FIRST Insights

On Watch: Trade Headwinds to Global Growth

The month of October started on a positive note with some constructive developments seen on the trade front. Canada agreed to join US and Mexico in a new trade deal - USMCA, to replace NAFTA. The new deal is expected to provide increased US access to the dairy market in Canada (Canada has agreed to provide US dairy farmers 3.5% of ~USD 16 bn annual domestic market) and mandates 75% of the vehicle's parts to be made in the areas of North America (Canada and Mexico agreed to a quota of 2.6 mn PVs exported to the US given Trump imposes 25% global auto tariffs on national security grounds). Additionally, on US-China trade front, some positive developments were seen too. China's ambassador to the US said that China is "ready to make a deal" to end the trade war with the US. Chinese government said that it is willing to take steps to curtail US trade deficit with China. In the preceding month, China announced to reduce import tariff on 1,585 products including machinery, construction materials and textiles (effective from 1st Nov), bringing overall tariffs level down to 7.5% from 9.8% last year.

Having said that, trade frictions are far from over. Recall, US imposed tariff of 10% on USD 200 bn worth of Chinese goods in late September and also threatened additional tariffs on an additional USD 267 bn worth of goods. Escalation in trade tensions and heightened trade policy uncertainty weighed on the trade growth. For H1 2018, global trade growth slowed to ~3.0% YoY vs. 4.7% in 2017. As such, WTO lowered world trade growth forecast for 2018 and 2019 to 3.9% (from 4.4%) and 3.7% (from 4.0%), respectively. Amidst escalating trade tensions, IMF cut its global growth forecasts for 2018 and 2019 to 3.7% from 3.9% for both the years.

Adding to the market woes, price of Brent crude (having breached USD 86/bbl recently), is hovering around USD 84/bbl, a rally of close to 8% since early Sep-18 on the back of concerns of supply shortage due to fall in Iranian exports once US sanctions come into effect in November. Reports that US is considering granting waivers to sanctions against Iran's oil exports, Saudi Arabia replacing potential shortfall from Iran, Russia and Saudi Arabia striking a private deal to raise output kept price rise capped.

On the macroeconomic front, data emerging out from the US has been robust, keeping the Fed on track to hike rates in December for the fourth time in 2018. US service sector activity rose to a 21 year high, manufacturing activity (IHS Markit) too rose to a four-month high in September. Additionally, private sector jobs increased by 230,000 and unemployment rate fell to a 49 year low at 3.7%. Further, industrial production rose in Aug for the third consecutive month aided by higher production of motor vehicles and parts. Meanwhile, data from Eurozone was mixed. PMI manufacturing slowed to a 2 year low, retail sales fell for the second consecutive month while unemployment eased to the lowest level seen since Nov- 2008.

Kanwar Vivek
Senior President and Head,
Program Management

Shubhada M. Rao
Chief Economist

YES BANK

Global Macro Developments

- ✓ US President Donald Trump said that the US Federal Reserve is moving too fast with interest rate increases when inflation is low and economy is on strong footing. Meanwhile, he also threatened to impose additional tariffs on China.
- ✓ The BoJ kept monetary policy steady (short-term interest rate target at -0.1% and that for long-term rates around 0% by a 7-2 vote) and maintained its view that the economy will continue to expand modestly, even as escalating global trade frictions threaten to drag growth.
- ✓ Turkey slashed growth forecast to 3.8% for 2018 (from 5.5% previously). Meanwhile, the country is prioritizing investments in pharmaceuticals, energy and petrochemicals to reduce its current account deficit.
- ✓ Brazil Central Bank left Selic Rate unchanged at 6.5% amid sluggish economic growth, slow inflation, political uncertainty and a weak currency.
- ✓ WTO lowers world trade growth forecast for 2018 and 2019 due to increased tensions among major trading partners. For 2018, the trade forecast is reduced to 3.9% from 4.4% forecasted in April. For 2019, trade growth is expected at 3.7%, down from 4.0% earlier.
- ✓ The World Bank lowered its growth forecast for East Asia and the Pacific (EAP) to 6.3% this year from 6.6% last year citing trade concerns and volatility in capital flows.
- ✓ IMF also cut its global economic growth forecasts for 2018 and 2019 to 3.7% from 3.9% for both the years citing trade policy concerns, impact of import tariffs on emerging market economies, capital outflows and tighter financial conditions. Further, it cut the US 2019 growth forecast to 2.5% from 2.7% earlier and Eurozone's 2018 growth forecast was cut to 2.0% from 2.2%. It has revised UAE's growth forecast upwards to 2.9% this year and 3.7% next year on expectations that oil production and state spending will trend upwards. It maintained its Asia forecast for 2018 at 5.6% however it slashed down its April projection by 0.2 percentage points to 5.4% for next year.

Events and Data Calendar

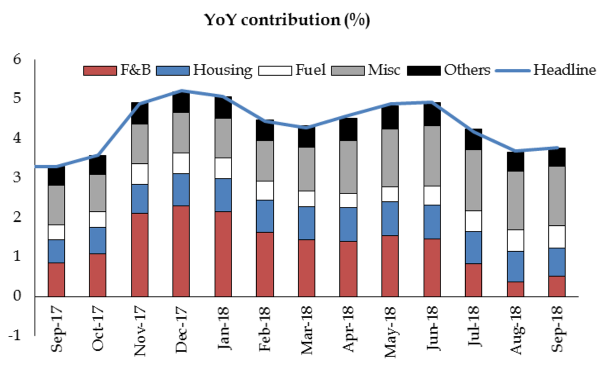
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	30-Sep-2018	Manufacturing PMI	Sep	51.20	50.80	51.30	⇩
	16-Oct-2018	CPI (YoY)	Sep	2.50%	2.50%	2.30%	⇧
UK	28-Sep-2018	GDP (QoQ)	2Q F	0.40%	0.40%	0.40%	⇨
	28-Sep-2018	GDP (YoY)	2Q F	1.30%	1.20%	1.30%	⇩
	10-Oct-2018	Industrial Production(YoY)	Aug	1.00%	1.30%	0.90%	⇧
US	5-Oct-2018	Unemployment Rate	Sep	3.80%	3.70%	3.90%	⇩
	11-Oct-2018	CPI (YoY)	Sep	2.40%	2.30%	2.70%	⇩
Japan	15-Oct-2018	Industrial Production (YoY)	Aug F	Nil	0.20%	0.60%	⇩

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

COMMODITY

- ✓ Gold prices decreased by 0.2% MoM in September vs. a decline of 3.0% MoM in August amid stronger dollar and surge in US treasury yields (10Y). Fed rate hike and rising expectations of another hike in December also weighed on the gold prices.
- ✓ Brent prices increased by 7.8% MoM in September vs. a decrease of 1.8% MoM in August due to concerns over supply from looming US sanctions on Iran's crude exports.

Domestic Market Macro Economics



India September WPI

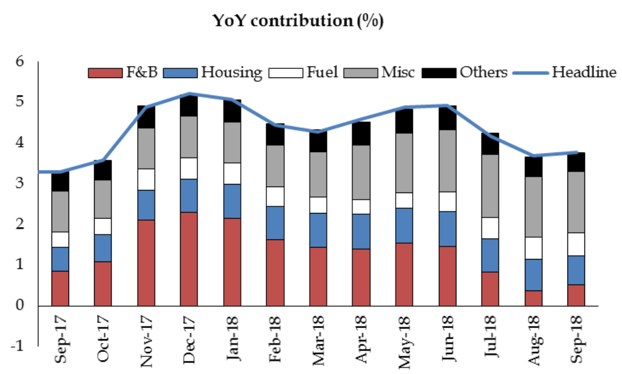
%YoY	Weights(%)	May-18	Jun-18	Jul-18	Aug-18
IIP	100	3.8	6.9	6.5	4.3
Sectoral Classification					
Mining	14.4	5.8	6.6	3.4	-0.4
Manufacturing	77.6	3.6	6.7	7.0	4.6
Electricity	8.0	4.2	8.5	6.7	7.6
Use Based Classification					
Primary goods	34.0	5.7	9.3	6.7	2.6
Capital goods	8.2	6.4	9.8	2.8	5.0
Intermediate goods	17.2	0.1	1.5	1.0	2.4
Infrastructure/construction goods	12.3	7.6	8.2	9.2	7.8
Consumer durables	12.8	6.7	13.4	14.3	5.2
Consumer non-durables	15.3	-1.6	0.2	5.5	6.3

Aug IIP: Growth moderated but infra led support continues

- ✓ PMI manufacturing rose on the back of expansion in output and new orders along with benign demand conditions both in domestic and international markets. However, PMI services moderated due to slowdown in new business orders.
- ✓ Core sector growth moderated to 4.1% YoY in Aug-18 (Jul: 7.3%) driven by a waning favorable base effect.
- ✓ Auto sales posted a downbeat growth in Sepember on account of high base effect, higher fuel prices and muted consumer sentiment and floods in the state of Kerala.
- ✓ GST collections average run rate for FYTD19 stands at Rs 962.5 bn, significantly above the average monthly collection of Rs 898 bn in FY18 though lower than the Government's target of Rs 1 tn per month for FY19. Going forward, an uptick in demand on account of upcoming festive season is expected to provide boost to the GST revenue collection.
- ✓ India's industrial production growth moderated to 4.3% YoY in Aug (YBL expectation 4.5%; consensus expectation: 3.8%) compared to a downwardly revised 6.5% in July (from 6.6% earlier). The moderation was on expected lines as the early indicators of core sector growth, automobile production and survey based PMI manufacturing – all of which witnessed a slowdown from the previous month.
- ✓ India's September merchandise trade deficit surprised on the downside by easing to a 5-month low of USD 14.0 bn, compared to an elevated USD 17.4 bn in August. The improvement was broad-based.
- ✓ India Sep-18 CPI inflation remained quite unflappable at 3.77%YoY (previous: 3.69%), remaining below the RBI's medium-term inflation target of 4.0% for the second consecutive month. The Sep-18 print surprised market expectations on the downside (YBL: 3.99% and Bloomberg consensus: 4.02%) – a trend that has remained nearly consistent over the last 4 months.

%YoY	Jul-17	May-18	Jun-18	Jul-18	Aug-18
Overall	2.9	4.3	7.6	6.6	4.1
Coal	0.6	12.2	11.8	9.7	2.5
Crude Oil	-0.6	-2.9	-3.4	-5.4	-3.7
Natural Gas	6.6	-1.4	-2.7	-5.1	1.0
Refinery Products	-2.6	4.9	12.1	12.3	5.0
Fertilizers	0.2	8.4	0.9	1.3	-5.2
Steel	9.4	0.7	3.4	6.0	4.0
Cement	1.1	13.0	13.3	10.7	14.4
Electricity	6.6	4.2	8.5	4.8	5.4

CORE – Growth moderates



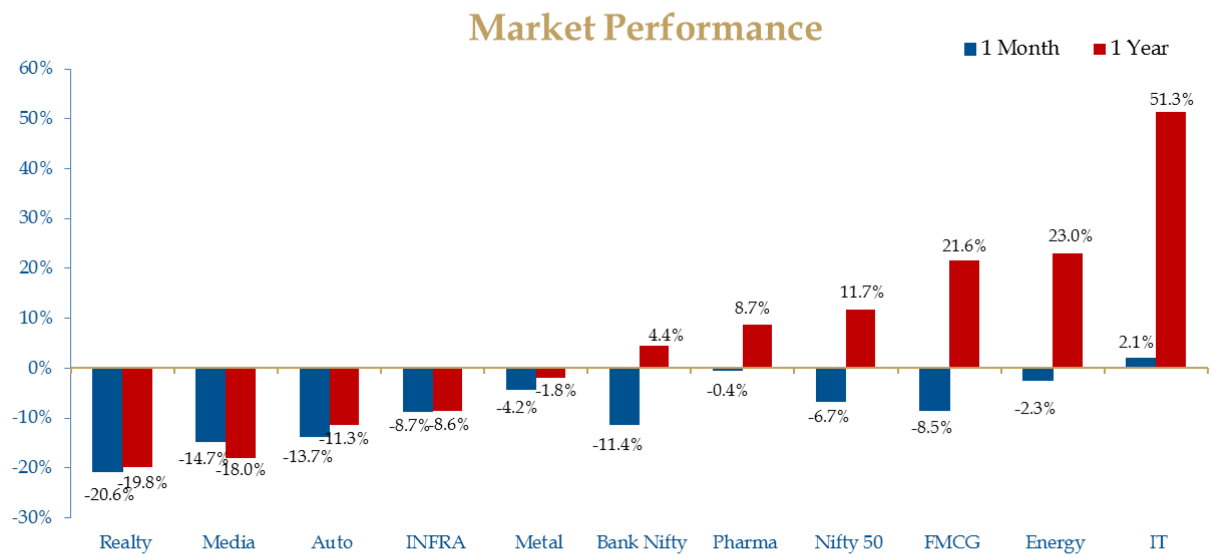
India Sep CPI - Remains unflappable

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 CPI inflation at 4.5% (vs. 3.6% in FY18). However, upside risks have started to stack up from the recent run in crude oil prices (FYTD USD ~75 per barrel vs. USD 59 per barrel in FY18), a deficit in monsoon and a weaker than anticipated INR (INR depreciated by 1.92% in Sep).

Equity Market Insights

- Indian markets stood out like a sore thumb in September 2018 when compared to other global markets. Sensex ended the month lower by ~6.3%, while most of the other major markets ended higher. The Nikkei and Dow Jones ended higher by ~5.5% and ~1.9% respectively.
- In the calendar year till date, the Sensex is up by ~6.4%, while the Dow, S&P 500 and Nikkei are up by about 7%, 9% and 6% respectively.
- Within India, weakness was seen in stocks across the board with the indices representing mid and small cap stocks falling by about ~14% and ~20% respectively in the month gone by.
- Foreign investors remained net sellers to the tune of INR 96 bn in September. In July 2018, FPIs were net buyers to the tune of INR 4.9 bn. Domestic funds (DIIs) on the other hand continued with their positive inflow trend, investing a net amount of about INR 79 bn during the month. However, when looking at the combined figure of both the type of investors, the net amount was negative (~INR 17 bn) for the first time since January 2017.

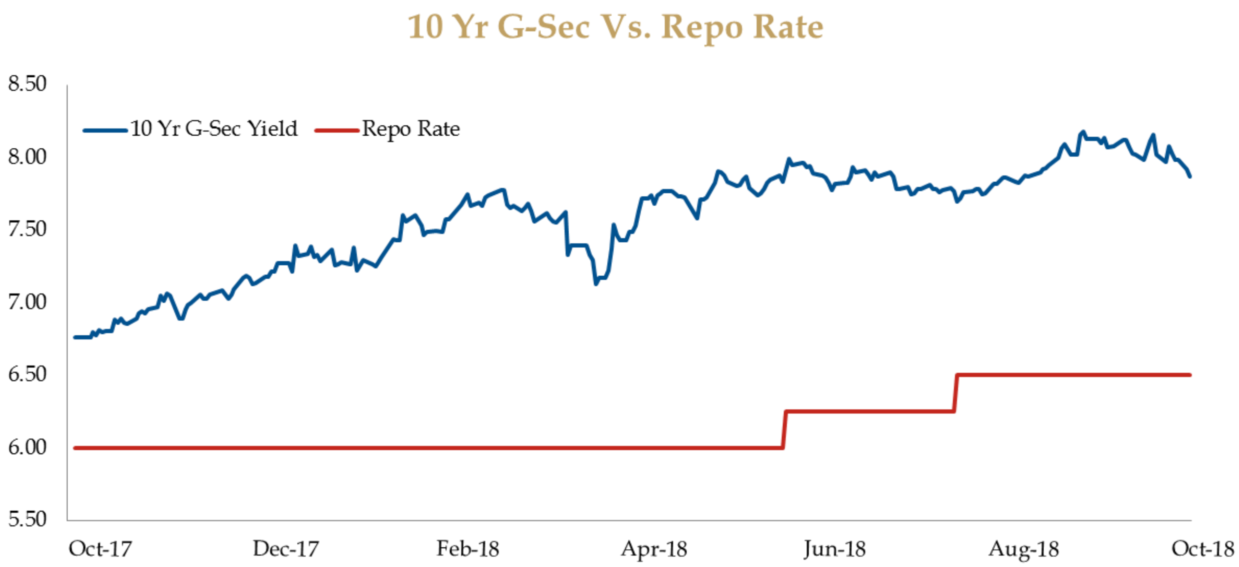


Outlook & Expectations

- The volatility in September 2018 was the highest seen in the past seven to eight months as gauged by the movement in VIX, an indicator of market sentiments and uncertainty.
- While weaker rupee and higher crude prices played a drag on the markets, rating downgrade in IL&FS and its domino effect on the NBFC pack, triggering a selloff.
- This took a toll on market overall, with carnage seen particularly in the small and midcap space. Furthermore, FPIs showed little interest as their dollar adjusted returns have been impacted with weaker rupee. Not to mention that the improving economic situation in the US, the rate hikes and the change in stance of the Fed (no more an accommodative stance). All of this led to a selloff in the emerging markets in general, with India not being spared as well.
- Going ahead, a few factors will influence market movements. This includes, the volatility in crude prices and the currency movement, in addition to the upcoming result season. This happens with a backdrop of large caps (read Nifty) valuations being above long-term averages.
- At the same time, the market correction in the year so far brought down valuations of almost all mid and small caps to much more sane levels.
- Given the sharp decline in stock prices in recent months, the time is right to begin accumulation and building a good solid portfolio of fundamentally strong companies that are available at comfortable valuations. But with the condition to hold on to them from a long-term perspective.
- While stocks will continue to be quite shaky, we suggest investors to have the stomach and the patience to power through the volatility that is expected to transpire in the coming weeks and months.

Debt Market Insights

- The average systemic liquidity turned to a deficit in September to INR 380 bn from a surplus of INR 28 bn in August.
- The average 10Y G-sec bond yield during September elevated to 8.1% from 7.8% in August. Rupee depreciation, expectation of rate hike by the RBI, rally in global crude prices, trade protectionism between US-China and rise in UST yield on 10-year paper above 3.0% pushed yields higher.
- We believe that RBI is likely to pre-emptively deliver a 25 bps rate at its forthcoming policy in Dec-18. Amidst the comfort on near term inflation after a cumulative 50 bps of rate tightening earlier in the year, RBI decided to maintain a status quo in October policy. More importantly, the monetary policy stance shifted from 'neutral' to 'calibrated tightening', there by signaling the possibility of a rate hike if upside risks to inflation materialize.



Outlook and Expectations

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- Based on domestic and global policy signals, we estimate the fair value of 10Y G-sec to be 8.0-8.1% for FY19.
- As such, we expect 10Y G-sec yield trading band at 7.8-8.3% for H2 FY19 from 7.5-8.2% earlier.
- While rate hikes (both global and domestic) would weigh, sizeable OMO purchases and lower than expected H2 FY19 G-sec borrowings could provide some relief.

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.

YES BANK Limited

Regd. & Corporate Office: Nehru Centre, 9th Floor, Discovery of India, Worli, Mumbai 400018. | Tel: + 91 22 6669 9000 Fax: + 91 22 6669 9018
Northern Regional Corporate Office: 48 Nyaya Marg, Chanakyapuri, New Delhi 110 021. | Tel: + 91 11 5556 9000 Fax: +91 11 5168 0144

Contact Details

Radhika Piplani and Sanjana Shah
Economist
radhika.piplani@yesbank.in
sanjana.shah@yesbank.in

Shubhada M. Rao
Chief Economist
shubhada.rao@yesbank.in

Kanwar Vivek
Senior President and Head
Program Management
kanwar.vivek@yesbank.in

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.
YES BANK has a knowledge driven approach to banking, and a superior customer experience for its retail, corporate and emerging corporate banking clients. YES BANK is steadily evolving as the Professionals Bank of India with the long term mission of "Building the Best Quality Bank of the World in India".