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Global headwinds lurking; fundamentals to support

The last few weeks have witnessed a semblance of stability in financial markets after turbulence that jolted risk assets globally in early 2016. The accommodative stance adopted by monetary authorities across US and Euro zone, relative firming up of oil prices and lower capital outflows from China have improved sentiment. In validation of same, March witnessed highest capital flows into EM assets in nearly 2 years, as per International Institute of Finance. Despite the calmness currently prevailing in the global financial markets, leading indicators suggest persistence of weak economic outlook.

In Euro zone, while manufacturing PMI improved marginally in March (51.6 vs. 51.2 in Feb-16), the Q1-2016 average (51.7) is at a four quarter low. Further, reflective of subdued demand conditions, inflation remained in the negative zone during March (-0.1% vs. -0.2% in February).

Despite Bank of Japan's accommodative monetary policy, recent economic indicators paint a weak recovery. Japan's industrial production declined sharply in Feb-16 (-6.2% MoM vs. +3.7% in Jan-16) while Bank of Japan's latest Tankan business sentiment survey for large manufacturers dropped sharply to 6 (vs. +12 in Dec-16). Meanwhile, even as PMI readings for China improved in March, they remained only marginally above the expansion zone. ADB expects China's economy would grow at 6.5% this year compared with China's own expectations of 6.5%-7%.

In contrast, data from US remained positive. The labor market looked strong as nonfarm payrolls rose by more than 200k print again in March. Manufacturing output also recorded an uptick in March with ISM manufacturing index rising to 51.8 after 5 months of contraction.

On domestic front, lead indicators released for Feb-March point towards gradual traction in economic recovery. India's core sector recorded robust growth in Feb-16 led by cement, fertilizers and electricity production. The gradual improvement in industrial outlook was also confirmed by expansion in Mar-16 PMI manufacturing on back of new orders. PMI services also accelerated to its highest level since June 2014.

While pickup in sales of tractors and two-wheelers point towards nascent signs of bottoming out in rural demand, more enduring upturn is likely to stem from implementation of measures announced in the Budget and expected normal monsoon. While private capex is likely to remain tepid amid high leverage and excess capacity, government's policy focus on stressed sectors, measures to attract FDI, concession on excise & custom duties and continued efforts towards ease of doing business are likely to assist improvement in investment climate.

Incremental growth in FY17 is likely to be aided mainly by consumption demand as benign inflation, increase in disposable incomes following 7th CPC (Central Pay Commission) implementation and OROP (One Rank One Pension), expected normal monsoon and continued monetary policy accommodation amid improvement in policy transmission would give a fillip to demand. We expect FY17 GDP growth to improve to 7.8% from 7.6% in FY16 as projected by the CSO.

Shubhada M. Rao
Chief Economist

Kanwar Vivek
Senior President and Head Wealth Management &
Global Indian Banking

Global Macro Developments

- ✓ Following recent downbeat comments by IMF Managing Director, Christine Lagarde, it is widely anticipated that the Fund may downgrade its estimates for global growth in its World Economic Outlook due to be released in April.
- ✓ In January, the IMF forecast world output would grow 3.4% in 2016 and 3.6% in 2017. That was 0.2 percentage points lower than forecasts made just three months earlier, and the fund said that the risks to its predictions were to the downside.
- ✓ The manufacturing PMIs that were released this month showed that with the exception of Japan and France, major manufacturing PMIs improved last month.
- ✓ US Q4-2015, GDP's slowdown was less severe than previously estimated but corporate profits fell, showing the economy entered 2016 on uneven footing.
- ✓ Federal Reserve officials signaled an interest-rate hike in April is unlikely, based on minutes of their March policy meeting, thereby confirming markets' growing conviction that the central bank will move cautiously until the global economy picks up steam.
- ✓ US employment increased solidly in March and wages rebounded. Non-farm payrolls increased 215,000 in March and data for January and February was revised slightly down to show 1000 fewer jobs created than previously reported.
- ✓ Euro zone economy remained in deflation territory at (-) 0.1% YoY in Mar-16, but showed a marginal improvement from the -0.2% in February as per the preliminary estimates.
- ✓ The UK economy grew more than expected during Q42015 at 2.1%YoY, higher than the previous estimate of 1.9% driven by dominant services sector. For 2015, UK GDP rose at a pace of 2.3% YoY, quicker than the previous estimated rate of 2.2%.
- ✓ Moody's downgraded its outlook on Chinese government debt to "negative" from "stable", citing uncertainty over authorities' capacity to implement economic reforms, rising government debt and falling reserves.

Events and Data Calendar

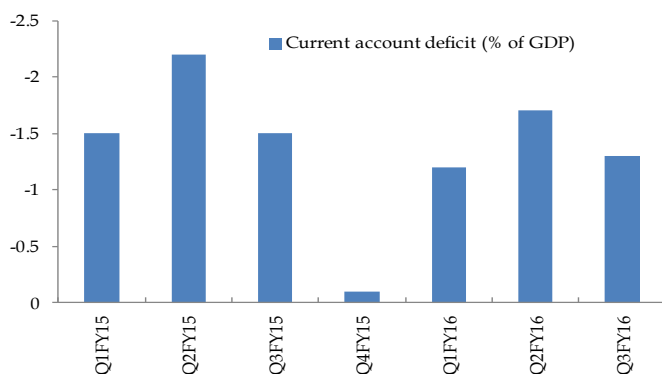
Date	Region	Event/Data	Period	Forecast	Actual	Prior	
3/31/2016	EU	Consumer Price Index - Core (YoY)	(Mar A)	0.90%	1.00%	0.80%	↑
3/25/2016	Japan	National Consumer Price Index (YoY)	(Feb)	0.30%	0.30%	0.00%	↑
3/17/2016	UK	Bank of England Rate Decision	(Mar 17)	0.50%	0.50%	0.50%	→
3/22/2016		Core Consumer Price Index (YoY)	(Feb)	1.20%	1.20%	1.20%	→
3/3/2016	US	ISM Non-Manufacturing/Services Composite	(Feb)	53.1	53.40	53.5	↓
3/15/2016		Advance Retail Sales (MoM)	(Feb)	-0.20%	-0.10%	-0.40%	↑
3/18/2016		U. of Michigan Confidence	(Mar P)	92.2	90.00	91.7	↓
3/24/2016		Durable Goods Orders	(Feb P)	-3.00%	-2.80%	4.20%	↓
3/29/2016		Consumer Confidence	(Mar)	94	96.20	94	↑
3/30/2016		Fed Chair Janet Yellen Speaks to Economic Club of New York	(Mar)				→

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

COMMODITY

- ✓ Gold registered a 3.5%MoM gain during Mar-16 vs. a 4.5%MoM gain in Feb-16, as a sharp rise in US equities reduced safe-haven demand for Gold. However, prices were supported by the dovish comments made by Fed Chairperson Janet Yellen, which weakened the dollar globally.
- ✓ Brent registered a 17.7%MoM gain during Mar-16 vs. a 7.8%MoM gain in Feb-16, as the greenback weakened post Yellen's dovish comments; aiding the dollar-denominated commodity.

Domestic Market Macro Economics

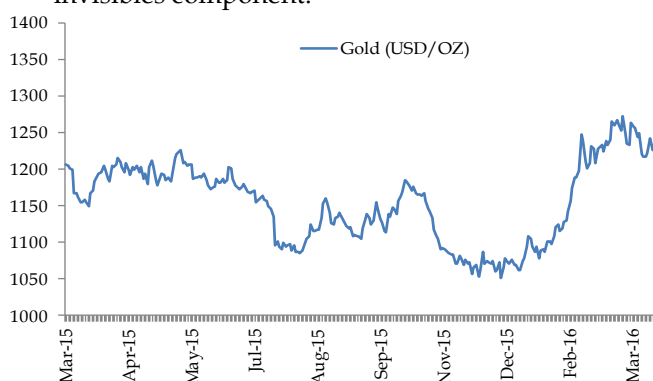


India CAD remains comfortable

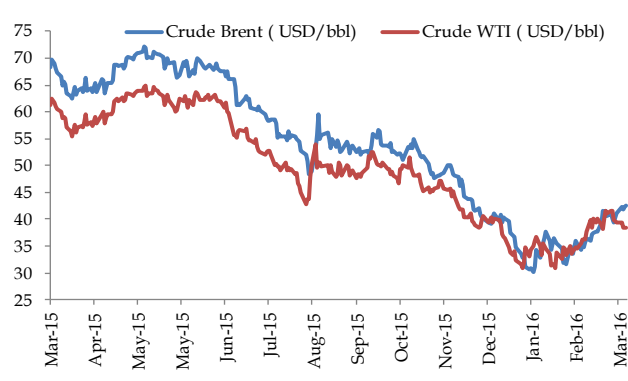
April-Feb	FY15	FY16	FY15	FY16
	%YoY		% of RE	
Gross Tax Revenue	7.1	20.7	76.3	79.0
Corporate Tax	5.3	10.1	70.8	73.4
Income Tax	8.4	11.3	71.6	74.2
Customs	7.8	15.7	88.8	92.5
Excise	5.4	58.5	75.7	78.3
Service Tax	8.6	26.3	80.2	81.2
Non-Tax Revenue	5.3	28.2	75.7	81.7
Non-Debt Capital	141.7	-11.8	96.5	81.3
Total Receipts	7.1	14.7	73.3	78.6
Non-Plan Expenditure	6.8	9.5	87.2	88.6
Plan Expenditure	-1.9	-1.0	85.8	83.2
Revenue Expenditure	6.7	3.0	87.3	86.4
Capital Expenditure	-12.0	36.2	83.2	91.7
Total Expenditure	4.3	6.6	86.8	87.1
Fiscal Deficit	0.5	-4.9	117.5	107.1

India's April-Feb FY16 fiscal summary

- ✓ In line with expectations, the RBI reduced repo rate by 25 bps to 6.50% taking the cumulative monetary easing to 150 bps since Jan-15. For FY17, RBI however, retained its GVA growth estimate at 7.6% and expects CPI inflation to average close to 5%
- ✓ India's Manufacturing PMI surged to an 8 month high of 52.4 in Mar-16 (as compared to 51.1 in Jan-16). On a quarterly basis, reading accelerated to 51.5 in Q4-FY16 (vs. 50.0 in Q3-FY16)
- ✓ India's fiscal deficit during April-Feb FY16 stood at 107.1% of revised estimate (RE) vs. 117.5% of RE in FY15
- ✓ India's February trade deficit came in line with expectations, slowing to a 29-month low of USD 6.5 Bn (Bloomberg consensus and YBL: USD 6.8 Bn), from USD 7.6 Bn in January.
- ✓ February CPI inflation slowed to a 4-month low of 5.18% YoY from 5.69% in January, lower than our and market forecasts (Bloomberg Consensus: 5.52%; YBL: 5.43%). In terms of momentum as well, CPI slowed to a seven-month low of 0.3% MoM s.a., after having increased unexpectedly in January
- ✓ India's industrial production contracted -1.5% YoY in Jan-16. The drag on headline IIP was single-handedly driven by the heavy weight manufacturing sector, which contracted by 2.8%.
- ✓ Belying estimates of a greater improvement, India's 3QFY16 current account deficit (CAD) came in USD 7.1 Bn (1.3% GDP) (Bloomberg consensus: USD 3 Bn; YBL: USD 1.7 Bn) vis-à-vis USD 8.2 Bn (1.7% of GDP) in 2QFY16. The upside on the CAD was mainly on account of across-the-board negative surprise on the invisibles component.



Gold Price expansion (USD/OZ)



Brent Price expansion (USD/bbl)

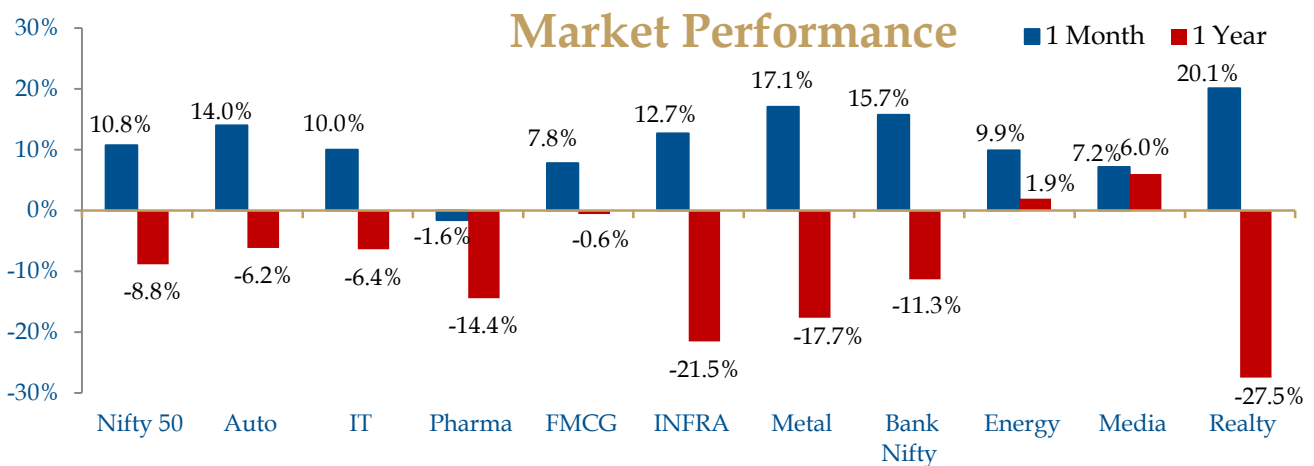
We expect:

- ✓ We continue to expect FY16 CAD at a 1.1% GDP, 10 bps higher than our previous estimate, as exports slowed while sharply lower commodity prices support. For FY17, we see a higher but still subdued CAD of 1.3% of GDP.
- ✓ We expect FY16 advance GDP growth estimate of 7.6% to carry a risk of mild downward revision. This is considering the impact of Chennai floods; unstable weather conditions this year, and a subdued global environment.
- ✓ For FY17, we continue to stick to our GDP growth forecast of 7.8% assuming a normal monsoon outturn, lagged impact of monetary easing, government's infrastructure push through various policies and the revision in wages for government employees.



Equity Market Insights

- ✓ The Indian stock markets staged a smart rally in March as investors started to build in expectations of an interest rate cut by the RBI. The rally was also driven by overall positive cues from the global markets. BSE Sensex closed at 25,342, higher by 10.2% for the month while the Nifty closed at 7,738; up by 10.8% during the same period. The CNX Mid-Cap and CNX Small-cap indices also posted a healthy return of 10.3% and 11.9% respectively during the month
- ✓ During March, FPI flows returned to the market. There was an inflow of US\$ 3.5 bn in the equity markets. However the debt markets saw an outflow of US\$ 0.4 bn taking the total tally to a net inflow of US\$ 3.1 bn during the month. DII's were net seller and there was an outflow of \$ 2.52 bn during the same period.



Factors to Watch

- ✓ The month of April started off with the RBI announcing a 25 bps cut in headline interest rates. With this, the central bank has cut rates by a cumulative 150 bps since January 2015. The highlight of the policy was RBI's commitment towards overhauling the liquidity framework through multiple steps. These steps are all collectively aimed at easing liquidity in the system to help ensure transmission of rate cuts into the system and create the base for improving the credit off take in the economy. All these measures would certainly help drive the fundamental improvement particularly for all the banks.
- ✓ The next key event that market participants would be watching out for would be the March quarter result announcements. The weakness seen in the earnings announcements year-to-date is expected to continue in March quarter as well. But earnings are expected to bottom out now. While demand and consequently top line would continue to remain under pressure however the profitability is expected to tick upwards (on a YoY basis | flat on a QoQ basis) as benefits of soft commodity prices and lower interest outgo would help companies at the bottom line level.
- ✓ Investors would also be keeping a close eye on commodity prices particularly that of crude. In the near term, global issues are the major risk to Indian stock markets particularly from the point of view of foreign fund flows.

Outlook & Expectations

- ✓ In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 19.2 times which is slightly above its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 15.3 times, which suggests that markets are not expensive at current levels. Building an assumption of a robust improvement in earnings in FY17, we believe that the markets are still attractive from a longer term perspective, i.e. for 2 to 3 years.
- ✓ The major issue for corporate India would be the turnaround in the top line which would depend on two things: (i) Monsoons: With 2 consecutive years of poor monsoons, the demand from the rural side which forms a significant chunk of the economy, has all but vanished. In the event of good monsoons this year, this segment would see a revival and drive consumption which in turn would lead to better demand for the companies. (ii) Reforms: As reforms (announced till date) start to gain traction, it would help in better execution which in turn would help drive the top line growth for the companies.
- ✓ We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.

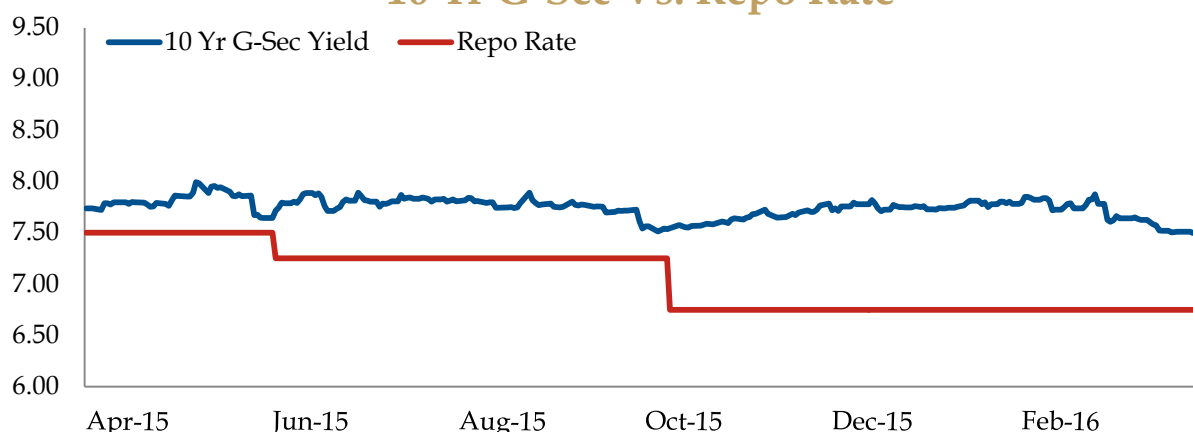
Debt Market Insights

- ✓ The average systemic liquidity deficit in March rose to INR 1889 bn compared to INR 1586 bn as government's cash balances rose amid higher than normal leakage in currency in circulation.
- ✓ In line with expectations, the RBI reduced repo rate by 25 bps to 6.50% taking the cumulative monetary easing to 150 bps since Jan-15.
- ✓ More importantly, the RBI announced a complete overhaul to the liquidity framework
 - The RBI will now progressively lower the average ex ante liquidity deficit in the system to a neutral level from the earlier deemed level of 1%
 - The policy rate corridor (MSF Rate-Reverse Repo Rate) now stands narrower at 100 bps from 200 bps. Daily minimum CRR maintenance stands reduced at 90% from 95% earlier.
 - The RBI will now smoothen the supply of durable liquidity through active usage of asset purchases/sales
- ✓ Average 10 yr yield during March eased to 7.56% compared to 7.79% in Feb as government's commitment to fiscal consolidation and range bound inflation supported the yields.

Outlook and Expectations

- ✓ With underlying inflation expected to track the 5% target and output gap still remaining negative, we continue to expect further policy support from the RBI in the form of
 - Another 25 bps cut in the repo rate in June policy review
 - Active use of OMO purchases in case of weak net forex inflows.
 - Considering a shorter time frame for migration to the neutral liquidity framework vis-à-vis the indicated 1-2 years window
- ✓ We expect average CPI (ex housing) inflation to moderate towards 5.0% in FY17 from our estimated level of 5.1% in FY16

10 Yr G-Sec Vs. Repo Rate



Model Portfolios - April 2016

Asset Class	Conservative	Cautious	Moderate	Growth	High Growth
I) Debt (%)	95	70	50	25	10
Ultra Short Term Funds	20	15	15	5	-
Dynamic /Income Funds	35	30	20	15	5
NCD/ Bank Deposit	40	25	15	5	5
II) Equity (%)	-	15	30	45	55
Large Cap	-	15	25	30	35
Mid cap	-	-	5	10	15
Sector/ Thematic	-	-	-	5	5
II) Alternate (%)	5	15	20	30	35
Gold ETF	5	5	10	10	10
Structured Products	-	10	10	10	10
PE/ Real Estate Funds	-	-	-	10	15
Total (%)	100	100	100	100	100

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, Chanakypuri, New Delhi 110 021. | Tel: + 91 11 5556 9000 Fax: +91 11 5168 0144
Contact Details

Garima Kapoor
Economist
garima.kapoor@yesbank.in

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

Kanwar Vivek
Senior President and Head
Wealth Management & Global Indian Banking
kanwar.vivek@yesbank.in

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