Nascent signs of global de-synchronisation

2017 marked the start of a synchronised recovery in global growth with 58% of the countries showing an uptick in real GDP growth momentum versus 44% in 2016. This synchronised recovery engineered by quantitative easing in developed markets (DMs) along with their expansionary fiscal policies, is now showing nascent signs of de-coupling in 2018 with weaker economic data from Euro Area since Mar-18. Moderation is seen in both - soft data or surveys such as PMI and hard data such as industrial production and retail sales. While it remains to be seen whether this is a temporary blip or a structural change, the recent ramp-up in crude oil prices could throw a spanner in the global growth dynamics.

The impact of the recent run-up in crude oil prices, averaging above USD 70 per barrel since Apr-18, is being felt through elevated bond yields, with US 10 year Treasury rate briefly touching 3%, levels last seen in 2014. While the pick-up in crude prices was expected against the backdrop of deepening global growth recovery, the recent spike in prices has been more of a supply side story, driven by geopolitical events such as Syria and prospect of US sanctions on Iran, greater production cuts by OPEC members and press reports of Saudi Arabia supporting a higher oil price target of USD 80 per barrel. An important factor which is influencing the behavior of key producers is fiscal considerations, as the crude oil price which balances the budget is ~ USD 70 per barrel (fiscal break-even oil price) for major oil producers such as Saudi Arabia.

If de-synchronised global recovery continues, then it has the potential to impact the pace at which monetary policy normalisation occurs in DMs. Indeed, we are seeing initial signs of divergence between key DM central banks with the Fed at a more advanced stage of policy normalization – gradually hiking policy rates and winding-down its asset purchase program, while ECB, BoE and BoJ still grappling with subdued inflation momentum. In its latest meeting in May, the Fed maintained status quo in line with market expectations, after delivering a 25 bps hike in Mar-18. The key change was the assessment of inflation, with the Fed now expecting a mild-overshoot in medium-term inflation over the 2% target. We continue to pencil-in two more rate hikes in the remainder of 2018, with the next policy review in Jun-18 providing a window for a 25 bps rate hike. Meanwhile, ECB too kept rates unchanged, it sounded more dovish than the markets had expected and confirmed the need for an ample degree of monetary accommodation to secure a sustained return of inflation rate towards levels that are below, but close to, 2% over the medium term.

On the domestic front, most of the lead domestic indicators released for the months of March and April fared better, pointing towards continued normalization of growth conditions post GST implementation. Both PMI manufacturing and services expanded on the back of rise in new orders amidst improvement in demand conditions. Meanwhile, auto sales posted a robust growth aided by improved spending in rural and semi-urban areas on the back of expectations of normal monsoon. Growth was led by UVs, CVs and 2-Wheelers.

For FY19, we expect GDP growth to pick up to 7.5% (up from 6.7% in FY18) with incremental growth likely to be consumption led on account of Government's focus on reviving rural economy, projected normal monsoon along with rollout of state pay commission award. Furthermore, normalization of business conditions, gradual recovery in investment climate amidst bank recapitalization and resolution of stressed assets and recovery in global demand augers well for economic growth.

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Global Macro Developments

- Post US withdrawal from the Iran nuclear deal, Germany, France and UK have announced that they will stick to their commitments. The French finance minister Bruno Le Maire would persuade US Treasury Secretary Steven Mnuchin later this week to grant exemptions for European firms. Meanwhile, Iran's President Hassan Rouhani said that his country will push to make the deal work with other countries, but may step up uranium enrichment again if the efforts of the remaining parties don't yield tangible results.
- As per the IMF, growth outlook for Asian economies remain strong, but the region is vulnerable to sudden tightening in global financial conditions, further market corrections and a shift towards protectionist policies. It projected Asia to grow 5.6% in 2018, an upward revision of 0.1% from its last update in Oct-17.
- Japanese workers' inflation-adjusted real wages rose for the first time in four months in March, in a sign of a gradual increase in salaries that should help stimulate consumer spending. Labor ministry data released showed real wages rose 0.8% YoY in March, snapping back from a revised 0.8% annual decline in the previous month.
- NIESR cut UK's growth forecast to 1.4% from of 1.8% (February estimate), following the release of data showing that the economy grew by 0.1% in first quarter.
- ECB kept interest rates unchanged in line with market expectations. ECB President reiterated the need for accommodative monetary policy. He also said that the underlying strength in the Euro zone economy supported the central bank's belief that inflation would return to its target of 2% in the medium term.
- Bank of Japan kept its policy rates unchanged in its monetary policy meeting. In the policy statement they removed the reference to the timeline for achieving is 2% inflation target, indicating that it was in no hurry to attain the target with the economy doing well.
- In a surprise move, China cut Required Reserve Rate for most banks by 1% effective from 25th April, with the aim to help small businesses by infusing liquidity into the economy. The last time the central bank cut RRR was in Mar-16.

Events and Data Calendar

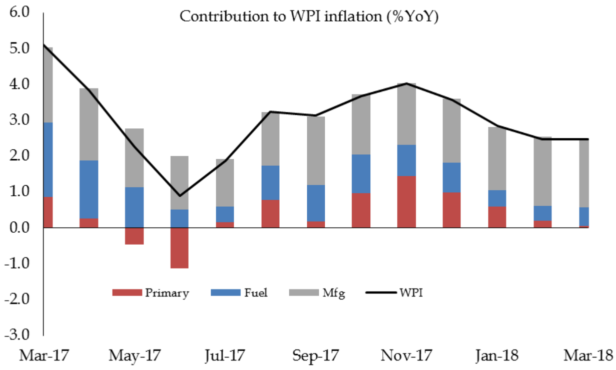
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	20-Apr-2018	National CPI (YoY)	(APR)	1.10%	1.10%	1.50%	⇩
	27-Apr-2018	BoJ Interest Rate Decision	(APR)	-0.10%	-0.10%	-0.10%	⇨
US	27-Apr-2018	GDP Annualized (QoQ)	1QA	2.00%	2.30%	2.90%	⇩
	2-May-2018	Fed Interest Rate Decision	(MAY)	1.75%	1.75%	1.75%	⇨
EA	4-May-2018	Change in Nonfarm Payrolls	(APR)	193K	164K	103K	⇧
	26-Apr-2018	ECB Interest Rate Decision	(APR)	0.00%	0.00%	0.00%	⇨
	2-May-2018	GDP SA (YoY)	1QA	2.50%	2.50%	2.70%	⇩
UK	18-Apr-2018	CPI (YoY)	(MAR)	2.70%	2.50%	2.70%	⇩
	27-Apr-2018	GDP (YoY)	1QA	1.40%	1.20%	1.40%	⇩
	10-May-2018	BoE Interest Rate Decision	(MAY)	0.50%	0.50%	0.50%	⇨
China	17-Apr-2018	GDP (YoY)	1Q	6.80%	6.80%	6.80%	⇨
	10-May-2018	Consumer Price Index (YoY)	(APR)	1.90%	1.80%	2.10%	⇩

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

COMMODITY

- Gold prices increased by 0.57% MoM in April (vs. a decline of 0.35% MoM in March) as the demand for safe haven rose amid tensions between US and Russia over Syria.
- Brent prices increased by 7.63% MoM in April (vs. an increase of 1.13% MoM in March) on the back of 1) reports of extension in OPEC led production cuts 2) supply concerns amid Middle East tensions and 3) decline in crude oil inventories in the US.

Domestic Market Macro Economics



India March WPI

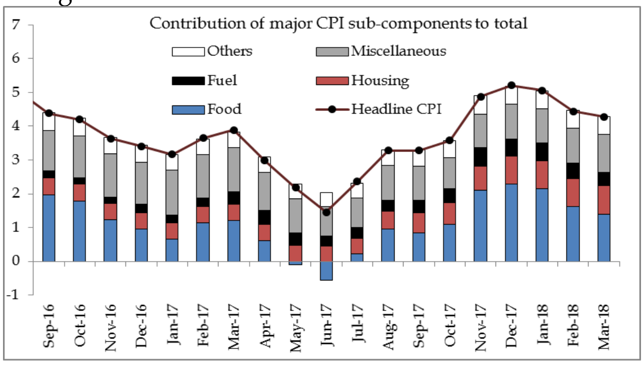
Growth in IIP (% YoY)	Weight (%)	Mar-17	Mar-18	FY17	FY18
IIP	**100**	**4.4**	**4.4**	**4.6**	**4.3**
Sectoral Classification					
Mining	14.4	10.1	2.8	5.3	2.3
Manufacturing	77.6	3.3	4.4	4.4	4.5
Electricity	8	6.2	5.9	5.8	5.4
Use based Classification					
Primary Goods	34	5.8	2.9	4.9	3.7
Capital Goods	8.2	9.4	-1.8	3.2	4.4
Intermediate Goods	17.2	3.1	2.1	3.3	2.2
Infrastructure & Construction Goods	12.3	1.1	8.8	3.9	5.5
Consumer Durables	12.8	-0.6	2.9	2.9	0.6
Consumer Non-durables	15.3	7.5	10.9	7.9	10.3

March IIP: A slow March

- ✓ Manufacturing activity, as seen from the NIKKEI PMI, continued to remain in the expansion zone for the ninth consecutive month, rising to 51.6 in April-18 vs. March's reading of 51.0. Pickup in the manufacturing activity was led by robust rise in output and new orders amid favourable demand conditions.
- ✓ The PMI services index increased to 51.4 in Apr-18 from 50.3 in Mar-18. The expansion in the service activity was led by new orders that increased at a modest pace amidst favourable demand conditions and output.
- ✓ Core sector grew 4.2% YoY in Mar-18 (Previous: 5.4% YoY), recording the weakest pace in three months led by moderation in refinery products, cement and fertilizer output and contraction in crude oil output and unfavourable base effect. For FY18, average core sector growth was at 4.2% vis-à-vis 4.8% growth in FY17.
- ✓ As per RBI's latest data, non-food credit growth was recorded at 11.8% YoY. The growth rate is buoyed by the demonetization afflicted base, which has gradually started to wane.
- ✓ India's industrial production moderated to 4.4% YoY in Mar-18 from 7.1% YoY in Feb-18, hitting a 5-month low. The growth was below our and consensus expectation of 5.8% and 6.2% respectively. For FY18, IIP grew by 4.3% vs. 4.6% in FY17. By Industry classification, growth was led by the sectors of mining and electricity. While on the user base side, capital goods contracted to 1.8% YoY (vs. 19.5% growth in Feb-18) after a hiatus of seven months on account of unfavourable base effect. However; slowdown in growth was noted across consumer durables, infrastructure, intermediate and primary goods.
- ✓ India's merchandise trade deficit widened to USD 13.7 bn in March (Bloomberg consensus: USD 12.3 bn, YBL expectation: USD 11.2 bn) from USD 12 bn in February. In sequential terms, the higher trade deficit was due to a faster pick-up in imports relative to exports. On annualized basis, exports declined by 0.7% in March, partly due to base effects and imports registered a growth of 7.1%.

%YoY	Jan-18	Feb-18	Mar-18	FY17	FY18
Overall	**6.1**	**5.4**	**4.2**	**4.8**	**4.2**
Coal	3.2	1.3	9.1	2.7	2.7
Crude Oil	-3.2	-2.3	-1.6	-2.5	-0.9
Natural Gas	-1.0	-1.4	1.3	-0.8	3.0
Refinery Products	11.0	7.9	1.0	5.2	4.6
Fertilizers	-1.6	5.1	3.3	0.2	0.2
Steel	1.7	5.0	4.8	10.8	5.8
Cement	19.6	23.0	13.0	-0.8	6.7
Electricity	7.6	4.5	4.5	5.9	5.2

CORE – Growth moderates



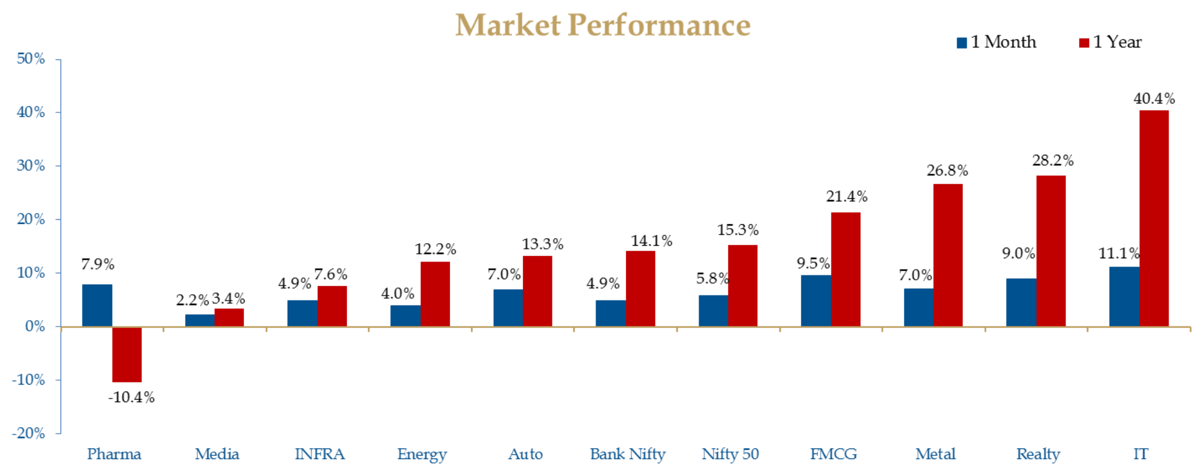
India March CPI - The last breather

We expect:

- ✓ FY19 GDP growth to accelerate to 7.5% 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 4.7% assuming normal monsoon, average crude oil price at USD 65 per barrel and recalibration of Kharif MSP. At the same time we also note that the future inflation trajectory faces upside risks from elevated crude oil prices currently averaging ~ USD 70 per barrel since April 18.

Equity Market Insights

- Global equities made a modest gain in April with Asian markets leading the pack even as oil price rallied strongly on demand dynamics.
- While gains were seen across the board, shares of the small and mid-sized companies outperformed their larger counterparts. The Nifty Midcap 100 and Nifty Smallcap 100 gained by ~7.7% and ~7.2% MoM, respectively. While the SENSEX and Nifty ended higher ~6.2% and ~5.8% MoM.
- Capital continues to be poured into equity by domestic institutions who invested a net amount of INR 112.9 bn in April 2018. Foreign investors remained net sellers with a net outflow of INR 64.7 bn during the month. In the calendar year till date, DII's invested INR 411 bn vs. INR 84 bn amount invested by FPIs.



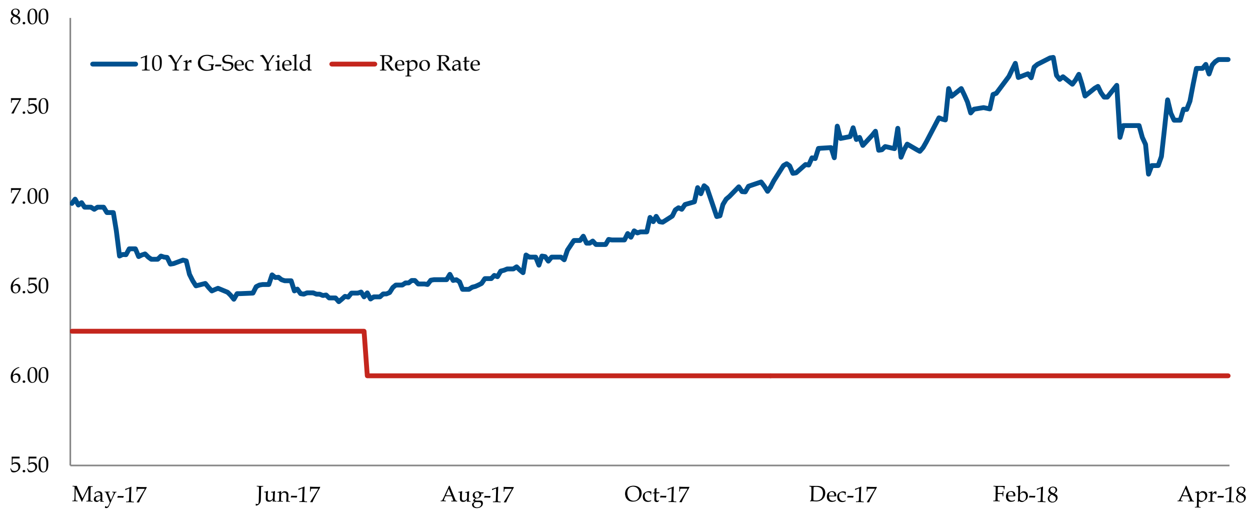
Outlook & Expectations

- 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 assets 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 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 turned into surplus in April at INR 504 bn vs. a deficit of INR 127 bn in March, with the resumption of government expenditure at the start of the financial year.
- The average 10yr G-sec bond yield during April remained elevated at 7.5% (vs. 7.6% in March) on the back of rising crude oil prices and US yields touching 3%. Moreover, the hawkish sentiment reinforced in the RBI minutes also kept yields elevated during the month.
- CPI inflation eased further in March for a third consecutive month to 4.28%YoY versus 4.44% in Feb-17, after hitting a 17-month high in Dec-17. However, the moderation was less than anticipated when benchmarked against our and market expectations (YBL: 3.97% and Bloomberg: 4.10%). For Q4FY18, average headline CPI inflation now stands at 4.6%YoY, a tad higher than RBI's recently revised Q4 projection of 4.5%. For FY18, CPI inflation average stood at 3.6%, 10 bps below our estimate of 3.7%.
- The RBI's Monetary Policy Committee published the minutes of its meeting held over Apr 4-5, 2018. This meeting was followed by the central bank's decision to keep repo rate unchanged at 6.00%. Overall, the April policy minutes reinforced the hawkishness observed in the February policy minutes, which was found to be rather subdued in the actual policy document (and the press interaction thereafter). Reasons for hawkishness stem from the balance of risk for inflation being tilted on the upside on account of both global and domestic factors. As such, the risk of a 25 bps rate hike in Aug/Oct-18 has risen in our view, post the reinforced hawkishness in the Apr RBI MPC minutes, with the number of members decisively at the hawkish end of the spectrum rising to two.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- On the monetary policy front, we expect that the likelihood of a 25 bps rate hike has increased in Aug/Oct-18 basis reinforced hawkishness in the April RBI minutes and the credible upside risk to inflation.
- Incorporating the recent run-up in bond yields, higher oil prices, rising US treasury yields and hawkishness of RBI minutes, we revise up our FY19 10 yr G-sec yield trading range to 7.5-8.2% from 7.0-7.5% previously.

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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