FIRST Insights

Global trade protectionism gaining ground; India's growth recovery getting more entrenched

From a global perspective, the last few weeks have witnessed a decisive turn on - economic, political and policy undercurrents. In the US, economic data has largely printed on a positive note, powering the Fed to sound more confident and as per market's appraisal - more hawkish. Reinforcing the FOMC minutes, the new Fed Chair Powell's in his testimony to the Congress, spurred expectations that the Fed could be in for more aggressive interest rate increases this year although there were no such explicit statements from him. His view on policy remains one to juggle between "avoiding an overheated economy" and lifting inflation to 2.0%. Probability of rate hike in March currently stands at 95%. Reflecting this, Dollar index in February posted its strongest monthly performance since November 2016, appreciating by 1.7% MoM, to partially reversing the 3.3% depreciation seen in January 2018.

On the other hand in the Euro-zone, sentiment turned less optimistic, data more flattish and inflation extended its moderation trend. PMI Composite for the region slipped to a 4-month low in February at 57.1 from 58.8 in January, with German ZEW confidence index taking a breather to 29.3 vs. 31.8 in January and annualized CPI inflation easing to a 14-month low of 1.2%. Further, political uncertainty returned to the region amidst the recently concluded elections in Italy, where support for euro-skeptic parties was significant, and outcome being of a hung parliament and prolonged coalition discussions hereon. For UK, amid 3% depreciation in the GBP in February and weaker than anticipated data recently, the focus remains on Brexit and BoE policy in May. The important EU summit on 22-23 March will be keenly watched for UK and EU's agreement on transition arrangements, as the central bank appears to be moving closer to a 25 bps hike in May policy. Currently, markets are pricing in a 63% probability of a hike.

In recent days, the focus has shifted to policy discourse with a palpable threat of 'protectionism' gaining ground, as US President, after increasing tariffs on solar powers and washing machines in January, announced higher duties on steel and aluminum in a bid to deliver on his promised 'America First' trade policies. With an aim to reduce US trade deficit, the policy announcement has been met with severe criticism of consequent higher input costs, higher inflation and limited capacity of creating incremental jobs, along with threats from Euro zone and China of retaliatory measures on imports from the US. The developments on the trade front will be closely watched as it can become a potential headwind to global growth in 2018.

On the domestic front, growth recovery continues to get more entrenched with broad-based improvement in high frequency indicators in consumption and investment driven sector. Industrial production grew at a robust pace for the third consecutive month, coming in at 7.5% YoY in January, passenger vehicle and two wheeler sales continued to register consistent upward pick-up and listed company net sales grew by 11.0% in Q3 FY18 vs. 6.6% in Q2 FY18. On the inflation front, CPI inflation decelerated for the second consecutive month to 4.4% in February led by broad-based decline in food prices. Core CPI (CPI ex food, fuel, and jewellery related items) held steady with presence of excess capacity keeping inflationary pressures contained.

For FY19, we expect GDP growth to pick up to 7.5% (up from our expectation of 6.7% in FY18) with incremental growth likely to be consumption led, both rural and urban with the former driven on account of Government's focus on reviving rural economy. Later-on, additional support is expected from center and state pay commission; recovery in global demand, gradual recovery in investment climate amidst bank recapitalization and resolution of stressed assets.

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Global Macro Developments

- US non-farm payrolls for Fed was recorded at 313K, much higher than market estimate of 200K (Jan: 239K) It was the biggest increase in more than 18 months.
- US President, Donald Trump, signed off on the tariff increase on imported steel and aluminum. However, Canada and Mexico were exempted from the new tariffs. The President said that the exemptions from the tariffs to Canada and Mexico were on the condition that the North American Free Trade Agreement is renegotiated with the most favorable terms for the US.
- European Central Bank left its interest rates unchanged in its monetary policy meeting in March. ECB president Draghi said that its benchmark rate would continue to remain at the present level for an extended period of time. He also confirmed the continuation of the asset purchase program till the end of Sepember-18, or beyond, if necessary.
- ECB minutes of the Jan monetary policy meeting showed that members were against any changes in communication to signal policy normalization given weak inflation. There was broad agreement that the recent volatility in euro required monitoring. The Euro strengthened against the dollar with the minutes showing the central bank's inflation focus.
- Eurozone Q4 GDP growth was maintained at 2.7% YoY, unchanged from earlier estimate. The latest reading for 2017 GDP growth was 2.3%, the fastest rate of growth since 3% recorded in 2007
- The rate of expansion in global economic output accelerated to 3.5 years high, with Markit Global composite PMI output rising to 54.8 in February vs. 54.6 with stronger growth in the service sector.
- According to the minutes of the Jan 30-31 FOMC meeting which were released in March, Federal Reserve officials grew more positive on economic outlook, and cited substantial underlying economic momentum and more optimism about achieving their inflation target.
- US CPI for January printed at 0.5% MoM, higher than the market estimates of 0.3% MoM (Dec: 0.2%) taking the annualized growth rate to 2.1% (Dec: 2.1% YoY). Core CPI rose 0.3%, higher than forecasts of 0.2% (Dec: 0.2%) making the annual growth rate 1.8% YoY (Dec: 1.8% YoY).

Events and Data Calendar

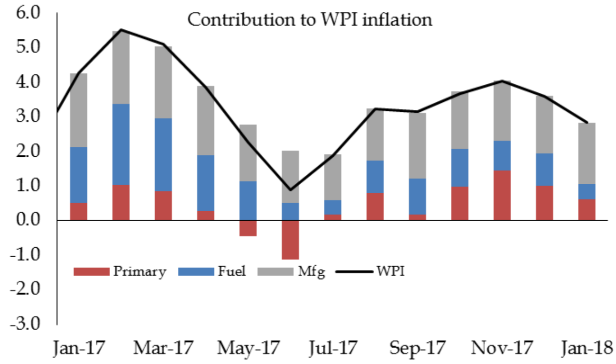
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	8-Mar-2018	GDP Annualized SA (QoQ)	4QF	1.00%	1.60%	0.50%	↑
	9-Mar-2018	BoJ Interest Rate Decision	(MAR)	-0.10%	-0.10%	-0.10%	→
US	28-Feb-2018	GDP Annualized (QoQ)	(4QS)	2.50%	2.50%	2.60%	↓
	1-Mar-2018	ISM Manufacturing	(FEB)	58.70	60.80	59.10	↑
	9-Mar-2018	Change in Nonfarm Payrolls	(FEB)	205K	313K	200K	↑
EA	1-Mar-2018	Unemployment Rate	(JAN)	8.60%	8.60%	8.70%	↓
	7-Mar-2018	GDP SA (YoY)	(4QF)	2.70%	2.70%	2.70%	→
	8-Mar-2018	ECB Interest Rate Decision	(MAR)	0.00%	0.00%	0.00%	→
UK	21-Feb-2018	Jobless Claims Change	(JAN)	-	-7.2K	8.6K	↓
	22-Feb-2018	GDP (YoY)	(4QP)	1.50%	1.40%	1.50%	↓
China	1-Mar-2018	Caixin China PMI Manufacturing	(FEB)	51.30	51.60	51.50	↑
	9-Mar-2018	Consumer Price Index (YoY)	(FEB)	2.50%	2.90%	1.50%	↑

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

COMMODITY

- Gold prices increased marginally by 0.08% MoM in February (Vs. an increase of 5.08% MoM in January) amid a weaker dollar.
- Brent prices decreased by 4.77% MoM in Feb (Vs. an increase of 7.54% MoM in January) on the back of 1) build-up in US crude oil inventories and 2) restart of the Fortis pipeline in the North Sea. Increase in US production managed to offset the optimism surrounding global supply cut efforts.

Domestic Market Macro Economics



India January WPI

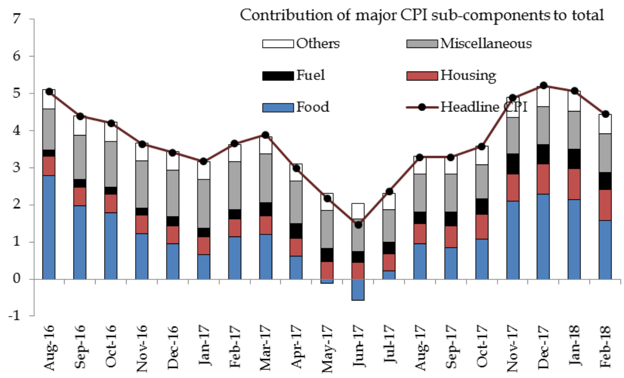
	Weights(%)	17-Nov	17-Dec	18-Jan	FYTD17	FYTD18
IIP (new base)	100	8.80%	7.10%	7.50%	4.60%	3.70%
Sectoral						
Mining	14	1.10%	1.20%	0.10%	5.30%	2.80%
Manufacturing	78	10.70%	8.50%	8.70%	4.30%	3.70%
Electricity	8	3.90%	4.40%	7.60%	5.80%	5.10%
Use Based						
Primary goods	34	3.20%	3.80%	5.80%	5.30%	3.70%
Capital goods	8	10.00%	14.40%	14.60%	3.00%	4.40%
Intermediate goods	17	6.50%	6.60%	4.90%	3.40%	2.00%
Infrastructure/ construction goods	12	13.90%	6.60%	6.80%	4.90%	4.40%
Consumer durables	13	3.20%	1.50%	8.00%	4.10%	-0.30%
Consumer non-durables	15	23.40%	16.60%	10.50%	7.70%	10.40%

January IIP: Validates growth recovery

- ✓ PMI for manufacturing remained in the expansion zone for the seventh consecutive month in February-18, however it eased marginally to 52.1 from previous month's reading of 52.4 due to slower rate of expansion in output. New orders increased for the 4th successive month on the back of improved demand conditions.
- ✓ The PMI services index slipped to negative territory after a hiatus of three months, coming in at 47.8 in February-18 (Previous Month: 51.7), halting the recent recovery seen in the services activity. The downturn in the service activity was due to new orders, which contracted at its fastest pace since August-17, amidst downbeat demand and competitive conditions.
- ✓ Core sector growth increased to 6.7% YoY in January-18, higher than previous month's growth of 4.2% YoY (January-17: 3.4% YoY) led by 1) Favourable base and 2) Robust growth in the sub-sectors of cement, electricity and refinery products.
- ✓ India's industrial production grew at a robust pace for the third consecutive month, coming in at 7.5% YoY in Jan-18, to better the 7.1% recorded in Dec-17. The growth was marginally below our expectation of 8.0% but was higher than consensus expectation of 6.4%.
- ✓ February CPI continued on its downward trajectory and printed at 4.44% YoY, down from 5.07% in the previous month. The reading was sharply lower than our and market expectations (Bloomberg Estimate: 4.70%, YBL: 4.67%). It marks the second consecutive month when inflation has surprised on the downside.
- ✓ India's monthly trade deficit widened to the highest in 4.5 years months coming at USD 16.3 bn in January compared to USD 14.9 bn in December, on the back of contraction in non-oil exports led by decline in engineering goods and chemical products. On a YoY basis, export growth slowed to 9.1% in January vs. 12.4% in December, while import growth picked-up pace to 26.1%YoY vs. 21.1% in Dec.

%YoY	Nov-17	Dec-17	Jan-18
Overall	**7.4**	**4.2**	**6.7**
Coal	0.0	-0.1	3.0
Crude Oil	0.2	-2.1	-3.2
Natural Gas	2.4	1.2	-1.0
Refinery Products	8.2	6.6	11.0
Fertilizers	0.3	3.0	-1.6
Steel	17.1	2.5	3.7
Cement	18.4	18.9	20.7
Electricity	3.9	4.4	8.2

CORE – Growth picks up



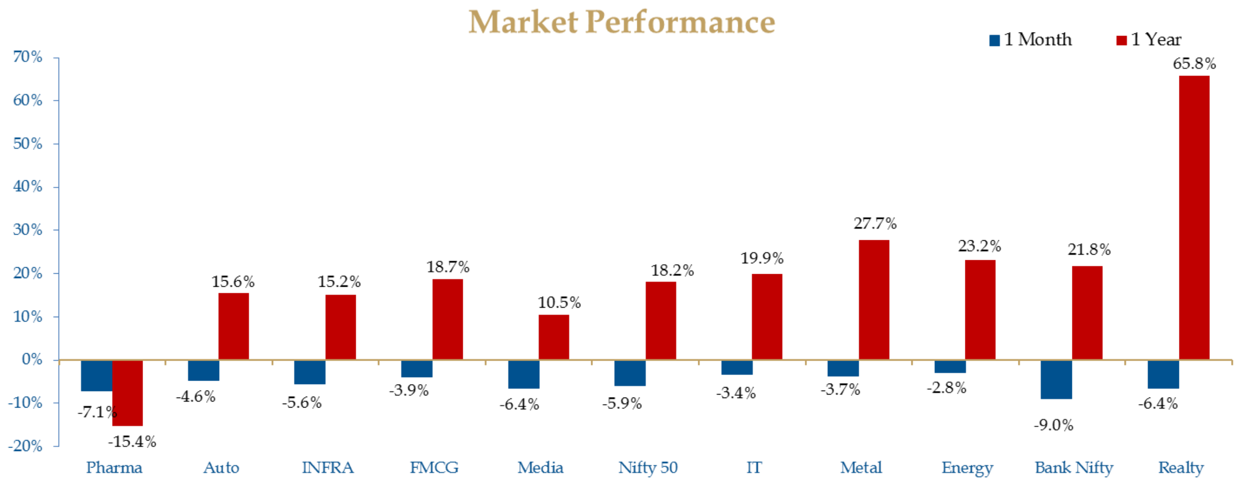
India February CPI - Food driving the downside surprise

We expect:

- ✓ FY19 GDP growth is expected to accelerate to 7.5% with a broad-based recovery led by consumption and modest capex cycle revival. Gains from structural reforms such as GST, insolvency resolution and bank recapitalization should begin to contribute.
- ✓ FY19 CPI inflation is expected at 4.7% assuming normal monsoon and crude oil price stays between USD 60-65 per barrel. Inflation is expected to peak in Jun-18 due to adverse base and subsequently moderate due to tapering HRA impact of 7th CPC.

Equity Market Insights

- Month of February witnessed weakness across the board. Within India, small and midcap stocks continued to underperform. While SENSEX and Nifty ended the month lower by ~6% each, the Nifty Freefloat Midcap 100 and Nifty Freefloat Smallcap 100 indices declined by ~7.8% and ~8.2% MoM, respectively.
- Indian markets underperformed other global markets, which saw declines in the range of 1.9-6.2% MoM. However on a YoY basis, India remained amongst the top performers.
- Capital continues to be poured into equity by domestic institutions who invested a net amount of INR 158.3 bn in February-18. Foreign investors, however, took a sharp U-turn in terms of flow as the net outflow figure stood at INR 124.9 bn, highest since August-17.
- Coming to the sectoral performance, weakness was seen across the board with stocks from the IT, metals and FMCG seeing the least declines; their representative indices fell in the range of 3 to 4%. Stocks from the banking, media and realty spaces were amongst the top underperformers in February 2018.

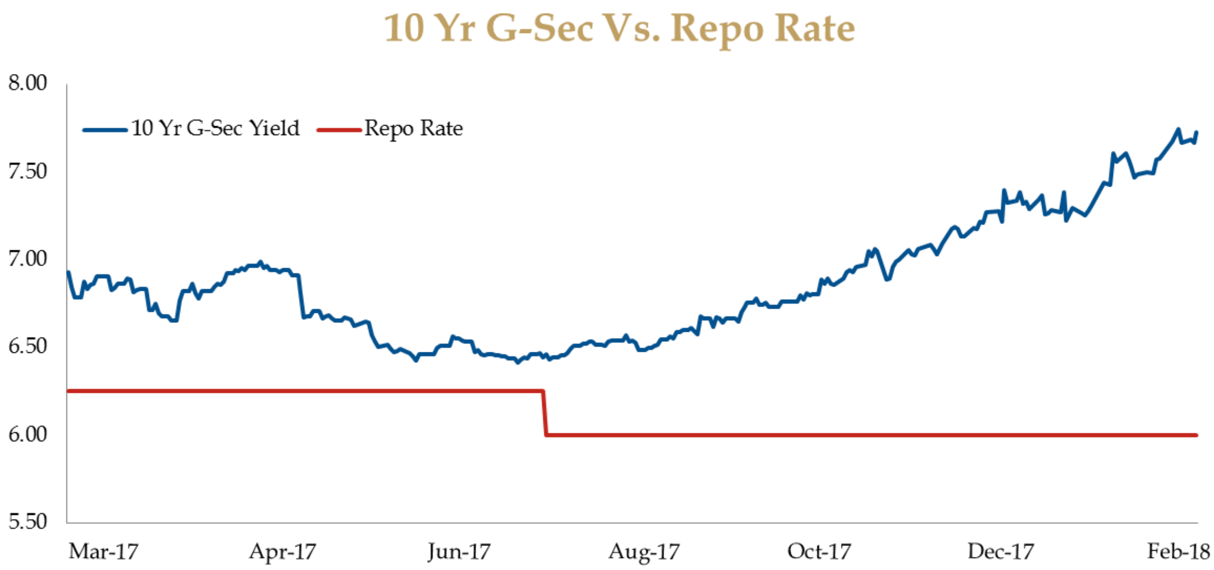


Outlook & Expectations

- Post the Union Budget, the Indian stock markets have been on a roller coaster ride. In recent times, they have been hovering in the negative territory. This is largely related to the PSU banking stocks that have been ruffled with news flows and developments related to one of the largest PSU bank. And this has had a negative impact on the headline indices considering that the banking stocks in general and the PSU banking stocks in particular, form a substantial chunk of the same. Small and mid-cap stocks have also taken a beating in the process – which is a common trait seen with this category of stocks whenever there is any kind of negative news in the market.
- We expect 2018 in general to be a relatively volatile year as compared to 2017, which saw a run up in stocks across the board. Over the medium term, news flows related to the elections in select key states this year will keep the markets on their toes. Corporate earnings should also play a key role especially at a time when expectations are becoming quite high.
- 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) to cope-up with the volatility in the short to medium term. Having said that, the broader situation is not completely bleak, as the macro fundamentals remain intact. The fact is that the problem of housing shortage does remain. The need for quality infrastructure in the country is still there. The story of higher consumption and discretionary spends is very much intact. The government's push towards improving the livelihood of the rural population is real.
- At the end of the day, the fact remains that there's no close competition when it comes to equities being the best asset class to invest in for wealth creation over the long term. And thus having exposure to this asset class is a must. But it goes without saying that this should be in conjunction with one's risk profile.

Debt Market Insights

- Average systemic liquidity in the banking system turned marginally negative to INR 25 bn in February vs. a surplus INR 373 bn in January, on the back of likely slowdown in government expenditure and large tax collections.
- Average 10 yr G-sec bond yield during February rose to 7.60% vs. 7.32% in January. Yields have been trading higher on the back of fiscal concerns, pick-up in CPI inflation and pick-up in US 10 yr yields. During February, net FII debt outflows were seen at USD 0.4 bn vs. inflows of USD 1.5 bn in January.
- The RBI's Monetary Policy Committee published the minutes of its meeting held over Feb 6-7, 2018. This meeting was followed by the central bank's decision to keep repo rate unchanged at 6.00%. Although the MPC members refrained from sharing their assessment on the potential impact of MSPs (and hike in custom duties) on inflation, the February minutes do indicate that the degree of caution with respect to inflation has clearly increased in the backdrop of higher global commodity prices and fiscal slippage (in FY18, coupled with risks for FY19 as highlighted by one of the MPC members). In fact, this is the first time since the inception of the MPC that one of the members explicitly voted for a rate hike.



Outlook and Expectations

- FY19 GDP growth is expected to accelerate to 7.5% with a broad-based recovery led by consumption and modest capex cycle revival. Gains from structural reforms such as GST, insolvency resolution and bank recapitalization should begin to contribute.
- On the monetary policy front, we expect RBI to hike policy rates by 25 bps in Jun/Aug policy review, with a chance of another 25 bps hike in H2 FY19, on the back of inflation remaining above 4% target, wider CAD with domestic growth recovery and elevated commodity prices, more moderate fiscal consolidation path and global monetary policy tightening
- FY19 10Y G-sec trading range is seen at 7.6-8.1% driven by rise in inflation, RBI policy rate hike, normalization in domestic liquidity conditions, more moderate fiscal consolidation path and global monetary policy tightening.

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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