FIRST Insights

Government sticks to the path of fiscal consolidation

Differing economic performance in major advanced economies has led to divergent monetary policies. While both ECB and BOJ continue to remain firmly anchored on the path of easing, encouraging economic data from US is expected to pave way for another hike in fed funds rate. The conviction or further normalization of interest rate in US stems from improved labour market performance and uptick in core inflation (1.7% YoY in Jan vs. US Fed's target of 2.0%).

On the other hand, latest economic developments from Eurozone are likely to weigh on policymaker's decisions. Flash February CPI inflation in Euro zone came in at -0.2% against a reading of 0.3% in January bolstering expectation of further easing. Moreover, recent indicators of growth such as PMI services and manufacturing suggest that recovery in economic activity remains sluggish.

Data flow out of Japan remained on the weaker side supporting BOJ's decision to implement negative interest policy last month. Retail sales in January contracted 1.1% MoM – a third straight month of decline. Japan Manufacturing PMI also fell sharply in February to 50.2 compared with expectations of 52 and January's 52.3 as domestic and overseas demand eased. Meanwhile downbeat data from China on exports, manufacturing and services PMIs underpinned the case for liquidity measures by China's central bank that lowered reserve Rate Ratio by 0.5% to arrest economic slowdown.

Against this global environment, Indian government displayed its commitment to preserve domestic macro stability by remaining committed to the path of fiscal consolidation - setting the fiscal deficit target of 3.5% of GDP in FY17. Meanwhile, incremental domestic data released during Jan-Feb suggests a gradual improvement in economic recovery even as broader economy continues to shown signs of patchy growth. India's core sector recorded an improvement in Jan-16 led by robust growth in coal, cement and electricity with broader uptick constrained by natural gas, crude oil and steel production. Bank credit growth also recorded an uptick in Jan-16 driven by improvement across all sectors barring services but PMI Manufacturing remained steady as acceleration in new business growth was offset by weakness in production. Additionally, PMI services fell sharply in Feb-16 on the back of only a modest expansion in output.

Private Capex is unlikely to see a strong recovery amidst over-leveraged balance sheets and concerns of bad assets in PSU banks. However government's measures to infuse capital in PSU banks and RBI's recent decision to ease capital norms are likely to aid in restoration of NPAs. For FY17, we expect GDP recovery to be gradual with incremental growth likely to be consumption led. In our view, 3 factors could drive consumption in near term- (i) extent to which 7th CPC is implemented in FY17 (ii) concomitant gains to rural incomes on back of budget's rural impetus and likely normal monsoon (iii) anticipation of 25 bps rate cut on or before Apr-16 from RBI - in reciprocation of centre's adherence to fiscal consolidation roadmap.

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FIRST Insights

Global Macro Developments

- In her largely balanced statements during her testimony to the Congress, US Fed Chair Janet Yellen said that she expected continued US economic growth which would allow the central bank to pursue its plan of "gradual" rate hikes.
- Bank of Japan's Kuroda has said that there are no plans of cutting interest rates further into the negative zone for now, though the bank stands ready to ease "without hesitation" if necessary.
- Exports in China posted their worst fall since 2009 (-25.4%, Forecast: -12.5%, Previous: -11.2%), and imports fell -13.8% (Forecast: -10.%, Previous: -18.8%). Averaging out the Lunar New Year effect as well, exports fell 17.8% and imports fell 16.7%, pointing to continued weakness in demand both home and abroad.
- Euro zone services PMI came in at 53.3 in February (Previous: 53.6), better than previous estimates, but lowest since January last year due to weaker rate of growth in new businesses.

Events and Data Calendar

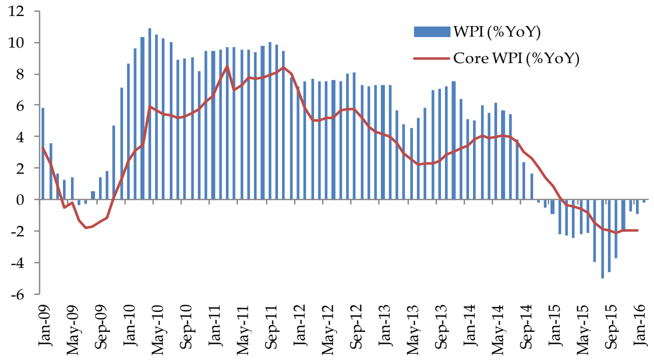
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	2/18/2016	Consumer Price Index (YoY)	(JAN)	-5.40%	-5.30%	-5.90%	↑
Japan	02/26/2016	National Consumer Price Index (YoY)	(JAN)	0.00%	0.00%	0.20%	↓
US	2/1/2016	ISM Non Manufacturing Composite	(JAN)	48.4	48.2	48	↑
	2/26/2016	Gross Domestic Product (Annualized)	(4Q S)	0.40%	1.00%	0.70%	↑
	2/26/2016	Personal Consumption Expenditure Core (YoY)	(JAN)	1.50%	1.70%	1.50%	↑
EU	2/16/2016	ZEW Survey (Economic Sentiment)	(FEB)		13.6	22.7	↓
	2/12/2016	GDP s.a. (QoQ)	(4Q A)	1.50%	1.50%	1.60%	↓
EU	2/25/2016	Gross Domestic Product (YoY)	(3Q A)	1.90%	1.90%	1.90%	⇒

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

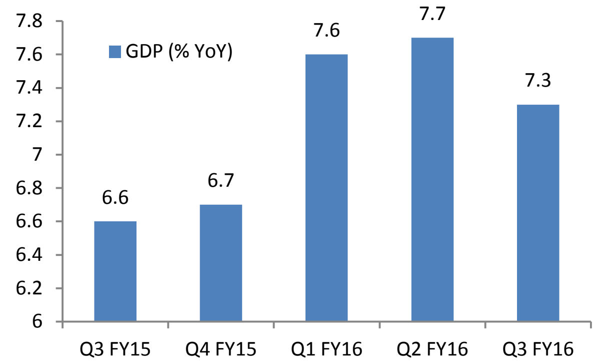
COMMODITY

- Gold prices expanded 7.3%MoM in Feb-16, after contracting 0.45%MoM in Jan-16 amid (1) statements by US Fed's Yellen that interest rate hikes in the US would be gradual, and (2) continuing global risk-off supporting safe-haven demand for the metal.
- Brent prices expanded 1.41%MoM in Feb-16, after contracting 18.64% MoM in Jan-16, amid reports that Saudi Arabia would cooperate with other major producers to limit sluggish global oil prices. Further, the hope of output agreement among large oil producers following Russia's energy minister comments that "critical mass" of producers have agreed to freeze production; weighed on Brent.

Domestic Market Macro Economics

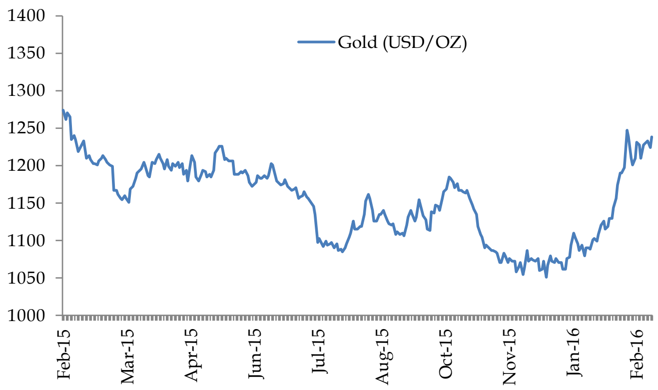


India WPI ticks up, but remains in the negative

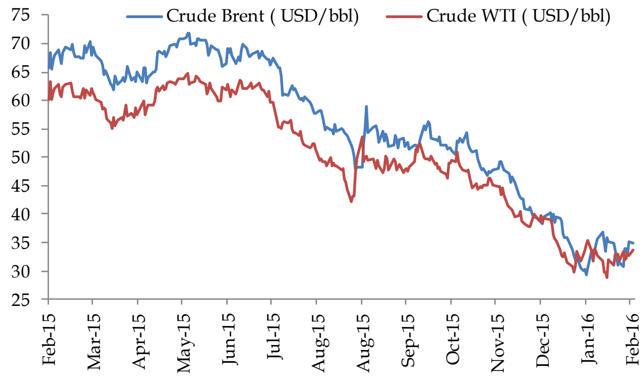


Moderation in overall growth momentum in Q3 vis-à-vis Q1 & Q2

- ✓ For FY17, Government decided to stick with the fiscal deficit of 3.5% of GDP- highlighting government's priority to macro stability over growth. India's fiscal deficit during April-Jan FY16 stood at 95.8% of Budget estimate (BE) as compared to 107.0% of BE in FY15 on the back of buoyancy in revenue receipts.
- ✓ As per government's advanced estimates, GDP growth is estimated to improve to 7.6% in FY16 from 7.2% in FY15. GVA growth is estimated to improve to 7.3% in FY16 from 7.1% in FY15. On a full year basis, this will record the highest real economic growth in the new national account series beginning FY12
- ✓ NIKKEI India Manufacturing PMI remained unchanged at 51.1 in Feb from Jan's reading; in expansion for the second consecutive month post a contraction in Dec-15. Output of core infrastructure industries expanded 2.9%YoY in Jan-16, compared to an expansion of 0.9%YoY in Dec-15
- ✓ India's January trade data surprised on the downside with trade deficit being reported at an 11 month low of USD 7.6 bn (Bloomberg consensus: USD 9.9 bn; YBL forecast: USD 9.3 bn) as imports fell sharply (-11% in Jan-16 vs. -3.9% in Dec-15) and decline in exports remained contained
- ✓ December IIP contracted (albeit less than expected) by 1.3%YoY (YBL expectation: -3.0%, Bloomberg consensus: -0.2%). The weakness in headline IIP was single-handedly driven by heavy weight manufacturing output, which contracted by 2.4%YoY.



Gold Price expansion (USD /OZ)



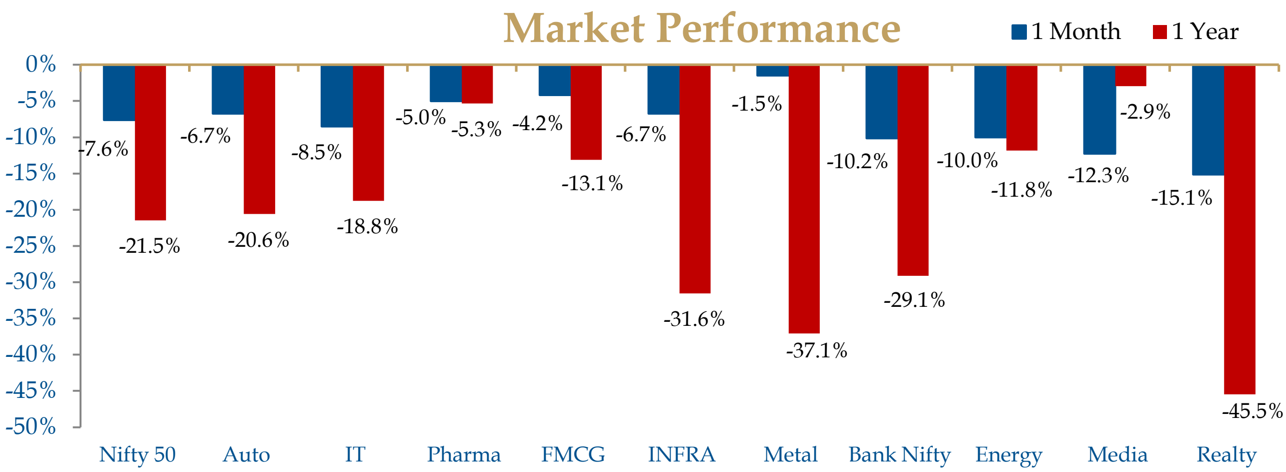
Brent Price expansion (USD/bbl)

We expect:

- ✓ Our FY16 current account forecasts remain at a comfortable 1.1% GDP, 10 bps higher than our previous estimate, as exports slow but 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 amid unstable weather conditions, 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 govt. employees.
- ✓ We expect USDINR to remain weak in the range 67-69 (Previous: 67-68/USD), due to continued global headwinds such as monetary policy uncertainty from central bank actions and financial volatility; though strong domestic macros would keep sharp depreciation pressures contained. Medium-term INR direction would depend on the execution and pace of domestic reforms.

Equity Market Insights

- The Indian stock markets remained under pressure in February as global cues took the centre stage. Sharp selloffs in global markets were further magnified in Indian markets as investors preferred to remain cautious in the run up to the Budget. Fears of increase in time period for long term capital gains tax, hikes in basic excise, etc. in the Budget resulted in investors getting into the panic mode whenever the global markets saw weakness of any kind. As a result, Indian markets were amongst the worst performing markets on the global stage in the month of February. BSE Sensex closed at 23,002, lower by 7.5% for the month while the Nifty closed at 6,987; down by 7.6% during the same period. The CNX Mid-Cap and CNX Small-cap indices also remained under pressure and ended the month with losses of 7.3% and 13.3% respectively.
- During February, FPIs pulled out US$ 1.23 bn from the equity markets and around US$ 1.28 bn in debt markets thereby taking the total tally to an outflow of US$ 2.51 bn during the month. DII's were net buyers and ~ $1.56 bn during the same period.



Factors to Watch

- The selloff was triggered by factors like sharp fluctuations in crude prices, meltdown in metals and relatively gloomier outlook for global growth as presented by the IMF. In the near term, global issues are the major risk to foreign fund flows in Indian markets. But given that the long term picture for India still remains intact; the long term flows should return to the country over a period of time.
- The key event that changed the course of the stock markets was the Union Budget presented at the end of February. The Budget was centered on nine pillars – agriculture and farmers' welfare; revival in the rural sector; social welfare; education, skill development and job creation; infrastructure; financial sector reforms; governance and ease of doing business; tax reforms and most importantly fiscal discipline. In fact fiscal discipline was the silver lining as the Government was able to meet the deficit target of 3.9% for FY16 and maintained the target for the next fiscal at 3.5%. This is commendable when seen in the light of driving economic growth in a challenging macro environment.

Outlook & Expectations

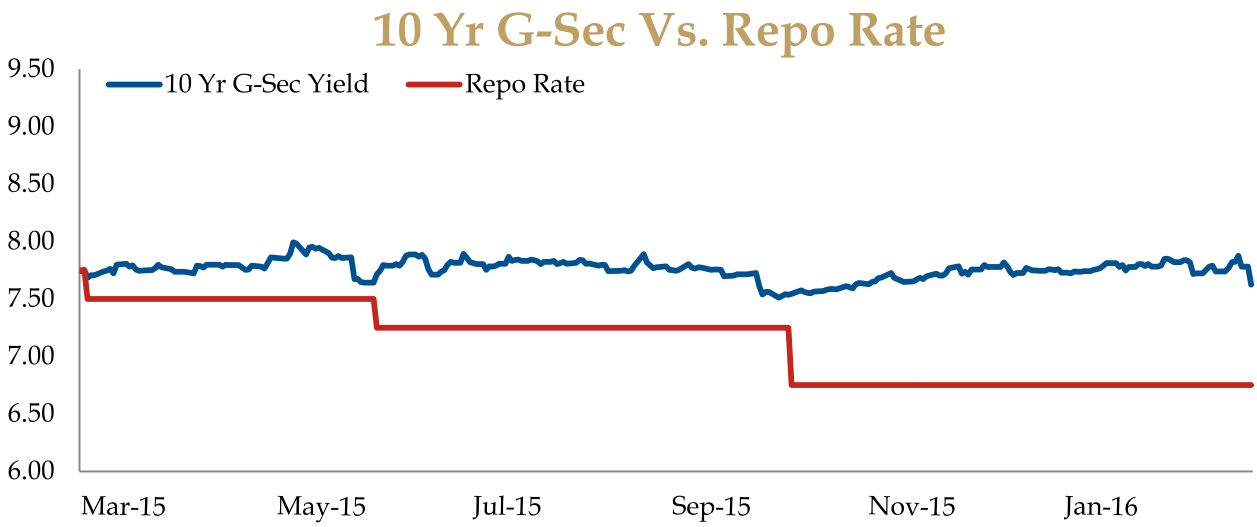
- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 18.8 times which is close to its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 17.5 times, which suggests that markets are not expensive at current 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.
- In terms of sectors, the Budget was positive for the infrastructure sector as a whole and out of that for roads and housing in particular. With Revival of the agri sector, rural economy would have a multiplier effect on sectors that are driven by consumption. Another sector that would be BFSI as a whole. BFSI would also benefit from RBI's recent amendments in capital norms. This amendment is particularly beneficial for the PSU banks that have been under pressure for a while due to issues related to capitalization and asset quality.
- 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 Feb-16 rose to Rs 1586 bn from Rs 1340 bn in Jan-16 as government continued to cut back on the pace of spending.
- Average 10 yr yield during Feb-16 remained largely unchanged at 7.79% as compared to 7.77% in Jan-16.
- RBI conducted OMOs worth Rs 110 bn during the month to support banking system liquidity.
- CPI inflation for Jan-16 rose to a 17-month high level of 5.69% YoY (Bloomberg consensus: 5.40%; YBL estimate: 5.61%). This is marginally lower than RBI's estimate of 5.8% with the official target being at 6.0%.
- India's WPI inflation moved lower to -0.90% YoY in January (Bloomberg Consensus: -0.13%; YBL: -0.28%; December: -0.73%), in its 15th consecutive negative print.

Outlook and Expectations

- We continue to expect RBI to ease policy repo rate by 25 bps in response to government's stance to stick to fiscal consolidation and continued comfort on inflation metrics.
- We expect average CPI (ex housing) inflation to moderate towards 5.0% in FY17 from our estimated level of 5.1% in FY16



Model Portfolios –March 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.

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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.
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".