Navigating through an uncertain world

Weakening of cyclical momentum in global growth, heightened uncertainty arising out of trade war, political uncertainty due to Brexit and tight global financial conditions have led major Central Banks to keep interest rates unchanged in their recently concluded monetary policy reviews in the last few months. Among the G4 central banks, the Fed sounded more upbeat about the economy after a slow start in early 2019 as the recent US GDP registered a surprising 3.2% growth in Q1 vs. 2.2% growth in Q4. Despite, a strong headline number, the details of the report revealed weakness in the economy as the components of the GDP such as consumer spending and business investment grew only modestly. Rather, growth was driven by inventory accumulation and sharply falling imports. Inflation remained well below the Fed's 2.0% target prompting its decision to keep policy rates on hold. However, the central bank sees the weaker inflation as the result of "transitory" factors, and reiterated that it will be patient on interest rates as it considers adjusting borrowing costs.

In its recent World Economic Outlook report, the IMF cut its forecast for global growth to 3.3% in Apr-19 vs. 3.5% in Jan-19, lowest since the financial crisis amid a bleak outlook in most major advance economies, with Brexit related uncertainties and US-China trade tensions fueling the downgrade.

The Brexit deadline was extended to October 31 which would force the UK to participate in European elections (23-26th May), or risk leaving the EU on June 1 without a deal. However, both the UK government and the main opposition Labour party talked up the prospects for a compromise plan and is aiming to wrap up the talks by mid-May either with an agreement or without one. The other global theme that continues to remain dynamic and on a close watch for its impact assessment is that of trade wars. While the US and China had repeatedly touted progress in the talks, the recent comment from President Donald Trump saw a shift in tone as he threatened China that he would impose tariffs on USD 200 billion worth of Chinese goods. However, China is preparing to travel to the US for further trade talks in the coming week.

Amidst these geopolitical tensions, volatility in the markets was amplified by the recent run up in crude oil prices, averaging at USD 71 per barrel in Apr-19, highest since Oct-18. The recent spike has been more of a supply side story, driven by production cuts by OPEC members, supply disruption in Venezuela, Libya clashes and removal of waivers on Iran sanction granted to eight countries including India. However, rising US oil production helped offset some of these disruptions.

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Global Macro Developments

- US Federal Reserve officials are sticking with their pledge for patience on interest rate; shrugging off President Trump's escalating trade war and pressure for a cut. Fed officials said that they will ignore political pressure as they focus on their mandate for maximum employment and stable prices.
- US President Trump asked Fed to help him counter China in trade fight by stimulating the US economy via pumping money into the system and reducing interest rates, to offset economic hardship caused by the tariffs. Alongside, President Trump said that the trade talks with China have not collapsed and said that he has a "very good dialogue" going with China.
- China is looking to impose higher tariffs starting 1 June on most US imports on a revised USD 60 bn target list, hitting back at a tariff hike by Washington on USD 200 bn of Chinese goods despite a warning by US President Donald Trump to not retaliate against a hike in tariffs he imposed.
- Britain and China will hold the next round of their Economic and Financial Dialogue (EFD) in mid-June in London. The EFD has been used in the past to announce closer cooperation on trade and banking initiatives, and to sign commercial contracts.
- UK PM Theresa May has promised to reopen Brexit talks with the European Union to bring back negotiations with the opposition Labor Party and take the UK out of the bloc by the summer.

Events and Data Calendar

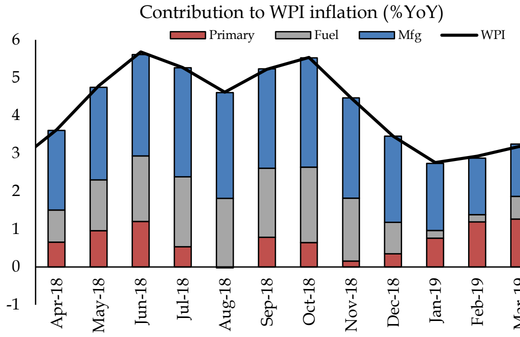
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	3-May-2019	Unemployment Rate	Apr	3.80%	3.60%	3.80%	⇩
	10-May-2019	CPI YoY	Apr	2.10%	2.00%	1.90%	⇧
UK	17-Apr-2019	CPI YoY	Mar	2.00%	1.90%	1.90%	⇨
	10-May-2019	GDP QoQ	1Q P	0.50%	0.50%	0.20%	⇧
	10-May-2019	Industrial Production YoY	Mar	0.50%	1.30%	0.10%	⇧
China	30-Apr-2019	Manufacturing PMI	Apr	50.50	50.10	50.50	⇩
	15-May-2019	Industrial Production YoY	Apr	6.5%	5.4%	8.5%	⇩
	9-May-2019	CPI YoY	Apr	2.50%	2.50%	2.30%	⇧
Japan	26-Apr-2019	Industrial Production YoY	Feb F	--	-1.10%	-1.00%	⇩
	26-Apr-2019	Industrial Production YoY	Mar P	-0.04	-4.60%	-1.10%	⇩

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

COMMODITY

- Gold prices contracted by 1.23% MoM in April vs. a contraction of 1.21% MoM in March due to growing optimism on finalization of US-China trade deal.
- Brent prices increased by 7.05% MoM in April vs. an increase of 4.13% MoM in March due to OPEC production cut, supply disruption in Venezuela, clashes in Libya, US ending Iran oil sanction waivers and more recently reports of Russian oil contamination affecting oil supply in Europe.

Domestic Market Macro Economics



India WPI Inflation

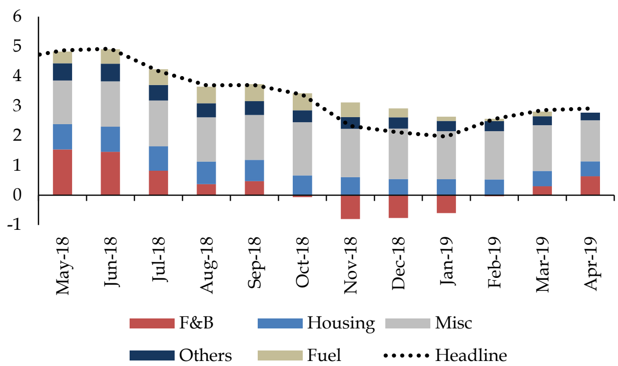
%YoY	Weights(%)	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19
IIP	100	0.2	2.5	1.4	0.1	-0.1
Sectoral Classification						
Mining	14.4	2.7	-1.0	3.9	2.0	0.8
Manufacturing	77.6	-0.7	3.0	1.0	-0.3	-0.4
Electricity	8.0	5.1	4.4	0.9	1.2	2.2
Use Based Classification						
Primary goods	34.0	3.2	-1.2	1.4	1.2	2.5
Capital goods	8.2	-4.1	4.9	-3.4	-8.8	-8.7
Intermediate goods	17.2	-4.1	-0.8	-3.2	-4.9	-2.5
Infrastructure/construction goods	12.3	4.8	10.0	6.8	2.4	6.4
Consumer durables	12.8	-3.0	3.9	2.3	1.2	-5.1
Consumer non-durables	15.3	-0.3	5.9	3.3	4.3	0.3

March IIP

- ✓ Both Manufacturing and Services PMI moderated in Apr-19 on the back of slower pace of expansion in new orders amidst election related uncertainty and competitive conditions. Owing to moderation in both service and manufacturing activity, the composite PMI eased to an eight-month low of 51.7 in Apr-19.
- ✓ Core sector grew by 4.7% YoY in Mar-19 (Previous: 2.2% YoY), recording the strongest pace in five months, driven largely by growth in refinery, steel, coal and cement output.
- ✓ Gross GST revenue collection stood at Rs 1.14 trn in Apr-19, registering a 10.05% YoY growth. Rise in tax collections can partly be attributed to the year-end adjustments owing to arrears.
- ✓ The India Meteorological Department's (IMD) 1st Stage Long Run forecast for 2019 Southwest monsoon season (June-September) predicts monsoon rainfall to be near normal at 96% of Long Period Average (LPA), with a model error of +/- 5%. The 5 category probability distribution indicates 51% probability of a normal to excess monsoon in 2019, with the expectation of rainfall being well distributed.
- ✓ India's industrial production for the month of Mar-19 contracted by 0.1%YoY vis-à-vis 0.1% in Feb-19, adding to the host of indicators confirming the weakening economic momentum. Manufacturing and mining sectors acted as a drag while electricity posted a mild uptick.
- ✓ India's retail inflation firmed up marginally in Apr-19 to a 6-month high of 2.92%YoY from 2.86% in Mar-19. The upside was driven by a sharp sequential rise in food prices marking the third month of uptick after 5 months of contraction till Jan-19. Looking at the internals, barring food and housing, all sub-categories recorded either a lower or unchanged momentum compared to Mar-19. As such, and owing to a favorable base, core inflation i.e. CPI ex Food & Fuel, eased to a 1-1/2 year low of 4.55%YoY from 5.01% in Mar-19.

%YoY	Feb-19	Mar-19	FY18	FY19
Overall	2.2	4.7	4.3	4.3
Coal	7.4	9.1	2.7	7.6
Crude Oil	-6.2	-6.2	-0.9	-4.2
Natural Gas	3.7	1.3	2.9	0.9
Refinery Products	-0.7	4.3	4.6	3.3
Fertilizers	2.5	4.2	0.2	0.7
Steel	4.9	6.7	5.8	4.7
Cement	8.0	15.8	6.8	13.4
Electricity	1.2	1.5	5.3	5.1

CORE Sector – Muted Performance



India CPI Inflation

We expect:

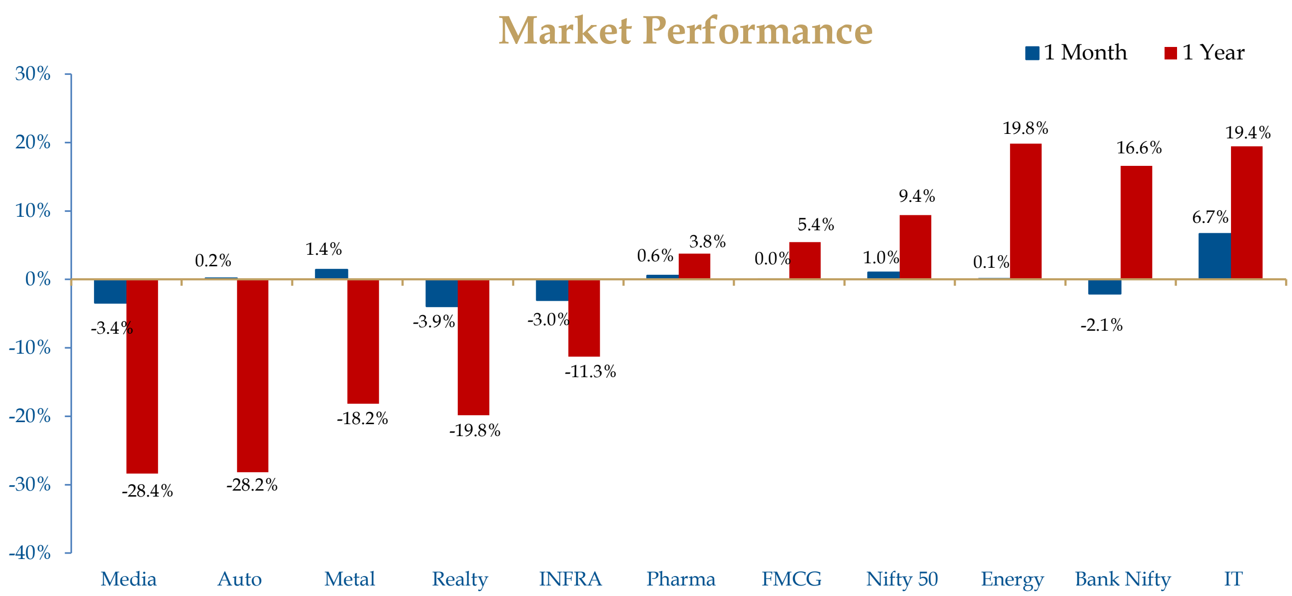
- ✓ GDP growth to rise to 7.2% vs. an expected 6.9% YoY in FY19, with incremental growth likely to be consumption led on account of fiscal stimulus, benign inflation outlook, along with gradual improvement in manufacturing capacity utilization and recovery in investment climate amidst bank recapitalization and resolution of stressed assets.
- ✓ Inflation to average at 3.8% (with marginal downside risks) vs. 3.4% in FY19, assuming crude oil price at USD 65-70 per barrel, on account of lower horticulture production and reversal of benign food inflation.

Equity Market Insights

- Month of April saw Nifty peak at 11,856 and eventually closing the month up by 1%. However, failure to sustain at peak and sharp rally in crude oil prices left the bulls wobbly at top. Brent crude oil rose above $75/barrel in the wake of tighter sanctions on Iran.

- Things begin to unfold in May as we move closer to the outcome of general elections. Moreover, trade war issues resurfaced yet again dragged the global markets lower. Meanwhile, FIIs pulled out nearly Rs. 4,000 cr for Indian equity markets so far in the month of May after pouring by about Rs. 60,000 cr in the first four months of 2019.

- Auto Index continues on a weak footing as automotive companies sitting on large inventories have seen yet another weak volume performance in April 2019. The commentary from the managements have indicated sustained weakness in the near term.



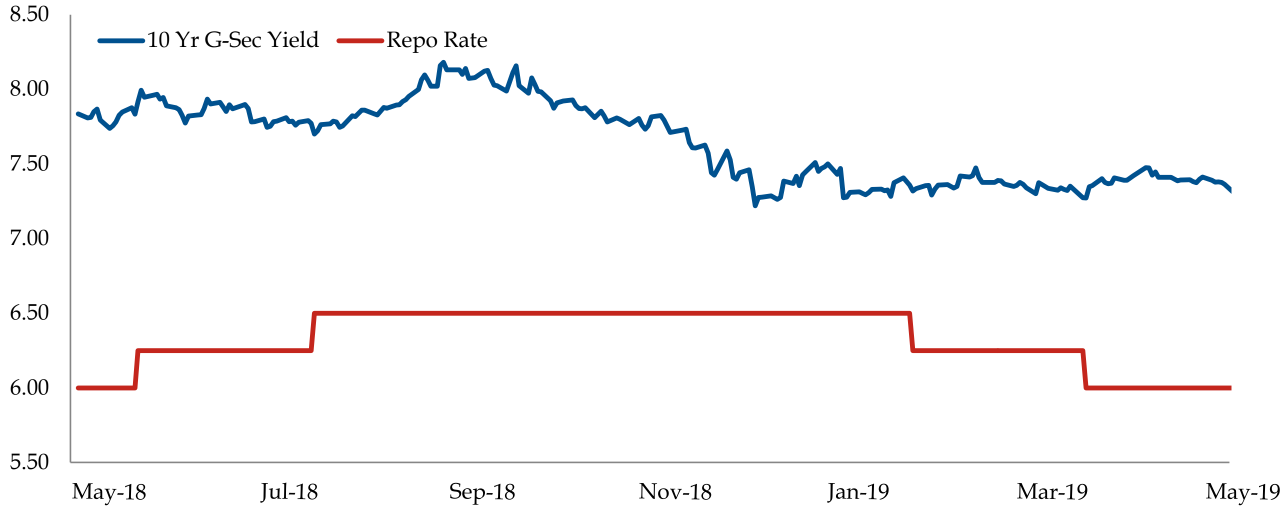
Outlook & Expectations

- Broader equity indices have done well in the last 5 years when compared with returns on other asset classes like Gold and Property. For a major part of these five years, there was no long-term capital gains (LTCG) tax on equities and therefore, the post-tax return was significantly better than fixed income investments as well.
- Equities would have possibly done even better had corporate earnings supported. We've now had a decade of sub-par earnings growth. The rise of players with innovative model in the non-listed space may have prevented pricing power for traditional players in many industries. The weak commodity cycle meant that companies linked to these sectors, didn't report strong numbers. In the last 12-15 months, PSUs did poorly even as the domestic facing private sector was on a recovery path. There has been over-reliance on the service sector to keep pushing GDP upwards. Agriculture has been weak and private capex cycle was downhill. Demonetisation, a gutsy move, clean in intent, was tardy in implementation and has not allowed GDP growth to rise to full potential. Likewise, with GST. However, we believe that, with teething troubles out of the way, these two mega initiatives will ably support higher growth of the formal economy going forward.
- As seen with market cycles historically, it could be the case that after a period of consolidation in indices, the second half of the bull-run may offer much higher returns compared to the first half. We feel the best for investors is yet to come.
- On Corporate earnings, Q4 FY19 numbers have been a mixed bag so far, with consumption pack witnessing moderation in volume growth. However, consumption is expected to improve post General elections given the government's emphasis on rural economy.

Debt Market Insights

- The average systemic liquidity maintained a deficit of INR 702 bn in April from a deficit of INR 518 bn in March.
- The average 10yr G-sec bond yield during April increased to 7.38% from 7.35% in March on the back of higher crude oil prices. RBI delivered a 25 bps rate cut however retained its 'neutral' policy stance, the central bank devolved 2021 paper on primary dealers reflecting weak appetite for shorter tenure securities.
- RBI's Monetary Policy Committee reduced its benchmark repo rate by 25 bps to 6.00% at its first bi-monthly policy review in Apr-19. As such, the reverse repo rate and the MSF rate now stand adjusted at 5.75%, and 6.25% respectively. The monetary policy stance was retained at 'neutral' by 5-1 vote, with one member opting for a shift in stance to 'accommodative'.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- Between Apr-19 monetary policy and now, two macro trends have gained ground. One, CPI inflation has bottomed out led by seasonal uptick in food prices and two, high frequency indicators are pointing towards a dip in growth momentum. Recall, Mar IIP contracted by 0.1%YoY following a meagre 0.1% growth in Feb-19, PMI manufacturing slowed to a 6-month low of 52.6 and Apr-19 passenger car sales have shrunk by 20%YoY. Looking ahead, RBI will assess the intensity and longevity of seasonal uptick in food prices and crude oil price trajectory, in reviewing its inflation outlook; along with growing evidence of growth slowing. In this context, we believe RBI will be inclined to maintain a more neutral to surplus liquidity along with support from rate cut. As such, we see scope of another 25 bps rate cut between now and Aug-19.
- Looking ahead, we expect RBI to deploy buy/sell swaps and OMO both to infuse the needed liquidity in the system. The first auction of buy/sell swap of USD 5 bn for a 3 year tenor was held on 26 Mar-19. This was followed by the second auction on 23rd Apr-19. In addition, the RBI has also announced its intent to infuse durable liquidity of INR 250 bn in May-19 via OMO purchases in two auctions of INR 125 each. Our back of the envelope calculation estimates the need for liquidity infusion to the tune of INR 1.7 tn, through a combination of Fx swaps and OMOs in FY20
- We expect 10Y G-sec to trade in the range of 7.2-7.6% in FY20. Based on domestic & global policy signals (i.e. no further Fed hikes, domestic fiscal deficit at 3.4% of GDP, and 1 rate cut by RBI), the fair value of 10Y G-sec is estimated at 7.4-7.5% for 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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