FIRST Insights

# Withering sentiments on global equity rout

Last month, India witnessed one of the largest stock market sell-offs spread across DM and Asia with equity market volatility index VIX, crossing this year's average of ~15.7 on 17 out of 23 trading days. US S&P 500 index slumped 3.3% during the month marking the largest decline since February. Other leading Asian equity indices followed a similar rout. The key factor that triggered the global equity sell-off was primarily the escalation in trade tensions between the US and China. Reports suggest that the US is likely to announce tariffs in December on remaining Chinese imports worth USD 257 bn if talks between Presidents Donald Trump and Xi Jinping during G20 summit fail to take a constructive turn. Unless the global trade situation improves with US-China trade spat reaching a final conclusion, Asia and the rest of world will remain under pressure of the US stock market fallout with tech stocks reeling, rising interest rates and a stronger dollar. The IMF, weary of rising trade tensions, slashed Asia's economic growth forecast by 0.2% to 5.4% in 2019 while maintaining the 2018 forecast at 5.6%.

Apart from trade war woes, Euro Zone and the UK outlook looks less sanguine. The worries of a "disorderly, cliff edge" Brexit are far from over though some positive developments have started taking shape. Meanwhile, Italy's draft 2019 budget was rejected by the European Commission as it did not adhere to EU rules on fiscal spending. The 10 year spread between Italian and German bond yields widened in October on account of fiscal concerns. Adding to future uncertainties, German Chancellor Angela Merkel announced that she would not seek re-election when her term expires in 2021.

Global uncertainty got stoked further by the GDP releases during the month. In Asia Pacific region, except for Singapore, Q3 GDP growth came in lower than the market expectations for China, South Korea and Taiwan. China's GDP growth moderated to 6.5% YoY from 6.7% in Q2 driven by weakness in the manufacturing sector. In tune, Taiwan and South Korea saw moderation in growth as they are highly integrated with China's supply chain. A further slowdown of these economies is quite likely in Q4 unless the Chinese government further ramps up fiscal spending, looks for alternative markets for exports and more importantly boosts domestic consumption. To add to these pressures, Euro zone GDP growth surprised to the downside at 1.7% YoY in seasonally adjusted terms as against 2.2% in Q2. In contrast, Q3 US GDP growth beat market expectations of 3.3% by clocking a strong 3.5% YoY.

With systemic global equity sell-off, tightening of global liquidity, uneven global economic recovery and higher debt levels, demand for safe haven assets like gold and JYP increased. JPY rose by ~0.7% MoM in October, meanwhile, gold has risen by 1.4% in October and ~4% from the August low this year. Oil prices have remained under pressure averaging USD 80.6 per barrel in October due to escalating trade war concerns and with implementation of US sanction on Iran (effective from November 5). However, crude prices had given up its gains as news that some nations would get temporary US waiver to buy Iranian oil (despite the sanctions) along with some indications that other OPEC members will increase supply to offset any shortfall.

In November we look forward to the unfolding of many important events. US oil sanctions on Iran have already come into effect from November 5. US Mid-term elections were held on November 6. Italy is expected to finalize its revised budget with the European Commission. A deal on Brexit is expected to be finalized. G20 summit is going to take place end of November in Argentina where the fate of trade war will be decided as President Trump is expected to meet his Chinese counterpart Xi Jinping.

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## Global Macro Developments

- Bank of England voted unanimously to hold interest rates steady at 0.75% while hinting there may be a need for a faster pace of rate increases in the coming year.
- Bank of Japan kept monetary policy steady and slightly trimmed its inflation forecasts amid global trade tensions, the central bank bought debt in the open market one day after the finance ministry auctions new bonds as part of the QE plan. BoJ governor Kuroda said that consumer inflation was moving around 1%. He further stated that "Japan's economy is expected to continue expanding moderately".
- Japanese PM Shinzo Abe called for a new public works spending program to boost the economy, amidst global risks and rising debt burden. Meanwhile Japan's government downgraded its export outlook amid signs of slowing shipments due to trade tensions between US and China.
- China's Premier Li Keqiang admitted that China and ASEAN countries have reached a critical moment on the RCEP agreement that involves creation of a Free trade zone, and expected the deal closure by next year after final negotiations.
- US President Donald Trump said that he will likely make a deal with China on trade, adding that a lot of progress had been made to resolve the two countries differences but warned that he still may impose more tariffs on Chinese goods. He also said his administration is planning to produce a resolution within two weeks calling for a 10% tax cut for middle-income people.
- US Fed Chairman Jerome Powell, highlighted that US economy was growing stronger due to fiscal policies like tax cuts and incremental government expenditure but showed concerns on high corporate borrowings, softness in housing segment and global slowdown.
- UK cabinet gave support to PM Theresa May's draft Brexit deal, which she mentioned is in the best interest of UK, thereby paving a way for further proceedings which will involve EU Emergency summit on Nov 25th, where remaining 27 members will approve it.

## Events and Data Calendar

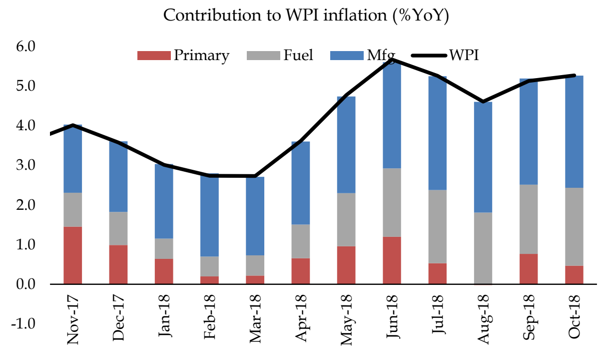
| Region | Date | Event/Data | Period | Forecast | Actual | Prior | Change |
|---|---|---|---|---|---|---|---|
| China | 31-Oct-2018 | Manufacturing PMI | Oct | 50.60 | 50.20 | 50.80 | ↓ |
| | 14-Nov-2018 | IIP | Oct | 5.80% | 5.90% | 5.80% | ↑ |
| | 9-Nov-2018 | CPI (YoY) | Oct | 2.50% | 2.50% | 2.50% | → |
| UK | 14-Nov-2018 | CPI (YoY) | Oct | 2.50% | 2.40% | 2.40% | → |
| | 9-Nov-2018 | GDP Annualized QoQ | 3Q A | 3.30% | 3.50% | 4.20% | ↓ |
| US | 5-Oct-2018 | Unemployment Rate | Oct | 3.70% | 3.70% | 3.70% | → |
| | 11-Oct-2018 | CPI YoY | Oct | 2.50% | 2.50% | 2.30% | ↑ |
| Japan | 15-Oct-2018 | Industrial Production (YoY) | Sep F | Nil | -2.50% | -2.90% | ↑ |

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

**COMMODITY**

- Gold prices increased by 1.4% MoM in October vs. a decline of 0.2% MoM in September amid weaker dollar, volatility in stock market and uncertainty around US mid-term elections.
- Brent prices increased by 2.0% MoM in October vs. an increase of 7.8% MoM in September due to concerns on US-China trade war and US sanctions on Iran's crude exports.

# Domestic Market Macro Economics




**India October WPI**

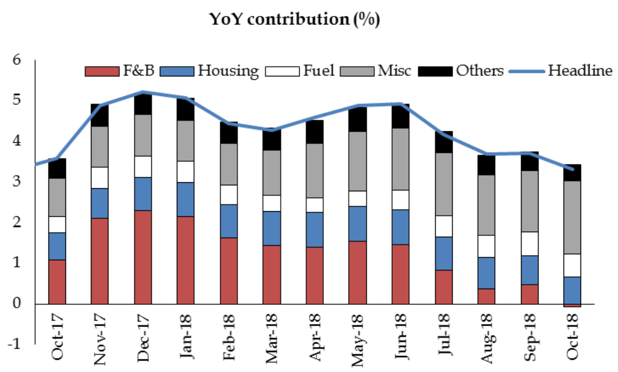
| %YoY | Weights(%) | Jun-18 | Jul-18 | Aug-18 | Sep-18 |
|---|---|---|---|---|---|
| **IIP** | 100 | 7.0 | 6.5 | 4.7 | 4.5 |
| *Sectoral Classification* | | | | | |
| Mining | 14.4 | 6.5 | 3.4 | -0.5 | 0.2 |
| Manufacturing | 77.6 | 6.9 | 7.0 | 5.1 | 4.6 |
| Electricity | 8.0 | 8.5 | 6.7 | 7.6 | 8.2 |
| *Use Based Classification* | | | | | |
| Primary goods | 34.0 | 9.2 | 6.7 | 2.5 | 2.6 |
| Capital goods | 8.2 | 9.7 | 2.8 | 9.3 | 5.8 |
| Intermediate goods | 17.2 | 1.5 | 1.0 | 2.8 | 1.4 |
| Infrastructure/construction goods | 12.3 | 9.4 | 9.2 | 8.0 | 9.5 |
| Consumer durables | 12.8 | 13.6 | 14.3 | 5.3 | 5.2 |
| Consumer non-durables | 15.3 | 0.2 | 5.5 | 6.5 | 6.1 |

**Sep IIP: Momentum holds**

- ✓ Core sector growth moderated to 4.3% YoY in Sep-18 (Aug: 4.7%) driven by contraction in production of crude oil and natural gas. d
- ✓ GST collection for Oct-18 stood higher at Rs 1,007 bn (vs. Rs 944 bn in Sep) on account of festive demand and better compliance due to anti-evasion measures announced earlier. GST collections average run rate for FYTD19 stands at Rs 969 bn; though lower than the Government's target of Rs 1 tn per month for FY19, but stands above average monthly collection of Rs 898 bn in FY18.
- ✓ Non-food credit growth continued to improve to 14.5%YoY as of 12th Oct-18 compared to 13.6% as of 14th Sep-18. Supporting the credit growth rate is the higher demand for working capital given the rise in global commodity prices especially crude oil and the rising interest rate which makes bank lending more favorable as compared to other sources.
- ✓ India's industrial production growth surprised positively, printing at 4.5% YoY in September. It does represent a slight moderation compared to an upwardly revised 4.7% in August (4.3% earlier). The decline in growth rate appears to be optical in nature as some consumer segments are affected more by the shift in both festive period and the preceding inauspicious period.
- ✓ India Oct-18 CPI inflation at a 13th month low of 3.31%YoY (vs. previous downwardly revised 3.70%), marks a sanguine start to the H2-FY19 inflation trajectory. Not only did the print continue to surprise on the downside for the sixth consecutive month but the month of October also led to resetting of some of the inflation expectations, here on, with the 1) disinflation in Oct food prices continuing to defy the seasonal trend 2) sharp correction in crude oil prices due to a temporary waivers to select countries from US sanctions on oil import from Iran and 3) stability in INR and a possible US-China trade deal, all could prove to be more supportive than in the past.

| %YoY | May-18 | Jun-18 | Jul-18 | Sep-18 |
|---|---|---|---|---|
| **Overall** | 4.3 | 7.6 | 6.6 | **4.26** |
| Coal | 12.2 | 11.8 | 9.7 | **6.50** |
| Crude Oil | -2.9 | -3.4 | -5.4 | **-4.24** |
| Natural Gas | -1.4 | -2.7 | -5.1 | **-1.89** |
| Refinery Products | 4.9 | 12.1 | 12.3 | **2.53** |
| Fertilizers | 8.4 | 0.9 | 1.3 | **2.56** |
| Steel | 0.7 | 3.4 | 6.0 | **3.24** |
| Cement | 13.0 | 13.3 | 10.7 | **11.85** |
| Electricity | 4.2 | 8.5 | 4.8 | **8.24** |

**CORE – Growth averages**



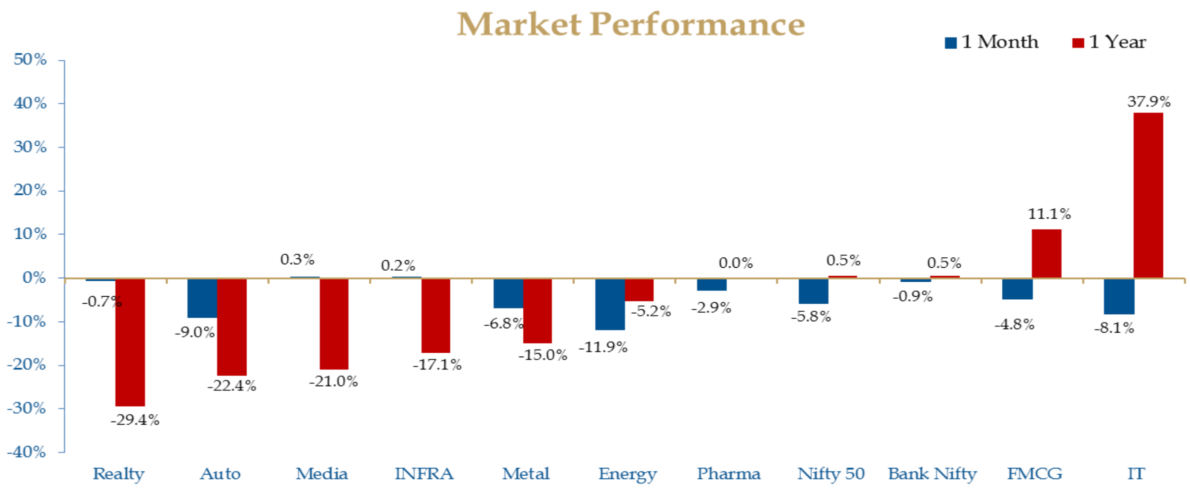

**India Sep CPI - Oct inflation remains lower than expected**

**We expect:**

- ✓ FY19 GDP growth to accelerate to 7.3% with a broad-based recovery led by consumption and modest capex cycle revival.
- ✓ We expect average CPI inflation at 4.3% in FY19 (vs. 3.6% in FY18) as upside risk to tradable inflation is likely to be offset by a benign food inflation trajectory.

## Equity Market Insights

- October was a tough one for the global markets. While weakness was seen across the markets, the Asian pack was amongst the worst performers. The Nifty ended the month lower by ~5.8%. The Nasdaq and Hang Seng declined by ~10%, while other markets declined by about 3-7% during the month.
- Foreign investors continued to remain net sellers, resulting in a net outflow of INR 272 bn during the month. This was offset to some extent with the buying activity of DIIs which increased substantially in absolute terms on a YoY basis; DIIs invested a net amount of ~INR 219 bn during the month.

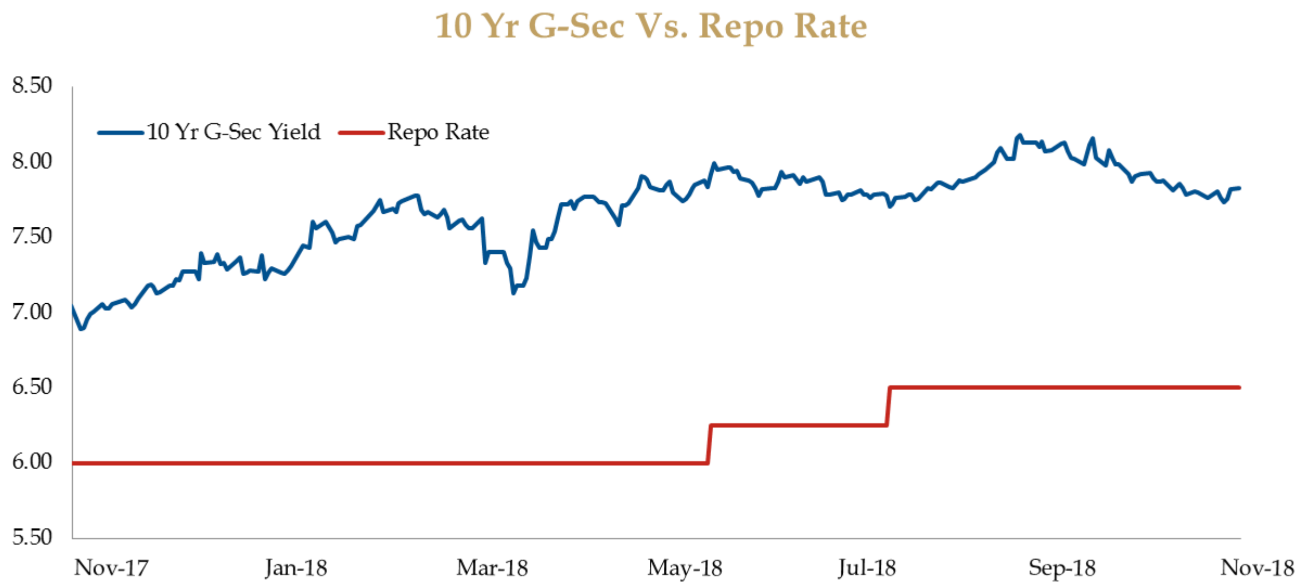



**Outlook & Expectations**

- October 2018 was yet another testing month for investors, with market volatility going off the charts. The volatility in the month was the highest since February 2018 as gauged by the movement in VIX, an indicator of market sentiments and uncertainty.
- In last two months, the market decline was due to global factors such as US – China economic cold war, crude price movement and its impact on CAD, fiscal deficit, INR etc. On domestic front, growing financial concerns about non-bank lenders have also soured sentiment. This took a toll on the overall market, with carnage seen particularly in the small and midcap spaces.
- The improving economic situation in the US, the subsequent rate hikes and the change in stance of the Fed (no more an accommodative stance) indicate towards rates moving to neutral levels. As such the 10-year Treasury bonds have crossed the 3% mark. All of this has led to a selloff in the emerging markets in general, with India not being spared as well.
- While there are factors such as the volatility in crude prices, the currency movement and the ongoing result season that will drive movement in the short term, we remain positive on India's growth prospects. We believe India will benefit from sustained structural reforms like taxation, insolvency & bankruptcy redressal and favorable demographic dividend. Economic recovery is supported by domestic demand led pickup and government capex.
- Not to mention that the increased rural income is likely to drive consumption will have a positive impact on agrochemical, auto & farm equipment and non-durables sector.
- While we are cautious on the market in the short term, the medium to long term outlook remains healthy. Our optimism is based on the manufacturing cost advantage to Indian companies in sectors like textiles, chemicals, etc; increasing income of households which is helping drive the domestic demand; and conversion into formal economy due to GST. Over the past few years, growth was driven majorly by Government capex. However, private capex has also started picking up and is likely to improve further due to improved capacity utilization and pickup in demand.
- We prefer quality companies with strong balance sheets and cash flows that provide better earnings visibility. We are also optimistic on the capacity utilization, margins and earnings growth of these companies which will help in valuation expansion and act as a driver for Indian equity markets.

## Debt Market Insights

- The average systemic liquidity maintained a deficit in October of INR 570 bn from a deficit of INR 380 bn in September.
- The average 10 yr G-sec bond yield during October moderated to 7.9% from 8.1% in September because oil prices had started correcting. RBI decision of OMO purchases of INR 400 bn also aided sentiment.
- Given the continued comfort on near-term inflation trajectory becoming more pronounced, amidst the recent softness in crude oil prices and stabilization in Rupee, we expect RBI to remain on a status quo in the remainder of FY19. Having said so, a trigger for a rate hike could arise if crude oil prices and/or Rupee were to show an upsurge post OPEC (meeting scheduled on 6th Dec-18) and Fed commentary at the FOMC meeting in December.




**Outlook and Expectations**

- Systemic liquidity has swung from a surplus of INR 1401 bn in Oct-17 to a deficit of INR 460 bn in Oct-18. On FYTD basis, demand for cash and RBI's forex intervention have resulted in an outflow of liquidity. We estimate, basis – 1) our expectation of a USD 35 bn BoP deficit in FY19 2) A higher currency in circulation leakage in H2 FY19 with the onset of the festive season and upcoming elections 3) Cash build-up of Government here on (in a bid to stick to its 3.3% fiscal deficit target), RBI would need to step up provision of primary liquidity via additional INR 1.3 tn of OMOs purchases in H2-FY19 (vs. INR 500 bn in H1). This would help absorb the back-loaded G-sec supply.
- We continue to expect 10Y G-sec yield trading band of 7.8 - 8.3% for H2 FY19.
- However, with near term comfort on inflation diluting the urgency for any immediate rate action, there can be a possibility of some relief rally in the short term. As such, some downside risk to our trading range cannot be ruled out in the near term.

## 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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