FIRST Insights

Global growth on an upswing; India's Q2 GDP rise validate nascent signs of recovery

On the global horizon, growth momentum in major advanced economies continued to remain on an upward trajectory in the month of November. Starting with the US, macro data has been robust with Q2 GDP being revised up to 3.3%YoY vs. initial estimate of 3.0%, accompanied by upbeat industrial production in Oct to mark the biggest increase in six months as the drag from hurricane-related disruptions unwound. In tandem, data emerging out of the Eurozone was also mostly upbeat. PMI manufacturing and economic sentiment rose with unemployment rate moderating to 8.8% and Q3 GDP expanding to 2.6% YoY. Reinforcing the recovery underway, the European Commission revised up its 2017 growth forecast for Eurozone by 50 bps to 2.2%, highest since 2007. In addition, Japan's consumer confidence rose to its highest level in 4 years and GDP grew by 2.5%YoY in Q3 2017 (vs. 2.6% in Q2), expanding for the seventh consecutive quarter.

On global monetary policy front, as per minutes of FOMC meeting held on Oct 31 and Nov 1, members were unanimously optimistic about economic growth uptick but disagreed on the pace of inflation (as some members believed that the softness was due to transient factors). A few members suggested that the Fed should move away from the 2% inflation goalpost and adopt a gradually rising path in prices instead. Meanwhile, ECB minutes for Oct meeting indicated that majority members supported paring back of asset purchase program but lacked unanimous support for giving an end date, as it was felt that an end date would reduce flexibility to respond to future shocks and induce undue tightening in financial conditions.

On the domestic front, the most significant event last month was the unanticipated Moody's upgrade of India's long term sovereign credit rating to Baa2 from Baa3 earlier, accompanied by change in outlook on the rating to 'stable'. Moody's highlighted key enablers of - 1) Reforms (GST, Monetary Policy Committee, etc) to strengthen institutional framework and foster sustainable growth 2) Government's support to public sector bank and 3) likelihood of Government's debt to remain stable, improving India's credit profile and driving the re-rating of the Indian economy.

On the monetary policy front, the recent inflation prints have surprised on the upside led by food and fuel prices, limiting the incremental space to cut policy rates further. As a result the RBI kept policy rates unchanged in its Dec meeting, in line with our and consensus expectations. The central bank marginally revised-up its CPI inflation trajectory by 10bps to 4.3-4.7% for H2FY18 amidst unwinding of supportive base and on-boarding of rise in HRA rates. For the remainder of FY18, we expect RBI to remain on hold.

On the growth front, Q2 GDP growth picked-up momentum expanding by 6.3%YoY vs. 5.7% in Q1, marking an end to the sustained slowdown seen in headline growth since Q1FY17. Core GVA (ex. agri and government services) rose for the second consecutive quarter to 6.8% in Q2FY18 vs. 5.5% in Q1FY18, indicating continued normalization in growth conditions post the transient impact of demonetization and GST-transition. We remain sanguine on growth outlook with uptick in most of the lead indicators in Q3 reinforcing our expectation of a back-loaded recovery in growth in H2FY18, aided by favourable base effects. Key growth factors in H2 are continued recovery in consumption aided by 7th Pay Commission allowances by Centre and awards by select states amidst rising real incomes, waning impact of demonetization and GST-transition related disruptions.

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Global Macro Developments

- ✓ US GDP expanded by 3.3% (second estimate) in Sep quarter vs. initial estimate of 3.0%, reaching a high since Q3 2016. Inventory build-up supported headline growth accounting for quarter of GDP growth.
- ✓ Japanese Q3 GDP growth printed at 2.5% YoY, much higher than preliminary estimates of 1.5% (Q2: 2.6%). The sharp jump was on account of big gains in capital expenditure which was significantly revised up on a sequential basis.
- ✓ UK CPI for November stood at 3.1% YoY, higher than the estimate of 3.0% YoY (Oct: 3.0%). Inflation reading is the highest since March 2012.
- ✓ US labor market data for November painted a mixed picture. While the headline unemployment rate remained steady at 4.1%, change in nonfarm payrolls surprised positively, printing at 228k vis-à-vis market (Bloomberg) expectation of a 195k gain. On the other hand, average hourly earnings surprised on the lower side with a sequential increase of 0.2% MoM, compared to market expectation of a 0.3% increase.
- ✓ China's consumer and producer price inflation moderated in November. The PPI inflation rose 5.8% (Bloomberg consensus expectation: 5.8%), while the CPI inflation climbed 1.7% (Bloomberg consensus expectation: 1.8%). Both inflation metrics showed a moderation vis-à-vis the October prints.
- ✓ Eurozone Q3 growth came in at 2.6% YoY, slightly higher than preliminary estimates and previous quarter (2.5%).
- ✓ Japan's consumer confidence in November rose to its highest level in 4 years driven by higher stock prices and a strong job market. The index was recorded at 44.9, a rise of 0.4 from the previous month.
- ✓ BoE in its half-yearly Financial Stability Report stated that if there is a disorderly Brexit, banks were strong enough to cope. For the first time since 2014 when the stress testing of banks began, none of the major lenders would need to raise extra capital.
- ✓ As per the European Banking Authority EU member country banks have reduced their exposures in terms of assets to UK from just over € 1.9tn in June 2016 when the referendum took place, to €1.6tn by June 2017.

Events and Data Calendar

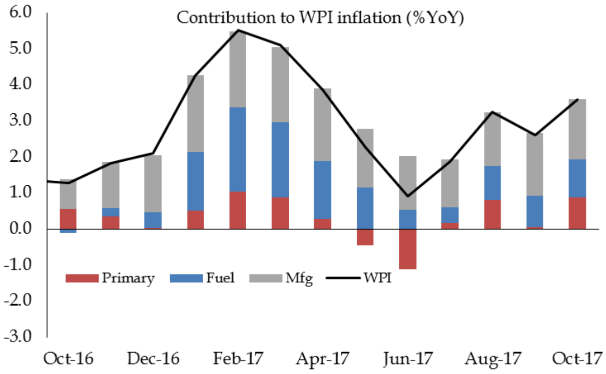
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	01-12-2017	National CPI (YoY)	(OCT)	0.20%	0.20%	0.70%	↓
	08-12-2017	GDP Annualized SA (QoQ)	(3QF)	1.50%	2.50%	1.40%	↑
US	29-11-2017	GDP Annualized (QoQ)	(3QS)	3.20%	3.30%	3.00%	↑
	12-08-2017	Change in Nonfarm Payrolls	(NOV)	195K	228K	261K	↓
EA	16-11-2017	Consumer price Index (YoY)	(OCT)	1.40%	1.40%	1.40%	→
	07-12-2017	GDP (YoY)	(Q3)	2.50%	2.60%	2.50%	↑
UK	15-11-2017	Jobless Claims Change	(Oct)	-	1.1K	1.7K	↓
	08-12-2017	NIESR GDP Estimate	(NOV)	0.40%	0.50%	0.50%5	↓
	12-12-2017	Consumer Price Index (YoY)	(NOV)	3.00%	3.10%	3.00%	↑
China	01-12-2017	Caixin PMI Manufacturing	(NOV)	50.90	50.80	51.00	↓
	09-12-2017	Consumer Price Index (YoY)	(NOV)	1.80%	1.70%	1.90%	↓

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

COMMODITY

- ✓ Gold prices increased by 0.07% MoM in Nov (vs. a contraction of 2.51% MoM in Oct) as the demand for safe haven rose amid geopolitical uncertainty in the Middle East. A firm dollar kept the gains in check
- ✓ Brent prices increased by 8.60% MoM in Nov (vs. 4.69% MoM in Oct); after OPEC and Russia agreed on a plan to extend the output cut. Greater than expected decline in crude oil inventories (-1.855mn vs. expectation of -1.54mn) also aided the gains.

Domestic Market Macro Economics

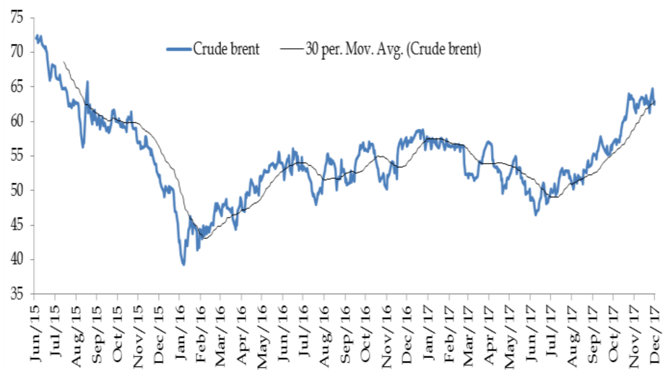


India October WPI: WPI inflation rises sharply to converge with CPI

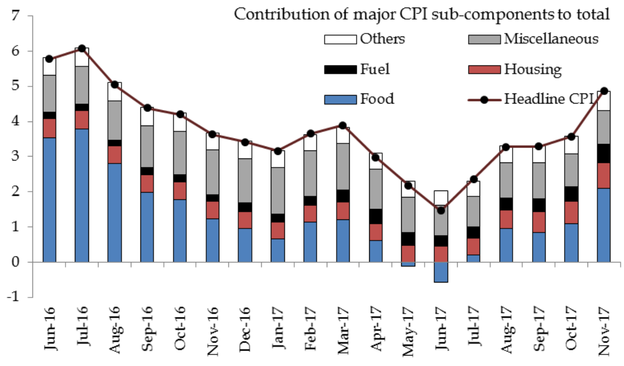
%YoY	Weights(%)	17-Aug	17-Sep	17-Oct	Apr-Oct FY17	Apr-Oct FY18
IIP	100	4.5	4.1	2.2	5.6	2.5
Sectoral Classification						
Mining	14.4	9.2	7.8	0.2	2.7	3.4
Manufacturing	77.6	3.4	3.8	2.5	5.9	2.1
Electricity	8	8.3	3.4	3.2	5.9	5.3
Use Based Classification						
Primary goods	34	7.1	6.6	2.5	5.1	3.5
Capital goods	8.2	5.2	8.2	6.8	4.6	0.8
Intermediate goods	17.2	-0.7	2.1	0.2	3.4	0.2
Infrastructure/construction goods	12.3	2.7	0.4	5.2	5.2	2.6
Consumer durables	12.8	3.4	-3.4	-6.9	6	-1.9
Consumer non-durables	15.3	7.3	10.3	7.7	9.5	7.5

October IIP: Seasonal factors impact momentum

- ✓ Manufacturing sector PMI remained in the expansion zone for the fourth consecutive month in Nov-17, coming in at 52.6 vs. 50.3 in Oct-17, indicating continued improvement in activity from GST related disruptions.
- ✓ Service sector PMI slipped into contraction territory in Nov-17 at 48.5 vs. (Previous: 51.7), on the back of decrease in new business orders due to torpid demand for services post GST implied hike in services tax rate.
- ✓ India's industrial production slowed further to 2.2% YoY in October vs. 4.1% rise in September (upward revision from 3.8%), coming in lower than expectations (Bloomberg consensus: 2.9%; YBL estimate: 2.6%). The lower reading is likely to have been biased by the early timing of festive period which affects manufacturing schedules. IIP prints have tended to be weaker in the past due to the variation in timing of the festive period.
- ✓ India's monthly trade deficit widened to the highest in 5 months coming at USD 14.0 bn in October compared to a seven month low of USD 9.0 bn in September, beating our and market expectations both pegged at USD 10.5 bn. The increase in trade deficit was largely a manifestation of quicker than anticipated mean reversion in exports after the sharp uptick recorded in September.
- ✓ Coming on the heels of a higher than consensus retail inflation print, India's wholesale (WPI) inflation also rose sharply to a 6-month high of 3.59% YoY in October (Bloomberg consensus: 3.01%; YBL expectation: 3.14%) from 2.60% in September. On a sequential basis, the headline index printed at strong level of 1.05% MoM, reversing the contraction seen in the previous month. The pickup in inflation momentum was led by food and fuel, even as core inflation remained steady.
- ✓ November CPI rose to a 15-month high of 4.88% YoY from 3.58% in the previous month, substantially higher than market expectations (Bloomberg Estimate: 4.29%, YBL: 4.57%).



Crude Oil: On an uptrend in last six months



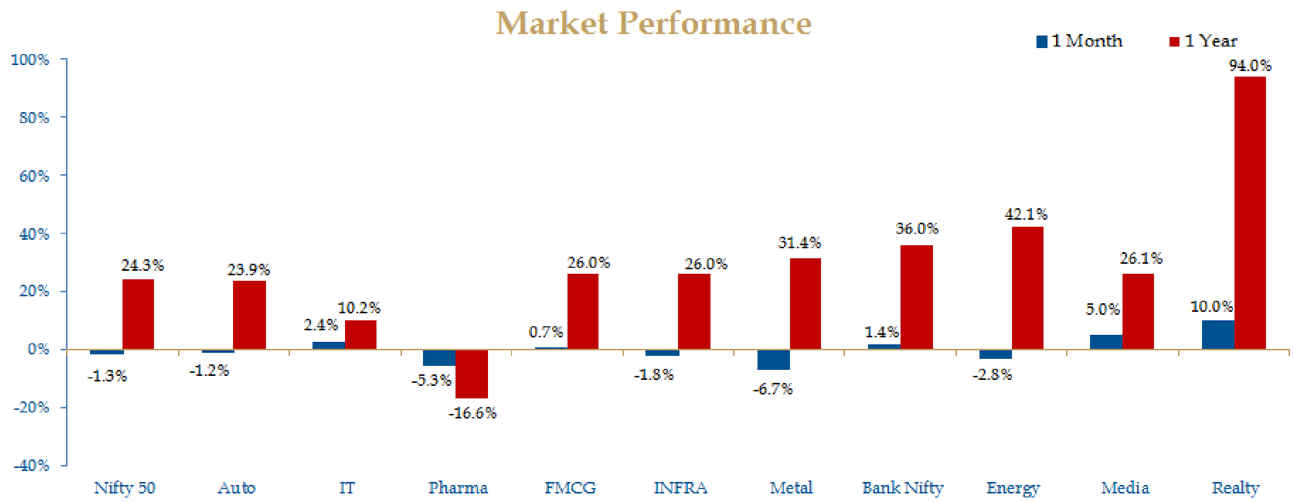
India November CPI - Food fuels upside trajectory

We expect:

- ✓ We estimate FY18 GDP growth at 6.8%, with growth conditions expected to pick-up in 2H FY18, supported by consumption growth and normalization of growth conditions.
- ✓ We see an upside risk to our FY18 average CPI estimate of 3.5% by up to 20 bps driven by elevated global crude oil prices and pass-through of GST and HRA and gradual revival in economic activity.

Equity Market Insights

- November turned out to be a tepid month for large cap stocks as Nifty closed at 10,226 and Sensex closed at 33,149; down 1.3% and 0.3% MoM, respectively. Nifty Freefloat Midcap 100 and Nifty Freefloat Smallcap 100 indices were up by 1.6% and 1.9% MoM, respectively.
- Foreign investors have shown a key interest in Indian stocks during the month of November as they invested around ~INR 192 bn (highest since March 2017). Domestic mutual funds invested a net sum of ~INR 120 bn.



Factors to Watch

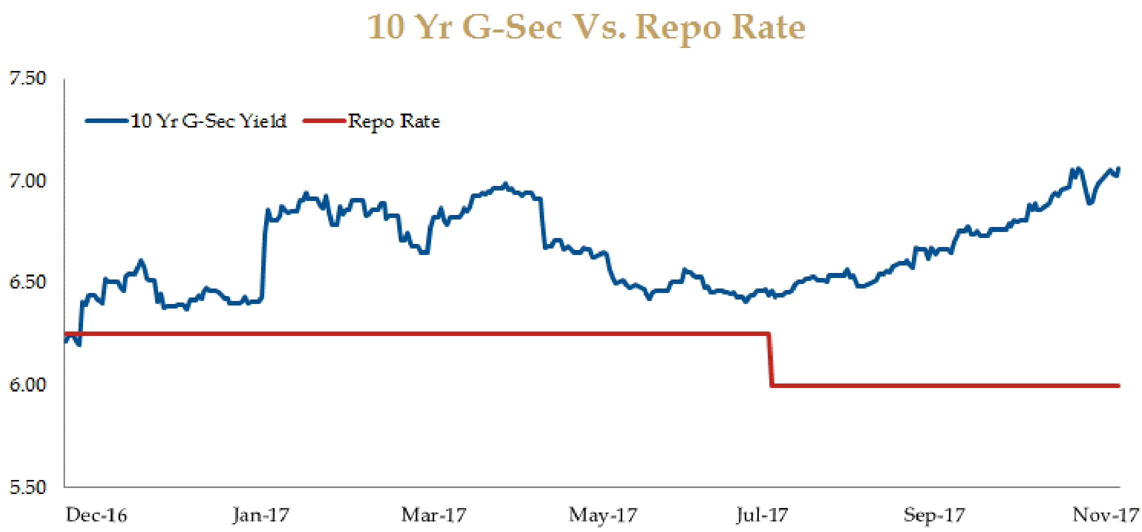
- Geopolitical developments, particularly in the US and North Korea. Global investors would also be keeping a close watch on developments and policy announcements in US.
- Whether foreign investor activity will continue in the month of December after the rating upgrade by Moody's in November (although S&P maintained its rating).

Outlook & Expectations

- Valuations of the benchmark indices do seem elevated and the current environment does not seem to be conducive for broad based returns. Thus, taking a bottom up approach would be the way to go.
- Investors can consider keeping some cash aside and/ or booking profits in stocks where there seems to be a mismatch between valuations and fundamentals. Poor fundamentals and high valuations rarely make for good long term investments.
- Broader fundamentals are expected to improve on the back of improving macroeconomic factors with recovery led by consumption, followed by public sector capex and external demand improvement, benefits of reforms percolating to the ground level and conducive inflation/interest rate environment. While we expect the markets to continue with their upward trajectory over the long term, there would be some aberrations due to global and other uncertain events. But as seen many times before, the Indian markets are quick to recover during such times as the domestic growth story remains intact.
- In terms of sectors, we remain positive on infrastructure (given the Government's focus towards the same), sectors linked to affordable housing, and consumption led sectors; we thus recommend investments in quality names in these spaces. We also like select names from the auto and auto ancillary sectors. The consumer durables sector is also an interesting space, particularly those companies which have a long runway of growth (due to lower penetration levels) and are slated to benefit from the lower share of the organized market (effect of GST implementation).
- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.

Debt Market Insights

- The average systemic liquidity in the banking system reduced to a surplus Rs 719 bn in Nov vs. Rs 1401 bn in October, on the back on increased festival related demand for cash.
- Average 10yr g-sec bond yield during November rose to 6.97% vs. 6.77% in October. Yields have been trading higher post the announcement of the bank recapitalization bonds, pick-up in crude oil prices and concerns regarding potential risks to FY18 Central Government Deficit target of 3.2% of GDP. During Nov, FII debt outflows were seen at USD 0.2 bn vs. inflows of USD 2.8 bn in Oct.
- On the monetary policy front, we expect RBI to remain on hold for the rest of FY18 with inflation expected to trend higher than target level. The future path of policy action remains data dependent with the central bank carefully monitoring upside risks to inflation - rise in inflation expectation, pass through of higher input costs by firms, potential risk of fiscal slippage and global financial instability caused by uncertainty over monetary policy normalization in Advanced Economies and potential fiscal expansion in the US.
- November CPI rose to a 15-month high of 4.88% YoY from 3.58% in the previous month, substantially higher than market expectations (Bloomberg Estimate: 4.29%, YBL: 4.57%). Underlying inflationary momentum rose to a four-month high of 1.10% MoM (Previous: 0.67%), after moving into the positive zone last month (see Table 1). On an FYTD basis as well, inflationary pressures are now tracking higher than last year (April-November FY18: 0.63% MoM; April-November FY17: 0.51%).



Outlook and Expectations

- We estimate FY18 GDP growth at 6.8%, with growth conditions expected to pick-up in 2H, supported by consumption growth and normalization of growth conditions.
- On the inflation front, while we and the markets have been anticipating a significant change in nature and trajectory of CPI inflation in H2FY18, with H2FY18 expected to show a significant uptick led by increased pass-through of GST and HRA and gradual revival in economic activity, incoming readings have been higher than projected. Indeed, from average inflation of 2.6% in H1FY18, H2FY18 is expected to average towards ~4.8%, suggesting a marked change in perception of inflation during this period, risking a breach of RBI projections of 4.3% in 3QFY18 and 4.7% in 4QFY18. These upside surprises, in combination with risks of elevated (albeit range-ish) global crude prices now pose an upside risk to our FY18 average CPI estimate of 3.5% by upto 20bps.
- 10Y G-sec yield to remain in the 6.95-7.10% range by Mar-18. Upside risks could dominate on fiscal risks, firm oil prices, structure of recap bonds and Fed hikes.

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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