Monetary policy takes center stage with key central bank policy meetings

September was marked by key monetary policy announcements from the major central banks. Starting with the US Federal Reserve, which in line with market expectations kept its policy rates on hold (Fed funds rate: 1.00-1.25%) and announced its plan to gradually reduce its USD 4.5 tn balance sheet beginning October. The FOMC indicated expectations of inflation to stabilize around 2% target in the medium term, post some anticipated ramp up owing to higher gasoline prices in the aftermath of the hurricanes. However, it outlined expectations of economic conditions evolving in a manner that will warrant continued gradual increases in the funds rate. As such, probability of a Fed rate hike in December currently stands at 75% with the Fed indicating strong possibility of three more hikes over 2018. Incremental data for the US has been mixed, ISM manufacturing increasing to its highest level since Apr-11, final estimate of 2Q 2017 GDP revised up by 10bps to 3.1% while, homes sales moderating for the second consecutive month.

Economic data from Eurozone area has been more robust. PMI manufacturing and business confidence rose to its highest level since 2011 and 2007, respectively and final estimate of 2Q 2017 GDP revised up by 10bps to 2.3% - marking back-to-back 2% plus quarters of growth. While inflation rose to 1.5% YoY in Aug-17, it was largely in line with market expectations. The ECB kept its rates on hold, with ECB President Draghi reiterated that the bank is getting increasingly confident of inflation rising back towards the 2% target, while assuring that "ample" accommodation was still needed for a sustainable recovery.

In the UK, while inflation unexpectedly jumped in Aug-17, rising by 2.9% YoY (as the slump in sterling since the Brexit vote continued to have a powerful impact on domestic prices), growth for 2Q 2017 expanded at a weaker rate of 1.5%YoY, lowest since 1Q 2013. Even though BoE kept its interest rates unchanged at 0.25%, it indicated the higher possibility of a rate hike by year-end to guide inflation towards 2% target in a sustainable manner. Additionally, the BoJ kept its interest rates on hold, in line with consensus expectations.

On the domestic front, most incremental lead indicators released for the months of Aug-Sep fared better, indicating continued normalisation of macro conditions post implementation of GST. PMI Manufacturing index stayed in the expansion zone for the second successive month in Sep-17 and index for the services sector rebounded in positive territory to its three-month high. Core sector registered a pickup in growth in Aug-17, led by healthy expansion in output of coal, electricity, natural gas and steel on account of rebuilding of inventories post GST implementation. Auto sales clocked an expansion in Sep-17 on the back of new launches and a boost in consumer demand due to onset of the festive season.

RBI kept policy rates on hold in line with expectations, maintaining a neutral policy stance. While inflation is moving as per the projected trajectory, the recent confluence of global (US Fed's quantitative tightening and firming up of oil prices) and domestic factors (risk of a fiscal slippage) has tilted the balance of risk somewhat upwards. This squeezes the space for any incremental monetary easing, especially when transient supply side factors are likely to have resulted in the deceleration in growth momentum. However, this does not necessarily imply an end to the monetary easing cycle, as there are various moving parts to inflation and growth and any unanticipated incremental softness in any of these metrics could open up space for monetary policy support.

Looking ahead we expect domestic growth to pick-up in 2H FY18, with nascent signs of normalization post GST transition and re-monetization process nearing completion. Among the growth drivers, consumption, as we head into the festive season driven by a good monsoon and of 7th CPC allowances and broader awards by various states, is likely to lead with marginal support from a gradual recovery in industrial activity.

Shubhada M. Rao
Chief Economist

Kanwar Vivek
Senior President and Head, Wealth Management

Global Macro Developments

- US nonfarm payrolls for September contracted by 33,000, in contrast to the market consensus which was expecting a rise of 90,000 jobs. The loss of jobs is on account of economic activity being affected by Hurricanes Harvey and Irma.
- Brexit Minister, David Davis, said that Britain wants to negotiate a Brexit agreement with the EU but is ready to walk away with no deal if the outcome of negotiations falls short of the desired deal.
- UK GDP growth for Q2 came in at 1.5% YoY, slowest since 2013 & lower than estimates of 1.7% (Q1: 1.7%).
- The final estimate of 2Q2017 US GDP was revised higher to 3.1% YoY (+10 bps), beating market expectations of 3% YoY, as private inventory increased more than previously estimated.
- Japan inflation rose to a 29-month high in August (0.7%, previous: 0.4%) driven by faster increase in cost of food, while industrial output rose more than expected to 2.1% (Previous: -0.8%, Forecast: 1.9%).
- US President Donald Trump proposed the biggest tax overhaul in three decades, calling for tax cuts for most Americans, but prompting criticism that the plan favours business.
- International ratings agency Moody's downgraded UK's credit rating to Aa2 (stable) from Aa1, citing a weaker outlook for the country's public finances and weaker economic growth due to Brexit.
- S&P Global Ratings downgraded China's long-term sovereign credit rating by one notch to A+ from AA-, stating the prolonged period of strong credit growth had increased economic and financial risks. The move by S&P's put its China rating on par with those of Moody's and Fitch.
- BoJ kept interest rates unchanged, in line with consensus expectation. The new board member Kataoka dissented to the central bank decision to maintain its interest rate targets, stating that the current monetary policy was insufficient to push inflation up to 2% during fiscal 2019.
- The US fed kept interest rates unchanged, in line with consensus expectations, signaling that it still expects one more rate hike by the end of the year. The central bank also stated that it will begin to reduce its balance sheet from Oct onwards.

Events and Data Calendar

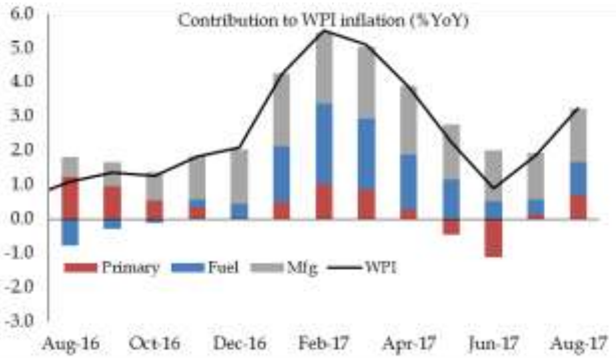
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
Japan	21-09-2017	BoJ	(Sep)	-0.10%	-0.10%	-0.10%	⇨
	29-09-2017	National CPI (YoY)	(Aug)	0.60%	0.70%	0.40%	⇩
US	20-09-2017	FOMC	(Sep)	1.00%-1.25%	1.00%-1.25%	1.00%-1.25%	⇨
	06-10-2017	Change in Nonfarm Payrolls	(Sep)	80,000	-33,000	1,69,000	⇩
EA	07-09-2017	ECB Interest rate Decision	(Sep)	0.00%	0.00%	0.00%	⇨
	07-09-2017	GDP (YoY)F	(Q2)	2.20%	2.30%	2.20%	⇧
	29-09-2017	HICP (YoY) (Flash)	(Sep)	1.60%	1.50%	1.50%	⇨
UK	14-09-2017	BoE	(Sep)	0.25%	0.25%	0.25%	⇨
	29-09-2017	GDP(YoY)F	2Q	1.70%	1.50%	1.70%	⇩
	12-09-2017	Consumer Price Index (YoY)	(AUG)	2.80%	2.90%	2.60%	⇩
China	14-09-2017	Industrial Production (YoY)	(Aug)	6.60%	6.00%	6.40%	⇩
	30-09-2017	Caixin PMI Manufacturing	(Sep)	51.50	51.00	51.60	⇩

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

COMMODITY

- Gold prices increased 2.20% MoM in Sep (vs. 3.88% MoM in Aug) buoyed by robust demand for safe-haven metal amidst escalating geopolitical tensions.
- Brent prices increased 7.11% MoM in Sep (vs. 5.58% MoM in Aug) as producer compliance with proposed output cuts rose. Optimistic global demand forecast by IEA (which stated that global oil demand will rise in 2017 at the fastest pace since 2015) and supply concerns after Turkey's threat to halt Kurdish crude shipments also aided the sentiment.

Domestic Market Macro Economics

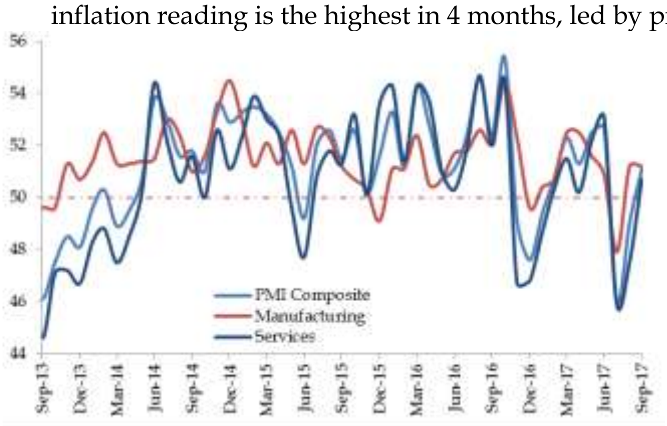


India August WPI: WPI inflation mimics CPI

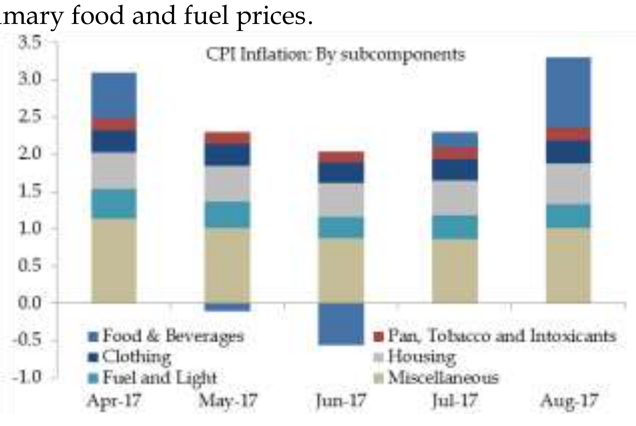
%YoY	Weights (%)	Jun-17	Jul-17	Aug-17	Apr-Aug FY17	Apr-Aug FY18
IIP	100	-0.2	0.9	4.3	6	2.2
Sectoral Classification						
Mining	14.4	0.4	4.5	9.4	3.9	3.3
Manufacturing	77.6	-0.5	-0.3	3.1	6.2	1.6
Electricity	8	2.1	6.6	8.3	6.7	6.1
Use Based Classification						
Primary goods	34	-0.2	2.2	7.1	5.6	3.1
Capital goods	8.2	-6.6	-1.3	5.4	9.5	-1.9
Intermediate goods	17.2	-0.3	-1.7	-0.2	3.4	0.4
Infrastructure/construction goods	12.3	0.1	3.5	2.5	4.1	2.1
Consumer durables	12.8	-2.4	-3.6	1.6	6.2	-0.9
Consumer non-durables	15.3	4.7	3.6	6.9	9.7	6.8

August IIP: Early festive cheer

- ✓ India's industrial production expanded by 4.3%YoY in August vs. 0.9% rise in July (revised lower from 1.2%), coming in significantly higher than consensus estimate (Bloomberg consensus: 2.6%; YBL estimate: 2.9%). On a sequential basis, seasonally adjusted momentum printed its strongest reading for the month of August, suggesting the start of normalization of production schedules as supply chains resume restocking post GST led liquidation of inventories in the previous two months. After stripping out the top 3 manufactured items in terms of contribution to headline growth, adjusted manufacturing index is a positive contributor after 3 consecutive months of negative contribution.
- ✓ PMI for the manufacturing sector stayed in the expansion zone for the 2nd consecutive month in Sep-17 at 51.2 reflecting improvement in manufacturing sector business conditions post GST related disruptions in July. The uptick was led by expansion in new orders. PMI for services sector returned to expansion territory at 50.7 in Sep-17 after a hiatus of two months indicating recovery from GST related disruptions.
- ✓ Centre's fiscal deficit for the period Apr-Aug FY18 stood at 96.1% of the Budgeted Estimate (BE) compared to 76.4% over the same period last year, on the back of frontloading of expenditure amidst a slower traction in revenues, especially non-tax revenues.
- ✓ India's trade deficit expanded marginally to USD 11.6bn in August vs. USD 11.4bn in July, broadly in line with our and consensus projections (YBL: USD11.4bn, Bloomberg consensus: USD11.2bn). On an annualized basis, pace of imports picked up to 21% YoY as compared to 15.4% in July. Exports too expanded at a faster pace, growing at 10.3% YoY, up from 3.9% in July. The expansion in imports is due to non-oil non-gold items, led by electronic goods, transport equipment and machinery
- ✓ India wholesale price index inflation for August quickened to 3.24% YoY from 1.88% YoY in Jul-17. The rise was broadly in line with our and market expectations (YBL: 3.33%, Bloomberg consensus: 3.20%). The WPI inflation reading is the highest in 4 months, led by primary food and fuel prices.



PMIs: Manufacturing - Recovery post GST disruptions;
Services - Returns to expansion zone



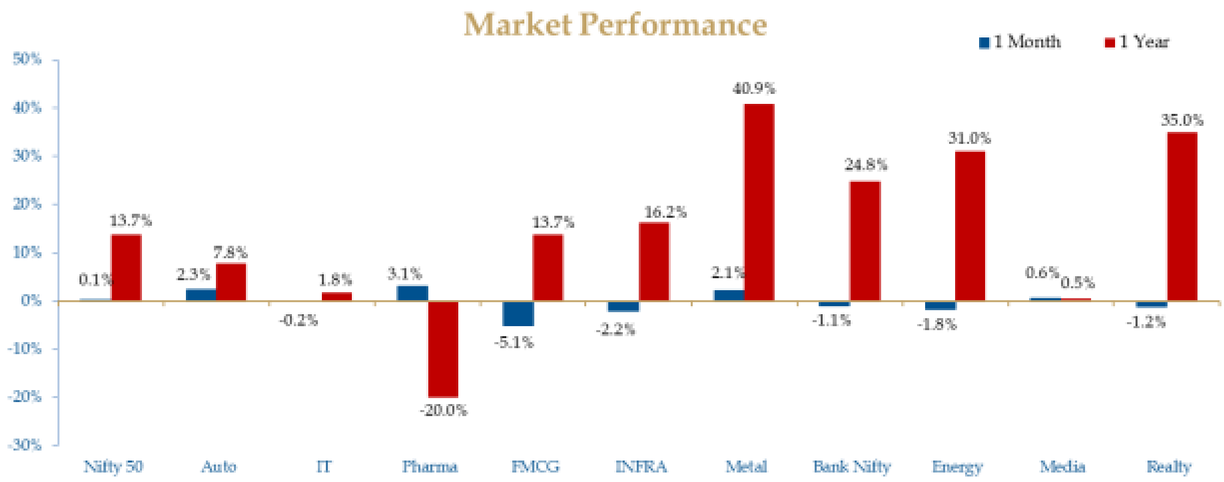
India August CPI - Depleting comfort

We expect:

- ✓ We revise down FY18 GDP estimate to 6.8% vs. 7.1% earlier, incorporating weaker agriculture production estimate and lesser support from government capex due to fiscal compulsions.
- ✓ We expect average FY18 CPI inflation at 3.5% in FY18 (vs. 4.5% in FY17), on the back of moderate food inflation, minimal impact from GST, benign commodity/exchange rate outlook and excess capacity.

Equity Market Insights

- The Indian equity markets remained tepid during the month of September. Nifty ended at 9,789 while Sensex closed at 31,284; down 0.1% and 0.3% MoM, respectively. Nifty Free float Midcap 100 and Nifty Free float Smallcap 100 indices continued to outperform with gains of 0.8% each during the same period.
- During September, FIIs continued to be net sellers in the equity markets and withdrew USD 1.66 bn from the markets. However, they invested USD 0.16 bn into the debt markets during the month. DII's were net buyers and invested ~ USD 3.27bn during the same period.



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.
- With a huge host of IPOs lined up in the coming months, we could see some part of the fund flows getting directed towards the primary markets thereby capping gains on the secondary market front.
- The earning season is likely to remain tepid with some sectors like energy, retail focused NBFCs and auto expected to report a strong set of numbers. However, sectors like Pharma and IT are expected to report a muted set of numbers overall. Consumption related stocks could see a continued impact of GST but we expect the outlook to be more robust given the improving consumer sentiment during the festive season.

Outlook & Expectations

- In terms of valuations, Sensex and Nifty are trading at a forward PE multiple of 20.9x and 20.4x respectively, which is a tad bit stretched as compared to historical valuations. In our opinion, rather looking at the headline indices which do seem to be trending upwards and which do seem to be a little stretched if you are looking at on the valuation side, it would be more prudent to look at stocks instead. And even at current market levels, there are plenty of stocks that offer value in terms of valuations.
- As such, the markets are on an upward trajectory supported by an improvement in the country's fundamentals. This is clearly reflecting in the earnings growth too that has improved from the levels seen 3-4 quarters back. Although recovery is yet to be broad based, nevertheless earnings are on the path of improvement too.
- 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 do think that markets would continue to trend upwards over the long term, however there could be some aberrations due to global events. But as seen earlier too, our markets are quick to recover during such times as the domestic growth story remains intact.
- In terms of sectors, we remain positive on autos and auto ancillaries given that they enjoy a multiplier effect to economic growth. We also like stocks from the infrastructure and capital goods spaces given the Government's focus in that space. We are thus optimistic on infrastructure, sectors linked to affordable housing, and consumption led sectors; we thus recommend investments in quality names in these spaces. Over the medium term, investors could also accumulate select names from the metals pack given the

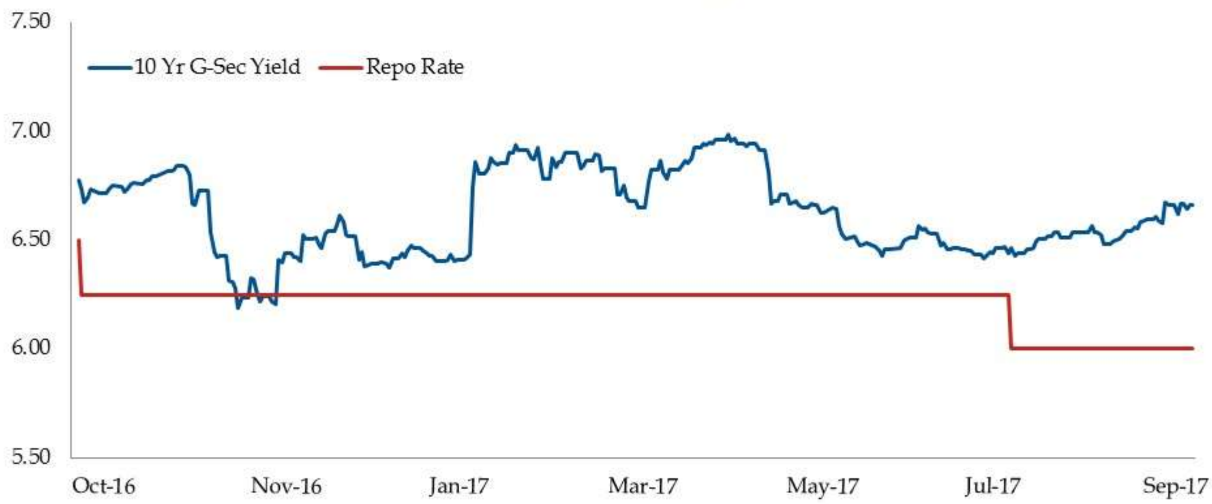
improvement in global prices, conducive Government policies and expectations of improvement in domestic demand.

- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.

Debt Market Insights

- 10 yr G-sec yield during September rose to 6.59% vs. 6.50% in August 2017. In October so far, yields have increased to around 6.73%.
- The average systemic liquidity in the banking system reduced to a surplus of Rs. 2236 bn in September vs. Rs. 2765 bn in August 2017.
- In line with expectations, the Reserve Bank of India's Monetary Policy Committee maintained status quo at its fourth bi-monthly monetary policy review, on 4th October 2017. Post the decision, the repo rate, reverse repo rate and the MSF rate stay unchanged at 6.00%, 5.75%, and 6.25% respectively. As per the pre-decided roadmap of reaching the minimum Liquidity Coverage Ratio (LCR) of 100% by January 2019, SLR was reduced by 50 bps to 19.5% of NDTL. In addition, the ceiling on SLR securities under HTM was also lowered by 75 bps to 19.5% of NDTL (to be applicable in a phased manner).
- Conforming to expectations, Aug CPI inflation rose to the highest level so far in FY18, to 3.36%YoY from 2.36% in July. The print marked the second consecutive month of significant sequential momentum at 0.97%MoM (vs. 1.67% previously), compared to a more subdued average momentum of 0.28% over Apr-Jun 2017. The sequential momentum in core CPI (CPI ex food, fuel, and jewellery related items) continued to rise at an elevated pace for the second consecutive month of 0.76%MoM (vs. 0.70% previously).

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- On the monetary policy front, while inflation is moving as per the projected trajectory, the recent confluence of global (US Fed's quantitative tightening and firming up of oil prices) and domestic factors (growing risk of a fiscal slippage – with 0.5% increase in fiscal deficit ratio expected to add 25 bps to inflation) has tilted the balance of risk somewhat upwards. This squeezes the space for any incremental monetary easing, especially when transient supply side factors are likely to have resulted in the deceleration in growth momentum. However, this does not necessarily imply an end to the monetary easing cycle per se, as there are various moving parts to the inflation and growth outlook and any unanticipated incremental softness in any of these metrics could once again open up space for monetary policy support.
- 10Y G-sec yield is expected to trade in the range 6.40-6.90% over the remaining months of FY18. Yields may harden slightly in H2 FY18 after remaining range-bound in Q2 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.

YES BANK Limited

Regd. & Corporate Office: Nehru Centre, 9th Floor, Discovery of India, Worli, Mumbai 400018. | Tel: + 91 22 6669 9000 Fax: + 91 22 6669 9018
Northern Regional Corporate Office: 48 Nyaya Marg, Chanakyapuri, New Delhi 110 021. |Tel: + 91 11 5556 9000 Fax: +91 11 5168 0144

Contact Details

Gaura Sengupta
Economist
gaura.sengupta@yesbank.in

Shubhada M. Rao
Chief Economist
shubhada.rao@yesbank.in

Kanwar Vivek
Senior President and Head
Wealth Management
kanwar.vivek@yesbank.in

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.
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