-1.0	4.3	6.2
Refinery Products	1.3	-4.9	-2.6
Fertilizers	-11.6	-2.4	10.5
Steel	2.6	13.3	8.3
Cement	18.5	11.6	11.0
Electricity	10.8	4.0	-0.3

CORE Sector – Muted Performance



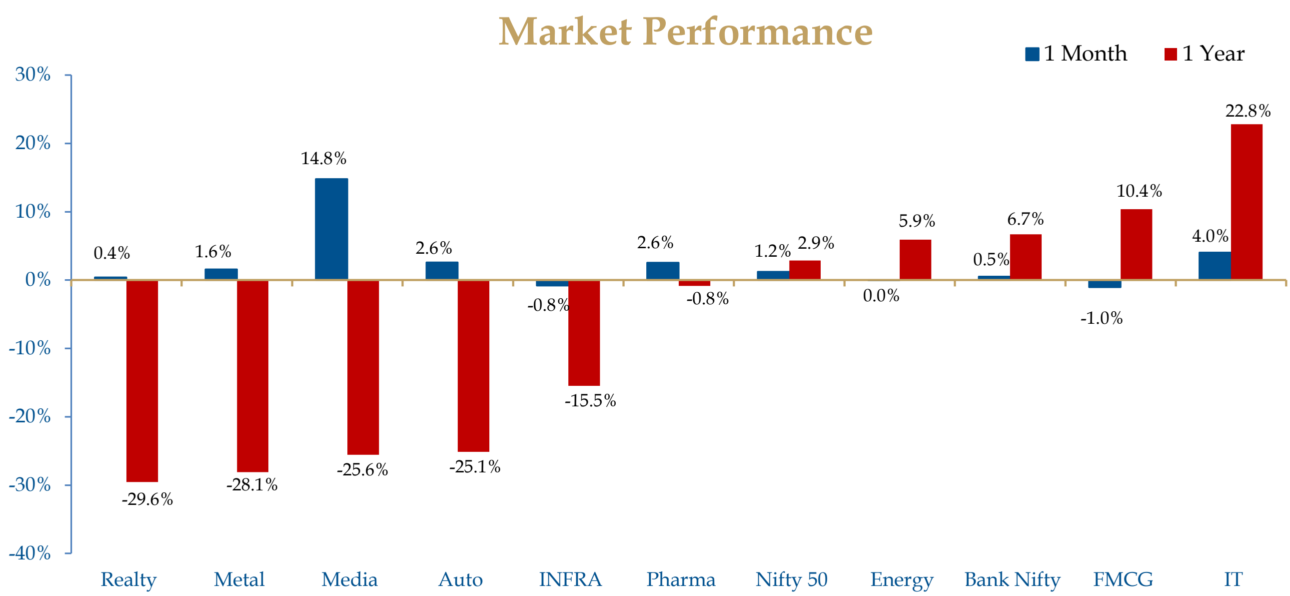
India Feb CPI - A subtle shift in underlying drivers

We expect:

- We have revised lower our GDP growth estimate from 7.2% to 7.0% (in line with CSO's estimate) for FY19. The H2 FY19 GDP is expected to reflect uncertainty on global trade prospects, nascent slowdown in manufacturing, and deceleration in non-core sectors of agriculture & government services and a slowdown in NBFC lending.
- On inflation front, we expect the inflation trajectory to remain benign with average annual CPI inflation estimate for FY19 revised lower to 3.5% from 3.7% earlier vs. 3.6% in FY18 due to benign food inflation and decelerating fuel inflation.

Equity Market Insights

- Tremors of the Pulwama terror attack were felt on Dalal Street as Nifty marked a low of 10,586 post the escalation of geo-political tension between India and Pakistan. Selling pressure was more evident in broader markets as Nifty Midcap 100 index came close to October 2018 lows.
- Within Emerging Markets space (EMs), Shanghai index made a comeback in 2019. Meanwhile, India underperformed its Asian and global peers amid rising Indo-Pak tensions. We believe that a reversal in trend is seen within EM basket as China has rallied by 19% and Nifty has been consolidating after 2018's relative outperformance.
- In last week, Energy stocks have outperformed led by RIL, which is witnessing a re-rating driven by 1) plans to deleverage its balance sheet through divestment of stakes in Jio's fibre and tower assets and 2) further strengthening of its retail business through plans of online entry. Gain in OMCs is on the back of healthy marketing margins despite election season.



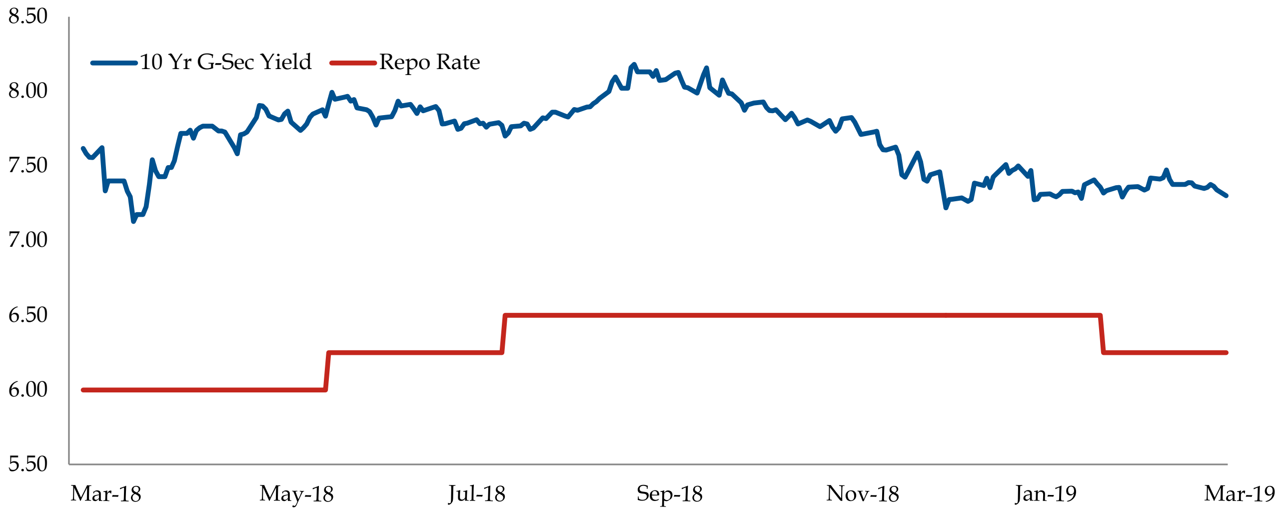
Outlook & Expectations

- Recent quarter's revenue growth was the highest seen in five quarters and while margins were under pressure, we expect relief in coming quarters. Importantly, PSUs did well and public sector banks reduced their loss. Looking at results of ICICI and Axis, we also get the feeling that NPA cycle will see a turnaround. Political equations for upcoming General election are getting clearer and the market is getting receptive to the same.
- Global equity markets will scale higher, with a rub-off effect expected on Emerging Markets. Central banks are re-aligning monetary policy stance, quite a divergent scenario when compared with the narrative of policy normalization a year back. Stressed global financial conditions recede after Fed's policy reset. ECB's policy stance has also turned dovish. Dividend yield of global equities is better than US treasury yield. This places riskier assets like equities in a relatively better spot.
- We prefer a bottom-up approach to stock selection. Many sectors and themes are looking attractive at this juncture. We like construction, discretionary consumption space, private banks (both retail and corporate funding ones), and capital goods as a contra play.
- Our assessment is that the next 3-4 years belong to financial assets and not physical assets. After the deep correction in 2018, the time is ripe to allocate more money to equities. If you have a higher risk appetite and are willing to stay invested for three years, then do add midcap flavor to your portfolio.

Debt Market Insights

- The average systemic liquidity maintained a deficit in February of INR 661 bn from a deficit of INR 301 bn in January.
- The average 10yr G-sec bond yield during February moderated to 7.36% from 7.37% in January because of dovish US monetary policy, lower CPI inflation prints and RBI repo rate cut by 25 bps to 6.25% in Feb-19 policy meeting. Risks of fiscal slippage, higher market borrowing pared further gains.
- The comfort on CPI inflation and moderating economic growth will once again tilt the MPC balance in favor of a 25 bps rate cut in Apr-19 policy review. We expect a pause thereafter with any monetary easing beyond Apr-19 dependent upon data and contingent upon the balance of caution stemming from the recent sharp acceleration in wage inflation, monsoon performance in 2019, unfolding of fiscal led consumption stimulus, and geopolitics driven uncertainty on oil price outlook.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- After providing primary liquidity worth INR 2,985 bn via Open Market Operation (OMO) purchases in FY19 so far, the RBI has now decided to augment banking system liquidity by introducing a new instrument to its toolkit. The central bank announced that it will inject rupee liquidity via dollar buy/sell swap of USD 5 bn for a tenor of 3-years.
- From bond perspective, we continue to hold on to our 10Y G-sec yield view of 7.35% for end Mar-19. If such swap based liquidity intervention gets more readily utilized in FY20, then it would tend to crowd out OMO purchases. As per the market based consensus, there is a likelihood of INR 1,700 bn OMO purchases in FY20. Part of this expectation could potentially get adjusted lower if RBI decides to use a mix of tools for liquidity infusion. This could have a marginal negative impact on long dated bonds. Meanwhile, short dated bonds could see buying interest (through the recently announced Voluntary Retention Route schemes for FPIs or otherwise) as RBI continues to depict readiness for liquidity infusion, there is an expectation of incremental monetary easing in the coming months (while we expect one rate cut in Apr-19 and a pause thereafter, the market is pricing in two rate cuts by Mar-20), and post the usage of FX swap, the hedging cost would get lower. Overall, the yield curve is set for steepness.

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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