# A synchronized slowdown

The whipsawing escalation of US-China trade war, with several rounds of tit-for-tat imposition of tariffs reached a pinnacle in the month of August. Recall, the US in early August had announced punitive tariff of 10% on USD 300 bn worth of Chinese goods after an unsuccessful trade meet between the two sides in Beijing. In response, China retaliated by halting all purchases of US agricultural goods and imposing new tariffs on USD 75 bn worth of US goods which further elicited an additional 5% tariff response from the US. However, amid fears of a global economic recession, US and China recently agreed to hold high-level trade talks in October, bringing back some level of optimism in the market sentiment. Meanwhile, in order to boost lending and bolster the slowing economy, the People's Bank of China (PBoC) decided to cut reserve requirement ratio by 50 bps.

Apart from wrangling of these trade giants, another trade spat emerged with Japan removing South Korea from the list of trusted trading partners placing export curbs on industrial and high-tech products, as it believed that South Korea was leaking sensitive information to North Korea. The series of these trade tensions continue to have a domino effect as other countries get caught in the crossfire, with real growth indicators turning disquieting. Meanwhile, some respite was offered on the Brexit front where the UK Parliament enacted a law to block a 'no deal' Brexit. It also rejected a second call from Prime Minister Boris Johnson's for a snap election, before the suspension until 14th October, making the extension of Brexit deadline more likely.

On the global macro data front, while J.P Morgan/Markit Global PMI improved marginally to 49.5 in August from 49.3 in the previous month, it remained below 50 mark for the fourth consecutive month. Fluid developments and mixed messages from US-China trade talks appear to have weighed on new orders, which recorded fastest pace of contraction in nearly 7 years. On the other hand, EM Asia manufacturing PMIs slowed down to a 3.5 year low of 49.8 in Aug-19. Within Asia deterioration in the aggregate PMI was led by India and Indonesia, whereas Korea saw the largest improvement from July's five-month low. This likely suggests the trade-related uncertainties may have started to spillover to the larger economies that had previously been relatively insulated from external risks.

On the domestic front, in line with the signals received from lead indicators, India's economic growth decelerated to a 6 year low of 5.0% from 5.8% in Q4 FY19. However, in an effort to revive economic growth, Finance Minister announced raft of measures, including rollback of super-rich tax on foreign and domestic equity investors, exemption of startups from 'angel tax', a package to address distress in the auto sector and upfront infusion of INR 700 bn to public sector banks. While we expect GDP growth in FY20 to decelerate to 6.3% from 6.8% in FY19, these measures are expected to arrest further downside risk to growth to some extent as well as lay the foundation for a higher growth trajectory in FY21.

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FIRST Insights

## Global Macro Developments

- The British Chamber of Commerce has cut its growth forecasts for the UK to 1.2% (from 1.3% earlier) for 2019 and to 0.8% (from 1.0% earlier) for 2020 amidst slowdown in global economy, US-China trade tensions and a persistent drag from Brexit. The forecasts are based on the assumption that UK avoids a no-deal Brexit.
- The lower house of UK Parliament passed a bill to prevent a no-deal Brexit. It also rejected PM Johnson's call for a snap election on Oct 15
- ECB reduced the deposit rate by 10 bps to a historic low of -0.5% and announced that it will restart quantitative easing from Nov to the tune of EUR 20 bn per month as long as it seems necessary.
- US President Trump said that he preferred a comprehensive trade deal with China but did not rule the possibility of an interim pact. Meanwhile, China's vice premier said that the officials from both the countries would meet next week to discuss topics such as trade balance, market access and investor projection.
- IMF said that the trade war between the US and China could shave off 0.8% off the global economic growth in 2020.
- China announced its first batch of tariff exemptions for 16 types of US products, including some anti-cancer drugs. "As a gesture of goodwill", US President Trump agreed to delay increasing tariffs on USD 250 bn worth of Chinese goods from Oct 1 to Oct 15. President Trump further said that he hoped to reach a trade deal with China.

## Events and Data Calendar

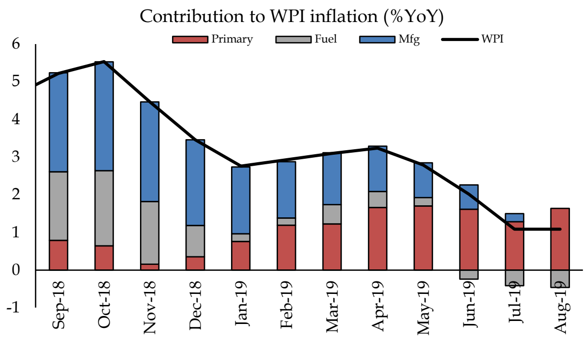
| Region | Date | Event/Data | Period | Forecast | Actual | Prior | Change |
|---|---|---|---|---|---|---|---|
| UK | 9-Sep-2019 | Industrial Production YoY | Jul | -1.10% | -0.90% | -0.60% | ↓ |
| US | 29-Aug-2019 | GDP Annualized QoQ | 2Q S | 2.00% | 2.00% | 2.10% | ↓ |
| | 6-Sep-2019 | Unemployment Rate | Aug | 3.70% | 3.70% | 3.70% | → |
| | 12-Sep-2019 | CPI YoY | Aug | 1.80% | 1.70% | 1.80% | ↓ |
| China | 31-Aug-2019 | Manufacturing PMI | Aug | 49.60 | 49.50 | 49.70 | ↓ |
| | 10-Sep-2019 | CPI YoY | Aug | 2.7% | 2.8% | 2.8% | → |
| | 16-Sep-2019 | Industrial Production YoY | Aug | 5.20% | 4.40% | 4.80% | ↓ |
| Japan | 30-Aug-2019 | Industrial Production YoY | Jul P | -0.60% | 0.70% | -3.80% | ↑ |

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

**COMMODITY**

- Gold prices increased by 6.2% MoM in August vs. an increase of 4.0% MoM in July amidst uncertainty over US-China trade tensions which kept the safe haven asset in demand.
- Brent prices contracted by 7.4% MoM in August vs. an increase of 0.5% MoM in July due to concerns regarding weakening of global demand as a) US-China trade tensions resurfaced again, and b) OPEC trimmed its outlook on oil demand.

# Domestic Market Macro Economics




**India WPI Inflation**

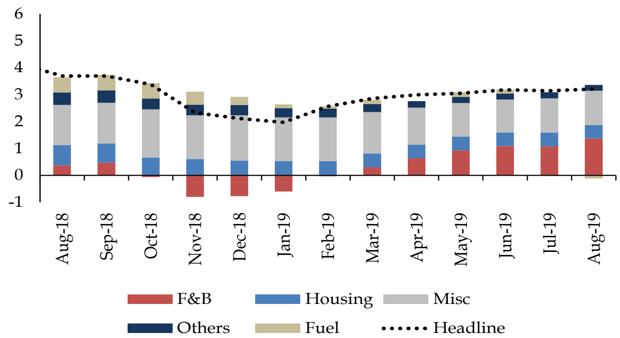
| *%YoY* | Weights(%) | Jan-19 | Feb-19 | Mar-19 | Apr-19 | May-19 | Jun-19 | Jul-19 |
|---|---|---|---|---|---|---|---|---|
| IIP | 100 | 1.6 | 0.2 | 2.7 | 3.2 | 4.6 | 1.2 | 4.3 |
| *Sectoral Classification* | | | | | | | | |
| Mining | 14.4 | 3.8 | 2.2 | 0.8 | 5.1 | 2.4 | 1.5 | 4.9 |
| Manufacturing | 77.6 | 1.3 | -0.3 | 3.1 | 2.5 | 4.5 | 0.2 | 4.2 |
| Electricity | 8.0 | 0.9 | 1.3 | 2.2 | 6.0 | 7.4 | 8.2 | 4.8 |
| *Use Based Classification* | | | | | | | | |
| Primary goods | 34.0 | 1.4 | 1.3 | 2.6 | 5.1 | 2.2 | 0.4 | 3.5 |
| Capital goods | 8.2 | -3.6 | -9.3 | -9.1 | -1.4 | -1.4 | -6.8 | -7.1 |
| Intermediate goods | 17.2 | -2.8 | -5.0 | 12.4 | 3.0 | 13.7 | 12.6 | 13.9 |
| Infrastructure/construction goods | 12.3 | 6.4 | 1.9 | 5.1 | -0.7 | 1.8 | -1.9 | 2.1 |
| Consumer durables | 12.8 | 2.5 | 0.9 | -3.2 | 2.2 | 0.3 | -10.2 | -2.7 |
| Consumer non-durables | 15.3 | 3.8 | 5.0 | 1.4 | 5.4 | 8.1 | 7.1 | 8.3 |

**July IIP**

- ✓ PMI manufacturing index slipped to a 15-month low of 51.4 in August from 52.5 in July and PMI services index eased to 52.4 in August from a near 1 year high of 53.8 in the previous month.
- ✓ Core sector growth rose to 2.1% in July from an upwardly revised print of 0.7% in June. The data offers mixed cues, with moderately growth in cement and steel juxtaposed against the annual contraction in coal, crude oil, natural gas and refinery products output.
- ✓ Auto sales in August declined for the tenth consecutive month, weighed down by a trifecta of spurt in cost of compliance because of changes in regulation, liquidity constraints and moderating income growth which has impacted overall demand sentiments.
- ✓ Gross GST revenues for August eased to a five-month low of INR 982 bn (July: INR 999 bn). GST collections average run rate for FYTD20 stands at INR 1027 bn.
- ✓ India's industrial production picked up to 4.3% YoY in July from a downwardly revised print of 1.2% YoY in June. On sequential basis, the headline index improved by 1.5% MoM after a contraction of 4.6% in June.
- ✓ India's CPI inflation rose a tad in August, maintaining it's ascent by coming in at 3.21%YoY vs. 3.15% in July. The monthly momentum of headline inflation at 0.49%MoM was driven by categories of – Food & beverages along with Housing, even as fuel prices contracted for the second consecutive month. The headline inflation marked the seventh consecutive month of rise, compared to a low 1.97% recorded in Jan-19. Nevertheless, it continues to remain well below RBI's medium term of 4.0% for over a year now.

| *%YoY* | Jun-18 | May-19 | Jun-19 | Jul-19 |
|---|---|---|---|---|
| **Overall** | **7.8** | **4.3** | **0.7** | **2.1** |
| Coal | 11.5 | 1.9 | 3.2 | -1.3 |
| Crude Oil | -3.4 | -7.0 | -6.8 | -4.4 |
| Natural Gas | -2.7 | 0.0 | -2.1 | -0.6 |
| Products | 12.1 | -1.5 | -9.3 | -0.9 |
| Fertilizers | 0.9 | -1.0 | 1.6 | 1.5 |
| Steel | 4.2 | 15.3 | 8.3 | 6.6 |
| Cement | 14.2 | 2.8 | -1.7 | 7.9 |
| Electricity | 8.5 | 7.4 | 8.1 | 4.2 |

**CORE Sector –Recovers from a sharp dip**



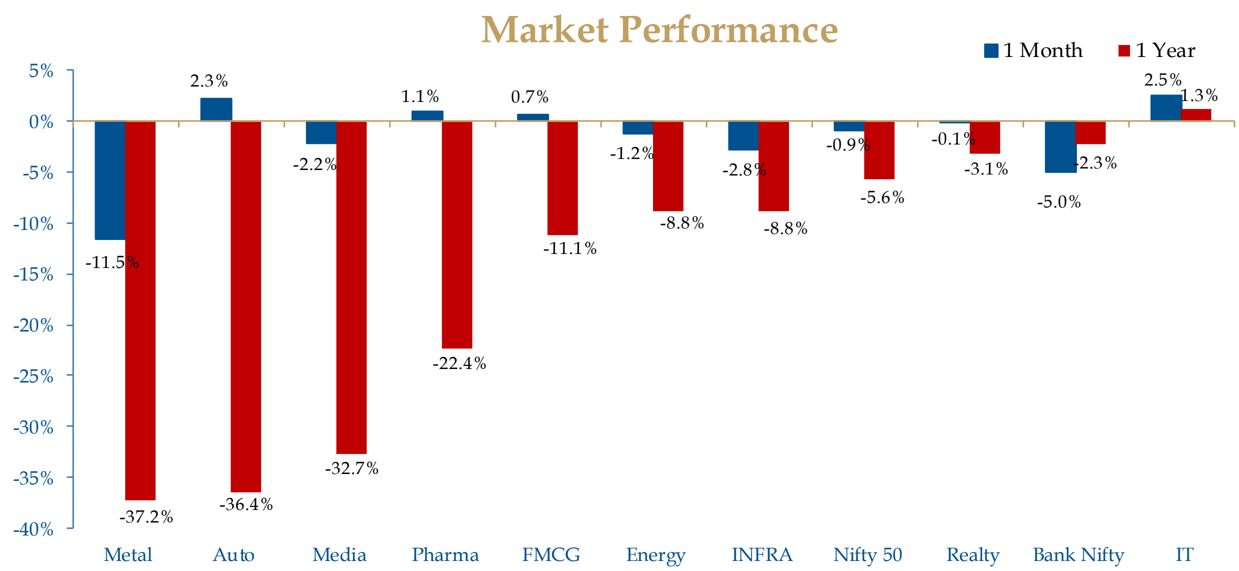

**India CPI Inflation**

**We expect:**

- ✓ Given sharper than expected slowdown in Q1 FY20, we have lowered our GDP growth forecast by 40 bps to 6.3% with downside risks. While weak statistical base along with festive season are likely to support growth momentum in H2 FY20 other factors like 1) Recent government measures 2) Monsoon resurgence 3) PM Kisan scheme in order to support rural demand 4) Sectoral initiatives for Affordable Housing, MSMEs, Roads, Aviation and Railways announced in the Union Budget and 5) Gradual transmission of 110 bps cut in policy rate by the RBI are expected to have a lagged impact on growth. Downside risk to growth could emanate from 1) Persistence of weak domestic demand 2) Sluggish global growth 3) Fiscal compression spillovers.
- ✓ We expect CPI inflation to average at 3.5% vs. 3.4% in FY19, assuming crude oil price at USD 65-70 per barrel, on account of reversal of benign food inflation and moderation in core price pressures.

## Equity Market Insights

- Indian markets were down for third consecutive month in August on global and domestic slowdown concerns. Broader markets continued to remain under pressure as midcap and small cap declined 1.3% and 1.2%, respectively.
- Nifty for the month of August managed to bounce back from the lows. However, investor confidence remained fragile even after government scrapped an extra capital gains surcharge that had sent investors fleeting for exits.
- Finance Minister also announced plans to inject Rs70,000 cr to swell PSU banks capital to push lending growth. GDP growth cooled for a fifth straight quarter to 5% in the three months ended June. That was the slowest pace since March 2013. Muted quarterly earnings and weak global cues weighed heavily on Indian markets as pullback rallies were short-lived. Weak domestic numbers accompanied by heavy FII selling led to sharp depreciation in USD-INR.



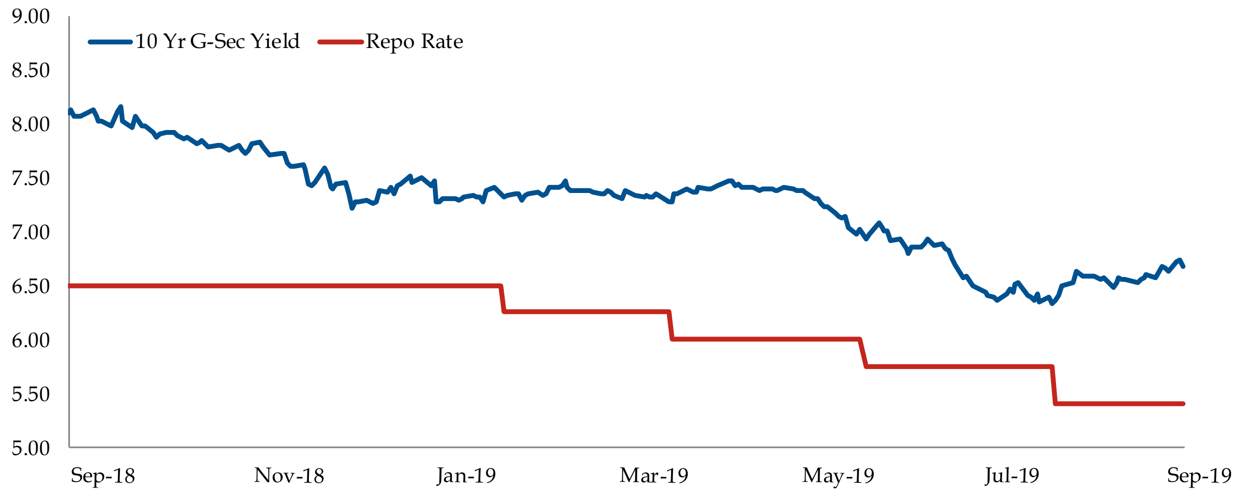

**Outlook & Expectations**

- Market to remain in a consolidation phase for the remainder of the year 2019 and some part of 2020, extending the trend since early 2018. Paradoxically though, we expect the Nifty to inch upwards in 2019, on the strength of only a handful of blue-chip counters. The broader market will continue to remain lackluster.
- The market support may likely come from rate cuts by RBI, enhancement in system liquidity and credit, government reforms and even the US Fed cutting interest rates. A thin stock participation will mean that an already heavy market, keeps getting heavier. We also envisage a massive correction somewhere down the road, may be at end of 2019 or early 2020. This should mark the end of this consolidation period.
- As the key index inches upwards, allocation to large caps makes sense at this juncture. But we also note that consumption is in a cyclical downtrend now, the economy has slowed, liquidity issues remain and the Budget didn't particularly excite either. Therefore, we believe that a systematic withdrawal (SWP) approach is equally warranted. A staggered approach to investing would be a better one, given the present state of equities.

## Debt Market Insights

- ✓ The average systemic liquidity maintained a surplus of Rs. 1,408 bn in August vs. a surplus of Rs. 1,298 bn in July.
- ✓ The average 10 yr G-sec bond yield moderated to 6.50% in August from 6.52% in July following moderation in US treasury yields along with fall in crude oil prices. Additionally, expectation of incremental monetary accommodation from the RBI continued to provide a supportive environment.
- ✓ Basis the Jalan Committee recommendations, the RBI decided to transfer INR 1761 bn to the GoI, comprising of INR 1234 bn of dividend income for FY19 (INR 280 bn paid to the GoI as interim dividend in Mar-19) and INR 526 bn of identified excess provisions. RBI's record surplus transfer to GoI is likely to aid liquidity in the near term.

**10 Yr G-Sec Vs. Repo Rate**




**Outlook and Expectations**

- ✓ For FY20, we continue to expect inflation trajectory to remain benign with average annual inflation at 3.5%, marking the third consecutive year of undershooting vis-à-vis RBI's 4% target. With the current state of negative gap in both inflation and GDP, we continue to expect the MPC to opt for incremental monetary accommodation with another 40 bps rate cut in Oct-19 review. The rate action thereafter would get data dependent with global trade outlook, persistence of the recent volatility in currency market, sustainability of the recent softness in global commodity prices, and last but not least, the degree of anticipated revival in domestic growth momentum as key variables to be watched.
- ✓ We expect the RBI to conduct ~1200 bn OMO purchases in rest of FY20 vs. the earlier estimate of INR 1750 bn. Liquidity infusion till now has come about via USD 5 bn FX swap and INR 525 bn OMO purchases.
- ✓ Our fair value model suggests a level of ~6.50% for the 10Y yield. However, we believe that the 10Y yield could trade in the range of 6.25-6.65% in the rest of FY20 due to dovish global environment, supply-demand mismatch with risks to fiscal still remaining alive.

## 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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