FIRST Insights

Central banks assessing Brexit impact; India's growth remains anchored

The month of July was a time for global central banks to assess the likely impact of an unanticipated Brexit vote on their respective domestic economies. With the UK exit process yet to unfold in entirety, most banks including the Bank of England, preferred to keep monetary policy on hold during the month. Moreover, early indications that the UK exit would be a gradual process, taking at least 2 years to be fully complete, lent some relief to markets which otherwise feared a significant downside to global macros. Nevertheless, with incoming data prints surprising significantly to the downside in UK, the Bank of England cut interest rates in its August meeting.

The tone of the European Central Bank also turned dovish, with an emerging likelihood of a rate cut in the September meeting, post a review of inflation and growth forecasts. On the other hand, the Bank of Japan undertook policy easing that was significantly less than anticipated by markets. In fact, the US Fed communicated that the near term risks to outlook had diminished, a contrast from its policy statement in June in which it had outlined Brexit as a key near term risk.

For India, we expect the direct impact of Brexit to be limited, amid a low and falling share of UK in India's export basket (3.5%). In fact, for the month of June and July, incoming domestic indicators have been largely positive. June core sector data showed an uptick to 5.3%, led by fertilizer, cement and electricity sectors. July PMIs for both manufacturing and services sectors saw an increase, moving the composite PMI to a three-month high of 52.4 (Previous: 51.1). Additionally, tax revenues remained robust, having risen 30% YoY during the ongoing fiscal compared to growth of 12% in FY16. The downside remains weak credit growth (7.3%, Previous: 8.0%), as industrial sector credit remains tepid.

Going forward, India's economic recovery is expected to gain further traction as benign inflation, increase in disposable incomes following 7th CPC outgoes on higher pays and pension, an above-normal monsoon and continued monetary policy accommodation engender both urban and rural demand, along with a gradual uptick in investment trajectory. As such, we continue to expect domestic recovery to gain a more sustained character and FY17 GVA growth to improve to 7.8% from 7.2% in FY16.

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Global Macro Developments

- China CPI inflation showed a pickup in momentum in July (0.2%; Previous: 0.1%), though the annualized print came in at a six-month low of 1.8% (Previous: 1.9%). Producer prices continued to decline (-1.7%; Previous: -2.6%), and deflation fell to the least in 23 months.
- China's Caixin (China Purchasing Managers' Index) for July came in at 50.6, compared to 48.6 in June and marking first monthly expansion since Feb-15.
- US 2Q2016 GDP growth came in lower-than-expectations of a significant rebound (1.2%, Previous: 0.8%, Forecast: 2.6%), as a sharp reduction in inventories and weak business investment offset robust consumer spending.
- After remaining on hold in July, the Bank of England reduced its benchmark interest rate by 25 bps to 0.25%, in its policy meet in Aug, marking the first cut since March 2009. In addition, the asset purchase program covering gilts was expanded by GBP 60 bn to GBP 435 bn while purchase of corporate bonds up to GBP 10 bn was also announced. The central bank slashed its 2017 GDP growth forecast to 0.7% from 2.3% earlier while it now expects CPI inflation to surpass its 2% target by the end of 2017.
- Eurozone manufacturing activity weakened in July, as per the Markit manufacturing PMI (52.0, Previous: 52.8, Preliminary: 51.9), though the reading signaled a 37th month of expansion, nearing the highest in five years. German PMI also slowed to 53.8, from 54.5 in June, led by slower expansion in new orders.
- Japanese Prime Minister Shinzo Abe's cabinet approved 13.5 trillion yen ($132.04 billion) in fiscal measures as part of efforts to revive the flagging economy, with cash payouts to low-income earners and infrastructure spending.

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	7/29/2016	BOJ Base Rate	(JUL 29)	-0.15%	-0.10%	-0.10%	⇨
US	8/5/2016	Non-farm payroll change	(JUN)	180k	255k	287k	⇩
	7/15/2016	Consumer Price Index (Annualized)	(JUN)	1.10%	1.00%	1.00%	⇨
	7/29/2016	Gross Domestic Product (Annualized)	(2Q A)	2.50%	1.20%	0.80%	⇧
EU	7/21/2016	European Central Bank Rate Decision	(JUL 21)	0.00%	0.00%	0.00%	⇨
	7/29/2016	Euro-Zone Gross Domestic Product (YoY)	(2Q A)	1.50%	1.60%	1.70%	⇩
UK	7/14/2016	Bank of England Rate Decision	(JUL 14)	0.25%	0.50%	0.50%	⇨
	7/19/2016	Consumer Price Index	(JUN)	0.40%	0.50%	0.30%	⇧
	7/27/2016	Gross Domestic Product YoY	(2Q A)	2.10%	2.20%	2.00%	⇧

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

COMMODITY

- Gold prices increased 4.9%MoM in Jul-16 (vs. 1.6%MoM in Jun-16), on 1) risk off following Brexit and 2) the Federal Reserve's decision to leave its monetary policy unchanged FOMC meeting in July.
- Brent prices declined 7.4%MoM in Jul-16 as compared to 4.0%MoM expansion in Jun-16 as EIA said crude stockpiles soared 1.7 mn barrels in last week of Jul; instead of falling 2.3 mn barrels as forecasted. Oil further extended losses as the dollar rallied after the Federal Reserve left interest rates unchanged while citing diminished near-term risks to the US economic outlook that meant a potential rate hike later this year.

Domestic Market Macro Economics

Snapshot of IIP Trend (% YoY)					
	Weight (%)	May-15	May-16	Apr-May FY16	Apr-May FY17
IIP	**100**	**2.5**	**1.2**	**2.8**	**-0.1**
Sectoral Classification					
Mining	14.2	2.1	1.3	0.7	1.2
Manufacturing	75.5	2.1	0.7	3	-1.5
Electricity	10.3	6	4.7	2.8	9.4
Use Based Classification					
Basic	45.7	6.2	3.9	4.4	4.3
Capital	8.8	3	-12.4	4.3	-18.9
Intermediate	15.7	1.2	3.6	1.8	3
Consumer	29.8	-2.2	1.1	0.3	-0.4
Durables	*8.5*	*-3.9*	*6*	*-1.4*	*8.9*
Non-Durables	*21.3*	*-1*	*-2.2*	*1.4*	*-6.6*

PMI: Manufacturing bouyant, services stagnates

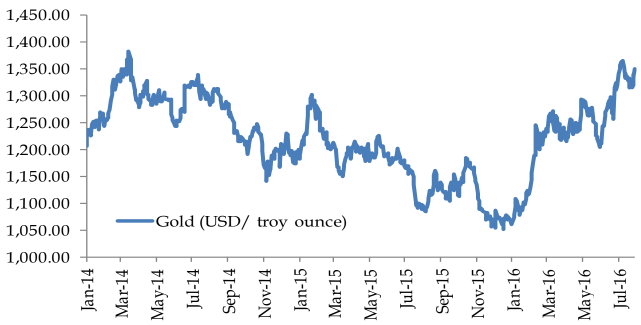
India's Merchandise Trade				
	Jun-15	Jun-16	Apr-Jun FY16	Apr-Jun FY17
(Value: USD bn)				
Trade Balance	**-10.8**	**-8.1**	**-32.2**	**-19.2**
Exports	22.3	22.6	66.7	65.3
Imports	33.1	30.7	98.9	84.5
Oil	*8.8*	*7.3*	*24.7*	*18.9*
Gold	*2*	*1.2*	*7.5*	*4*
Non-oil-non-	*22.5*	*22.2*	*67.2*	*61.7*
(Growth: % YoY)				
Exports	-14	1.3	-16.2	-2.1
Imports	-13.7	-7.3	-12.1	-14.5

Trade deficit for Jun-16 rose to a six month high

- ✓ India's fiscal deficit for 1QFY17 stood at 61.1% of budgeted estimate (BE), higher than 51.6% in 1QFY16, owing to tepid pace of non-tax revenue growth. Non-tax revenue for the Q1FY17 was recorded at 7.3% of BE compared to 17.8% of BE in FY16.
- ✓ Reflecting improvement in the pace of growth of manufacturing sector, NIKKEI India Manufacturing PMI surged to a four-month high in July (51.8; previous: 51.7).
- ✓ Output of core infrastructure industries expanded by 5.3%YoY in June, showing a rebound from the slowdown noted in May (2.9%; Previous: 8.4%). Of the eight core sub-sectors; all sectors apart from Crude Oil and Natural Gas recorded an expansion.
- ✓ India's merchandise trade deficit for Jun-16 rose to a six month high of USD 8.1 bn (Prior: USD 6.3 bn). The increase in trade deficit was driven by higher oil imports along with a moderate increase in the non-oil-non-gold imports. Despite the increase in the size of the monthly deficit, the cumulative trade deficit on FYTD basis stands much lower at USD 19.2 bn during Apr-Jun FY17 vis-à-vis a level of USD 32.2 bn in the corresponding period in FY16.
- ✓ India's industrial production rose marginally in the month of May to 1.2% YoY. However, the previous print of -0.8% for April was revised lower to -1.3%. As such, on cumulative FYTD basis (Apr-May) IIP registered a contraction of 0.1% YoY vis-à-vis an expansion of 2.8% in the corresponding period in FY16.

%YoY	April	May	June	Apr-Jun FY16	Apr-Jun FY17
CPI	**5.47**	**5.76**	**5.77**	**5.09**	**5.67**
Food	6.29	7.2	7.38	5.43	6.96
Pan & Tobacco	8.04	7.66	7.28	9.53	7.66
Clothing	5.56	5.37	5.01	6.12	5.31
Housing	5.37	5.35	5.46	4.59	5.39
Fuel	3.03	2.94	2.92	5.77	2.96
Misc	4.26	3.96	3.85	3.75	4.02
Core	4.89	4.67	4.55	4.57	4.7

CPI accelerates, led by food and miscellaneous category



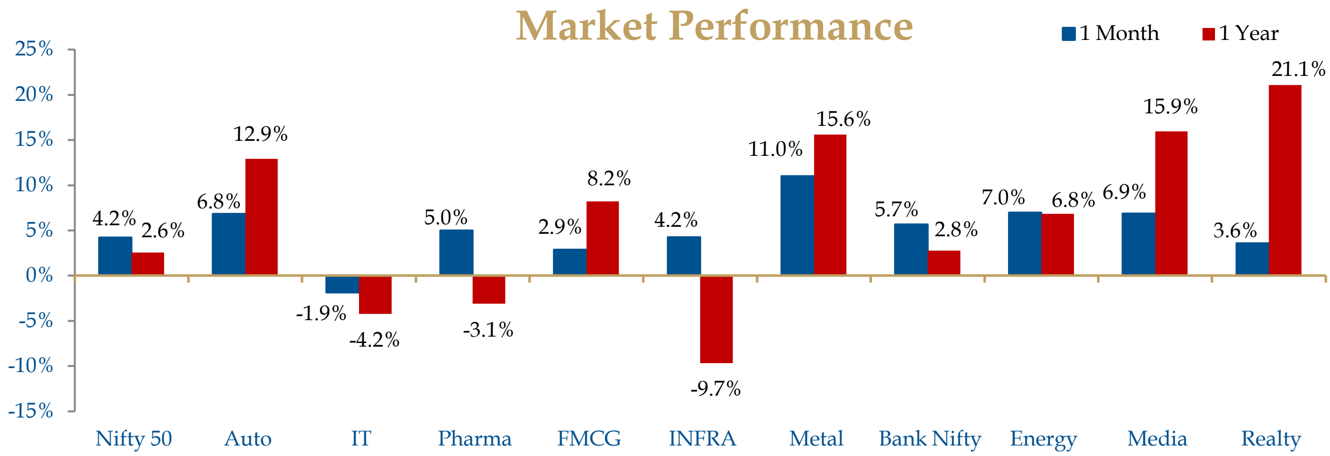
Gold Price expansion (USD /OZ)

We expect:

- ✓ We continue to expect GVA growth to improve to 7.8% from 7.2% in FY16. A significant boost to growth is expected to stem from the agriculture sector which is expected to record a value added growth of 5.5% compared to 1.2% in FY16.
- ✓ While we expect average CPI inflation in FY17 to increase moderately to 5.1% from 4.9% in FY16, we continue to anticipate another 25 bps cut in the repo rate in Q3 FY17 on account of anticipated disinflation in food prices following encouraging traction in sowing and government's structural measures in the form of subdued MSPs.
- ✓ We expect USDINR to remain in the range 67-69 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. As such, passage of GST and Bankruptcy code remains supportive.

Equity Market Insights

- Global markets put the fears of Brexit behind them and rallied upwards for most part of July and Indian markets were no exception to this. BSE Sensex closed at 28,052, higher by 3.9% for the month while the Nifty closed at 8,639; up by 4.23% during the same period. The CNX Mid-Cap and CNX Small-cap indices outperformed with returns of 6.92% and 4.69% respectively during the month.
- During July, foreign investors remained optimistic on the equity markets and were net buyers in the debt markets. There was an inflow of US$ 1.69 bn in the equity markets and US$ 1.04 bn in the debt markets taking the total tally to a net inflow of US$ 2.73 bn during the month. DII's were net seller in equity with outflow of US$ 0.91 bn during the same period.



Factors to Watch

- Monsoon update: As of now the forecasts have been that the monsoons should be above normal and a lot is dependent on not just the quantum of rains but also the geospatial distribution of the same. This would have an impact on consumption as well as on inflation which has started to trend up in recent times. Therefore any delay/adverse news related to monsoons would result in a sharp decline in the markets.
- Corporate earnings: The ongoing earnings season has been a mixed bag so far. Although profitability has shown signs of improvement but the demand is still lagging as indicated by the low growth in volumes.
- Geopolitical developments across the world.

Outlook & Expectations

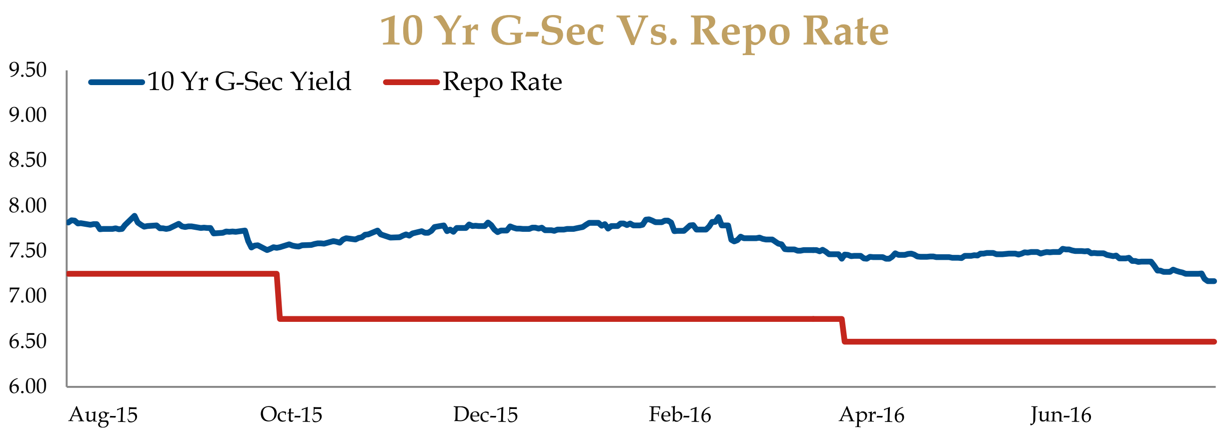
- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 20.6 times which is slightly above its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 17.5 times.
- Therefore it can be argued that valuations at current levels have ballooned and could in turn lead to some correction in prices. However given the expectations of recovery in demand driven by better monsoons as well as the payout related to the 7th Pay Commission, earnings are expected to improve towards the second half of the year, 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.
- Going forward, we continue to remain optimistic on the agri sector. Revival of the rural economy would have a multiplier effect on sectors that are driven by consumption. This includes consumer goods, FMCG, autos (2 wheelers in particular), etc. Revival in demand would eventually translate to revival in private capex as well. With this in mind we are optimistic on infrastructure, consumption led sectors and agri sectors and would recommend investments in the quality stocks in the same.
- 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 July turned to a surplus of Rs 139 bn from a deficit of Rs 354 in June as government spending increased and cash leakage eased sharply. OMO purchases conducted during Q1 FY17 also provided durable liquidity to the market.
- ✓ Average 10 yr yield during July slipped to 7.30% from 7.48% amid comfortable liquidity conditions and expectations of a continued accommodative stance of RBI.
- ✓ In line with expectations, the RBI maintained status quo in its third bi-monthly policy review while continuing to maintain upside bias to its inflation target of 5%.The cautious stance stemmed largely from the recent emergence of some upside risks to inflation, especially from food.
- ✓ India's June CPI print came in at a 22-month high of 5.77%, in line with market expectations, led mainly by food and fuel prices. Core CPI continued to remain range-bound in the 4.5-5.0% range, though momentum eased somewhat.
- ✓ The WPI inflation for June overshot our and market expectation by rising to a 20 month high of 1.62%. While the increase was broad-based, the surge in food prices was sharper than the seasonal trend primarily due to intense and prolonged summer.

Outlook and Expectations

- ✓ While we expect average CPI inflation in FY17 to increase moderately to 5.1% from 4.9% in FY16, we continue to anticipate another 25 bps cut in the repo rate in Q3 FY17 on account of anticipated disinflation in food prices following encouraging traction in sowing and government's structural measures in the form of subdued MSPs.
- ✓ We also anticipate the provision of comfortable liquidity to maximize the impact of the current accommodative monetary policy stance.



Model Portfolios – July 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.