FIRST Insights

IMF revises global growth forecast; India's fiscal deficit target pegged at 3.3% of GDP for FY19

The year started on a positive note, with IMF revising global growth forecast for 2017 by 10 bps to 3.7% and by 20 bps to 3.9% for 2018, led by broad based recovery in advanced economies and on expectations that the US tax cuts would boost investments. Validating the synchronous recovery underway, global macros remained positive with JP Morgan Global Manufacturing PMI rising to a near 7-year high led by robust expansion in advanced and emerging economies. New export orders, which is a key gauge of international trade flows rose to its highest level (in Jan-18) since 2011, pointing towards a faster pace of global trade recovery. In line, IMF expects global trade volume to grow at a robust 4.6% in 2018 aided by a pickup in investments.

On the domestic front, the Government unveiled FY19 Union Budget (the last full year budget before the 2019 general elections) outlining its policy vision for next year. The budget targeted a moderate consolidation path with fiscal deficit pegged at 3.5% of GDP for FY18 (vs. target of 3.2% of GDP) and 3.3% in FY19. The focus lay on ensuring the benefits of growth reach every segment of society via enhancing farmers' income, creating rural infra, augmenting livelihood and reviving MSMEs to boost employment generation. The continued momentum in economic recovery was further reinforced by lead domestic macro indicators released for the months of Dec-Jan.

- ✓ Both manufacturing and services PMI remained in the expansion zone in Jan-18, with the former moderating vis-à-vis previous month but the latter rising to a three-month high. As such, the composite index eased marginally to 52.5 in Jan-18 from 53.0 in Dec-17.
- ✓ Core sector growth slowed to a five-month low of 4.0% YoY in Dec-17 led by de-growth in the sub-sectors of coal and crude oil and slowdown in steel production.
- ✓ Auto sales continued to grow in Jan-18, aided by 1) improved consumer sentiment on the back of a broader economic revival and 2) low base owing to demonetization last year. The growth was led by passenger vehicles, commercial vehicles and 2-wheelers
- ✓ Non-food credit growth improved further in Dec-17, to a 15-month high of 10% YoY supported by a favorable base owing to last year's demonetization which triggered loan repayments and reversal of credit given against FCNR deposits. The pickup in credit was broad-based, with all four sub-sectors of Agriculture, Industry, Services and Personal Loans recording a robust growth.

In line with expectations, RBI kept policy rates unchanged in its sixth bi-monthly monetary policy meeting and revised its Q4 FY18 CPI inflation estimate up to 5.1%. We expect CPI inflation to gradually rise towards 5.75 - 6.00% by Jun-18, marginally higher than RBI's H1 FY19 estimated range of 5.1% - 5.6%, amidst rise in crude oil prices, unfavourable base and HRA impact (other factors such as monsoon and recently announced MSP hike on kharif crops could pose upside risks on inflation and needs to be closely watched). As such, we expect RBI to remain on a prolonged pause in 2018 with upside risks to inflation balanced by growth concerns as the economy remains in nascent stages of GST transition.

For FY19, we expect GDP growth to pick up with incremental growth likely to be consumption led on account of Government's focus on reviving rural economy and further normalization of business conditions.

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Global Macro Developments

- The US Fed kept rates on hold in line with consensus expectations. The central bank expects inflation on a 12 month basis to move-up this year and stabilize near the 2% target over the medium-term.
- Bank of England's monetary policy committee left interest rates unchanged at 0.50% with no changes in its asset purchase program. The decision was in line with market expectations.
- US House of Representatives has passed a funding bill to keep the government funded till March 23rd. The plan also includes funds for Pentagon through September 30 and two years of funding for community health centres and extends several expiring health care programs.
- Global composite PMI (JP Morgan and Markit) rose to 54.6 in January vs. 54.3 previously, a 40-month high. Manufacturing production increased at a pace matching December 2017's near seven-year high, while output growth in the service sector improved fastest in three months.
- In Japan, macro data was mixed with Dec construction orders declining by 8.1%YoY, housing starts lower by 2.1%YoY and household confidence remaining unchanged 44.7 in January.
- China NBS manufacturing PMI came in at 8-month low in January (at 51.3, Previous: 51.6), as output and new orders rose at a softer pace, amid a cooling property market and tighter pollution rules.
- The rate of unemployment in Japan rose to 2.8% in December (Previous: 2.7%), though the continued rise in job vacancies suggested that the increase could be temporary in nature.
- US Q4 2017 GDP showed that the economy remained resilient during the quarter (2.6%, Previous: 3.2%, Forecast: 3.0%). While the reading slowed due to a downturn in private inventory investment, it was partly offset by acceleration in exports and government spending.
- UK economic growth slowed to the lowest since 2013 in Q4 2017 (1.5%, Forecast: 1.4%), as output rose at a slower pace for both manufacturing and construction, in the backdrop of the 2016 Brexit vote.
- In line with market expectations, European Central Bank kept monetary policy on hold. In the Press Conference that followed the meeting, ECB president Mario Draghi said that incoming data had further strengthened the bank's confidence that inflation will converge to the central bank's target of below or close to 2%.

Events and Data Calendar

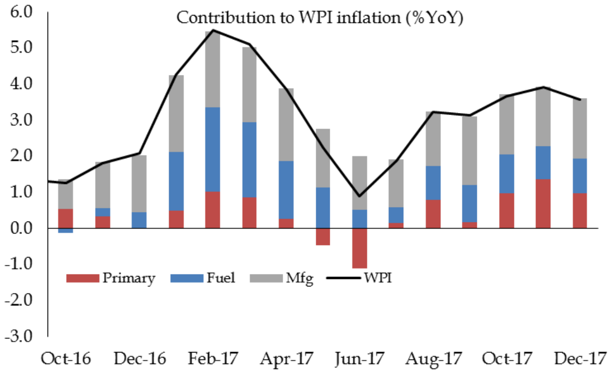
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	23-Jan-2018	BoJ Interest Rate Decision	(JAN)	-0.10%	-0.10%	-0.10%	⇨
	30-Jan-2018	Unemployment Rate	(DEC)	2.70%	2.80%	2.70%	⇧
US	26-Jan-2018	GDP Annualized (QoQ)	(4QA)	3.00%	2.60%	3.20%	⇩
	31-Jan-2018	ADP Employment Change	(JAN)	185K	234K	250K	⇩
	2-Feb-2018	Fed Interest Rate Decision	(JAN)	1.50%	1.50%	1.50%	⇨
EA	17-Jan-2018	Consumer price Index (YoY)	(DEC)	1.40%	1.40%	1.40%	⇨
	15-Jan-2018	ECB Interest Rate Decision	(DEC)	0.00%	0.00%	0.00%	⇨
UK	26-Jan-2018	GDP (YoY)	(4QA)	1.40%	1.50%	1.70%	⇩
	8-Feb-2018	BoE Interest Rate Decision	(FEB)	0.50%	0.50%	0.50%	⇨
China	18-Jan-2018	GDP (YoY)	(4Q)	6.7%	6.80%	6.80%	⇨
	9-Feb-2018	Consumer Price Index (YoY)	(JAN)	0.02	0.015	0.018	⇩

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

COMMODITY

- Gold prices increased by 5.08% MoM in Jan (vs. a contraction of 1.28% MoM in Dec) amid a weaker dollar. Increase in safe haven demand amid fears of US government shutdown also aided the gains in gold prices.
- Brent prices increased by 7.54% MoM in Jan (vs. 2.51% MoM in Dec) on the back of 1) commentary by OPEC participants that the cartel would remain committed to output cuts 2) fall in US crude inventories 3) continued signs of rising global demand and 4) continued expectations of a tighter oil market amid OPEC-Russia production cuts.

Domestic Market Macro Economics

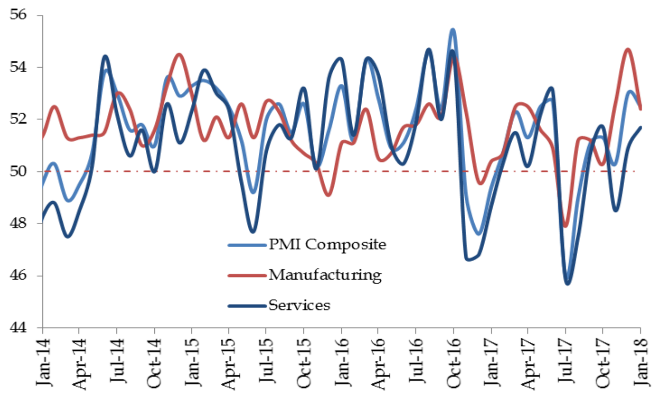


India December WPI: Positive surprise

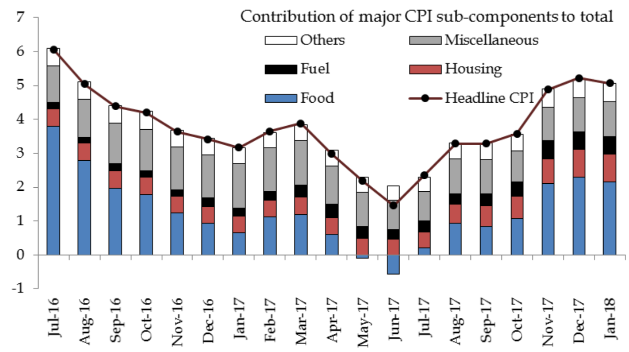
	Weights(%)	17-Oct	17-Nov	17-Dec	FY17	FYTD18
IIP (new base)	100	2.00%	8.80%	7.10%	4.60%	3.70%
Sectoral						
Mining	14	-0.10%	1.10%	1.20%	5.30%	2.80%
Manufacturing	78	2.20%	10.70%	8.40%	4.30%	3.70%
Electricity	8	3.20%	3.90%	4.40%	5.80%	5.10%
Use Based						
Primary goods	34	2.40%	3.20%	3.70%	4.90%	3.50%
Capital goods	8	6.60%	10.00%	16.40%	3.20%	3.80%
Intermediate goods	17	0.20%	6.50%	6.20%	3.30%	1.60%
Infrastructure/ construction goods	12	5.50%	13.90%	6.70%	3.90%	4.20%
Consumer durables	13	-8.60%	3.20%	0.90%	3.00%	-1.30%
Consumer non-durables	15	7.90%	23.40%	16.50%	8.00%	10.40%

December IIP: Recovery getting entrenched

- ✓ PMI for manufacturing remained in the expansion zone for the sixth consecutive month in Jan-18 coming in at 52.4, lower than previous month's reading of 54.7, suggesting that economy is still to recover fully from GST related disruptions.
- ✓ The PMI services index remained in expansion zone for the third successive month, coming in at 51.7 in Jan-18 (up from 50.9 in Dec-17), signaling a faster expansion in the service sector activity.
- ✓ Fiscal Deficit stood at 113.6% of budget estimate (BE) over Apr-Dec FY18 as compared to 94% of BE in the corresponding period last year. The steep rise in fiscal deficit run rate versus last year has been on the back of higher expenditure outgoes and lower revenue receipts, mainly on the non-tax front.
- ✓ India's industrial production grew at a robust pace for the second consecutive month indicating a gradual entrenchment of recovery. On a YoY basis, IIP rose by 7.1%YoY in Dec-17 vs. 8.8% in Nov-17 (revised-up from 8.4%). The December print is significantly higher than our and consensus expectation of 5.9% and 6.0% respectively. The expansion was led by consumer non-durables, primary, capital and intermediate goods.
- ✓ CPI inflation in January declined to 5.07% YoY from 5.21% in the previous month, lower than our and market expectations (Bloomberg Estimate: 5.10%, YBL: 5.22%). It marks the first instance in four months where the inflation print has surprised on the downside.
- ✓ India's wholesale (WPI) inflation moderated to 3.58%YoY in Dec from 3.93% in Nov, coming significantly lower than our and consensus expectations of 4.0%. The surprise was mainly due to lower than expected food prices.
- ✓ India's merchandise trade deficit posted a deterioration to USD 14.9 bn in December (Bloomberg consensus: USD 13.0 bn, YBL expectation: USD 13.5 bn) from USD 13.8 bn in November.



PMIs: Manufacturing - Manufacturing production growth eased, Services - 3-month high



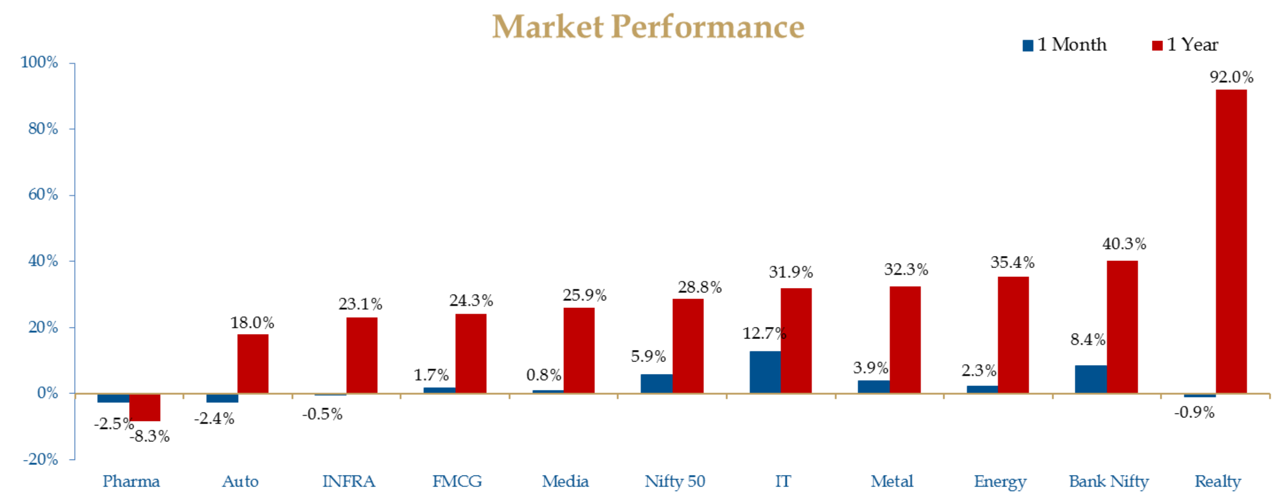
India January CPI - Inflation takes a breather

We expect:

- ✓ We estimate FY18 GDP growth at 6.7%, with growth conditions expected to pick-up in 2H FY18, supported by consumption growth and normalization of growth conditions.
- ✓ On the inflation front, we expect headline inflation to rise gradually towards 5.75 - 6% by Jun-18, which is higher than the RBI's range of 5.1 - 5.6% in H1 FY19.

Equity Market Insights

- 2018 started on a strong note with global equity markets continuing their run in the positive territory. Indian markets performed well as compared to other global markets which saw gains to the tune of 1.5 - 10% (barring UK which declined by 2%) on a MoM basis. On a YoY basis as well, India's performance remained robust as it featured amongst the top performers.
- Within India, the large caps were in favor as the Sensex and Nifty ended the month higher by ~ 6.5% and 5.9% MoM, respectively, as compared to the Nifty Freefloat Midcap 100 and Nifty Freefloat Smallcap 100 indices which declined by ~1.6% and 4.0% MoM, respectively.
- Capital continues to be poured into equity by domestic mutual funds which invested a net amount of ~ INR 90 bn in January 2018. However, foreign investors also preferred the Indian markets in the month gone by - after being net sellers in the preceding month – as FPIs poured in ~ INR 140 bn.
- Coming to the sectoral performance, gains were largely seen in stocks from the IT and Banking space with their representative indices gaining by over 12.7% and 8.4% MoM, respectively. Stocks from the technology space were in demand following the results of some of the larger companies beating expectations coupled with the improved outlook guidance for FY19.

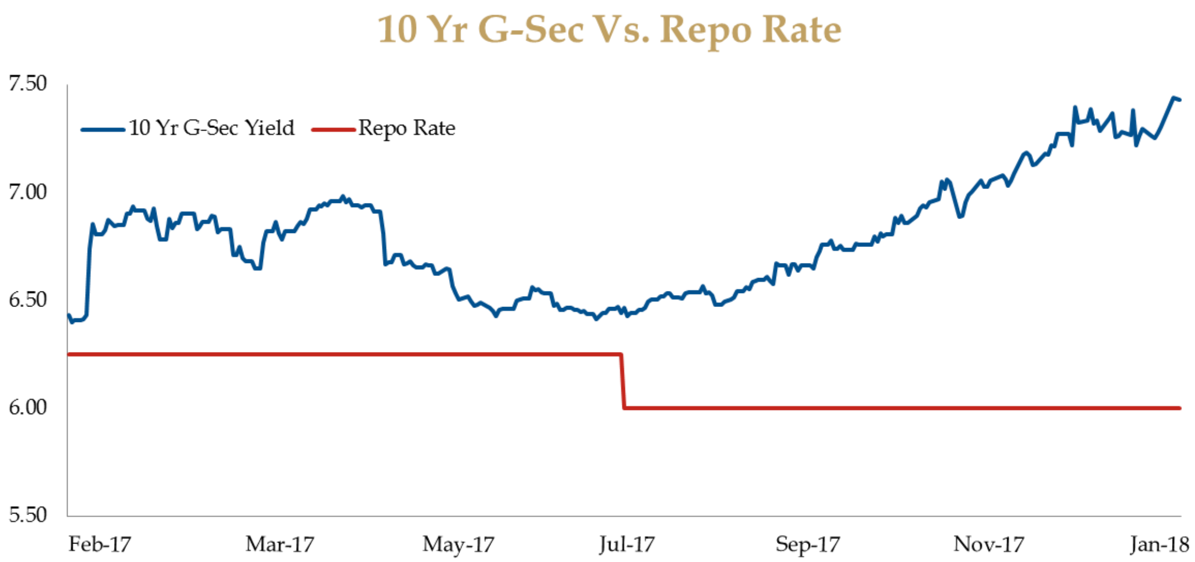


Outlook & Expectations

- Notwithstanding the volatility amongst Indian stocks, we expect the broad fundamentals to improve on the back of better macroeconomic factors with recovery led by consumption, followed by public sector capex, external demand improvement and benefits of reforms percolating to the ground level.
- Indian equities continue to be under penetrated (within the gross household savings). And thus, marginal increase in money moving towards this asset class will provide the category with a flush of liquidity. Not to mention that with other assets classes not being as attractive and the ability of equities to provide strong double digit returns over longer periods (despite LTCG of 10%) will keep this asset class in demand.
- While the markets are expected 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.
- We continue to like a few broad themes. We remain positive on infrastructure (given the Government's focus), 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 suggest investors take a bottom up stock selection approach and book profits in stocks where valuations and fundamentals are out of sync.
- Investors wanting to take a staggered approach towards the markets can consider investments through a Systematic Transfer (STP) route with a minimum investment horizon of 36 months.

Debt Market Insights

- The average systemic liquidity in the banking system increased to a surplus of Rs. 373 bn in January vs. Rs. 336 bn in December.
- Average 10 yr G-sec bond yield during January rose to 7.32% vs. 7.18% in December. The pick-up in yields was driven by rise in crude oil prices, concerns regarding fiscal deficit slippage and rise in US bond yields. Post the presentation of the FY19 Union Budget, yields firmed-up further rising to 7.54% (average) in February on the back of more gradual path of fiscal deficit consolidation. During January, FII debt inflows were seen at USD 1.34 bn vs. USD 0.4 bn in December.
- On the monetary policy front, we expect the RBI to remain on a prolonged pause in 2018, with upside risks to inflation balanced by growth concerns as the economy remains in nascent stages of GST-transition. While CPI inflation is expected to remain above RBI's 4% target, the breach of inflation target doesn't warrant a rate hike in our view as it doesn't represent build-up of general inflationary pressures, but instead partly reflects the transient effect of adverse base in H1 2018 and statistical impact of HRA hike. The MPC commentary is likely to remain cautious in the near-term as CPI inflation is expected to rise in H1 FY19 and subsequently moderate in H2. However, upside risk to our call of a prolonged pause cannot be ruled-out at this stage as a number of moving parts remain, with details awaited on Kharif MSP hike and uncertainty over monsoon this year.



Outlook and Expectations

- We estimate FY18 GDP growth at 6.7%, with growth conditions expected to pick-up in 2H, supported by consumption and normalization of growth conditions.
- On the inflation front, we expect headline inflation to rise gradually towards 5.75 - 6% by June-18, which is higher than the RBI's range of 5.1-5.6% in H1 FY19. Contingent to a normal outturn of monsoon, we expect inflation to trend downwards in the H2. Inflation trend is expected to remain above the 4% mark for the majority of 2018 driven by staggered implementation of HRA, rise in crude oil prices, unfavourable base till H1 and rise in Kharif MSP. The moderate central government fiscal glide path is not expected to be inflationary as total expenditure to GDP is expected to moderate in FY19. However, the worsening quality of expenditure in FY18 with a contraction in capital expenditure and potential slippages in state government fiscal deficit on the back of farm loan waiver remains a risk to inflation. The upside pressures will be partly mitigated by seasonal disinflation in foods prices, improvement in food supply management, presence of excess capacity which will keep core inflation pressures contained and normalization in production chains as companies especially MSMEs become more acclimatized to GST.
- 10-yr yields are expected to stay elevated in the 7.1-7.6% range in FY19 with upside risks, as liquidity conditions move towards neutrality and issuance of bank recapitalization bonds in Q4 FY18.

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".