## Dollar softens on geo-political tensions; early signs of normalization post GST transition

August was marked by rising geo-political tensions between the US and North Korea. Impact of geopolitical uncertainties was seen in DXY (US dollar index), which continued to lose ground (depreciating ~0.20%), marking the sixth consecutive month of Dollar weakness. However, weakness in DXY was capped by robust US economic data which included upward revision of Q2 GDP to 3.0% vs. 2.6% previously, reflecting upbeat consumer spending and strong business environment; and ISM manufacturing recording the highest reading since 2011.

Looking beyond US, global economic recovery continued during the month, with the Global Manufacturing PMI rising to 53.1 in August, a 75-month high. Details suggest that developed economies recorded stronger rate of improvement than emerging economies led by Euro area, UK, Japan and the US. In EMs higher manufacturing prints for China and Taiwan were offset by growth slowdown in Russia and contraction in Thailand and Myanmar.

In September, markets' focus will remain on 1) Federal Reserve policy meeting (19-20th Sep): Minutes of meeting released in August (for Jul-17 policy meeting) suggested a split among Fed members over future path for rate hikes. While majority of Fed officials believed that low-inflation was transitory, others expressed concerns about the recent decline in inflation and suggested Fed 'could afford to be patient' in raising interest rates. As such, markets remain skeptical of a rate hike amidst lackluster inflation print vis-à-vis Federal Reserve target (Sep-17 status quo probability pegged at 99.4%). President Trump and congressional leaders agreed to support the extension of government debt limit and government funding until December, increasing likelihood of Fed embarking on balance sheet reduction in Sep-17 FOMC meeting 2) German Federal Elections (24th Sep): Deutschland trend poll shows Angela Merkel (Christian Democrats) is ahead with 39% support.

On the domestic front, growth in economic activity as seen by GVA for Q1FY18 remained unchanged at 5.6%YoY (vis-à-vis Q4FY17), as inventory decline and slowdown in production ahead of GST implementation weighed on industrial activity. However, on the positive side, the data also reflected signs of nascent recovery in cash intensive sectors such as real estate and construction post demonetization. Incremental lead indicators released for the months of Jul-Aug fared better, indicating normalization post implementation of GST with manufacturing PMI index rebounding to a three-month high in Aug-17 from a GST induced sharp contraction in Jul-17. Core sector registered a pickup in growth in Jul-17, led by healthy expansion in steel, electricity and natural gas sectors and moderate expansion in coal sector output on account of rebuilding of inventories post GST implementation. Auto sales clocked an expansion in Aug-17 ahead of the festive season. Non-food credit growth, improved in Jul-17, marking fastest pace of expansion in FYTD18, despite an adverse base. On a sectoral basis, barring agriculture, credit off take growth improved for all – industry, services and personal loans sectors. However, PMI for the services sector contracted for the second consecutive month, as concerns over onset of GST continued to linger.

Looking at lead indicators for Q2FY18, initial signs of normalization are already visible in select sectors, which we expect to get more pervasive as GST implementation smoothens out and re-monetization process nears completion. As such, we expect growth recovery to become palpable in H2FY18. Among the growth drivers, consumption, as we head into the festive season driven by a good monsoon and 7th CPC allowances, 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

- The UK Parliament voted 326-290 in favor of moving the EU withdrawal bill, in turn taking the country a step closer to exit from the EU after its Brexit vote in 2016.
- In its monetary policy meeting on 7th Sep, the European Central Bank kept rates on hold, in line with market expectations. ECB President Draghi reiterated that the bank would decide on tapering its ongoing monetary policy stimulus in October, as it monitors weaker inflation due to a strengthening Euro.
- China consumer price inflation rose to a 7-month high in August to 1.8%, (previous: 1.4%), beating expectations, in a sign that domestic demand remained resilient in the economy during the month.
- Japan Q2 CY2017 GDP was revised down to 0.6%, 40 bps below preliminary reading of 1% growth, as business spending rose slower-than-expected and private consumption rose slightly less-than-anticipated.
- US President Trump and congressional leaders agreed to raise government debt limits and government funding by three month, reducing the likelihood of a government shutdown.
- US Q2 GDP second estimate was revised up to 3.0% vs. 2.6% previously, beating consensus expectations of 2.7% rise. The upward revision reflected robust consumer spending as well as strong business investment.
- Moody's maintained its forecast for G20 economic growth at just over 3% for this year and next. The agency cut its US forecast to 2.2% in 2017 (vs. 2.4% previously) and 2.3% in 2018 vs.2.5% previously due to weaker than expected 1H performance and modest fiscal stimulus.
- IMF raised China's real GDP growth forecast for 2018-2020 to 6.4% from 6.0% and with a greater chance that the government will meet its target of doubling 2010 real GDP by 2020, however at the risk of large increases in debt.
- ECB members expressed concerns on possible overshooting of Euro, which rose to 2.5 year high due to two factors – absence of political risk post French election & market expectations over U.S. interest rates.

## Events and Data Calendar

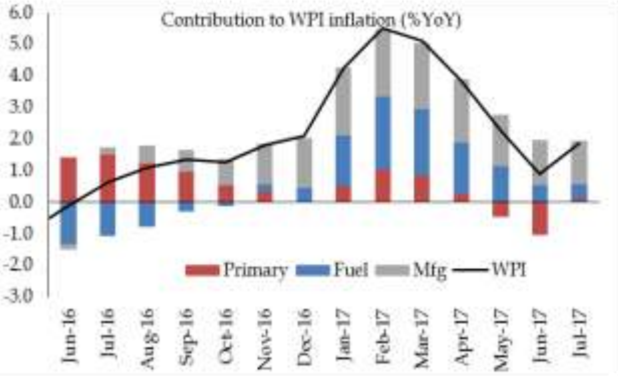
| Region | Date | Event/Data | Period | Forecast | Actual | Prior | Change |
|---|---|---|---|---|---|---|---|
| Japan | 25/08/2017 | National CPI (YoY) | ((Jul) | 0.40% | 0.40% | 0.40% | ⇨ |
| | 08/09/2017 | GDP SA (QoQ) | (2QF) | 0.70% | 0.60% | 1.00% | ⇩ |
| US | 01/09/2017 | Change in Nonfarm Payrolls | (AUG) | 180K | 156K | 209K | ⇩ |
| | 01/09/2017 | ISM Manufacturing | (AUG) | 56.5 | 58.8 | 56.3 | ⇧ |
| EA | 17/08/2017 | Consumer price Index (YoY) | (JUL) | 1.30% | 1.30% | 1.30% | ⇨ |
| | 07/09/2017 | ECB Interest rate Decision | (SEP) | 0.00% | 0.00% | 0.00% | ⇨ |
| | 07/09/2017 | GDP (YoY) | (Q2) | 2.20% | 2.30% | 2.20% | ⇧ |
| UK | 16/08/2017 | Unemployment Rate | (JUN) | 4.50% | 4.40% | 4.50% | ⇧ |
| | 08/09/2017 | NIESR GDP Estimate | - | 0.40% | - | 0.20% | ⇧ |
| | 12/09/2017 | Consumer Price Index (YoY) | (AUG) | 2.80% | 2.90% | 2.60% | ⇩ |
| China | 01/09/2017 | Caixin PMI Manufacturing | (AUG) | 51 | 51.6 | 51.1 | ⇧ |
| | 09/08/2017 | Consumer Price Index (YoY) | (JUL) | 1.60% | 1.80% | 1.40% | ⇩ |

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

**COMMODITY**

- Gold prices increased 3.88% MoM in Aug (vs. a contraction of 1.60% MoM in Jul) buoyed by robust demand for safe-haven metal amidst escalating geopolitical tensions. Further, Fed minutes released in August hinted that interest rates could rise more slowly than expected aiding the increase in price.
- Brent prices increased 5.58% MoM in Aug (vs. 3.78% MoM in Jul); after the closure of one of the largest refineries, reducing global crude oil supplies. Fall in oil exports from Saudi Arabia (reaching 33-month low) also drove the prices.

## Domestic Market Macro Economics

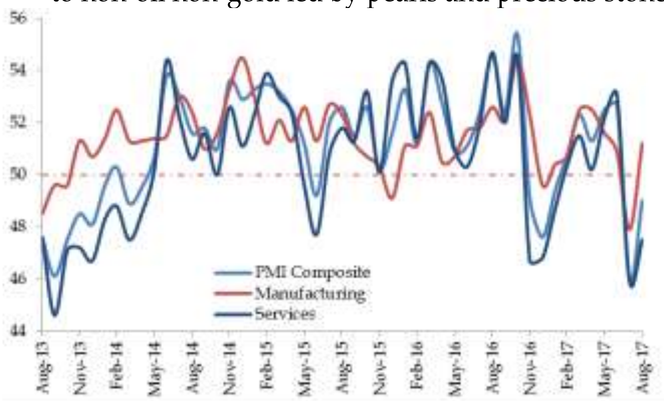



**India July WPI: A lopsided increase**

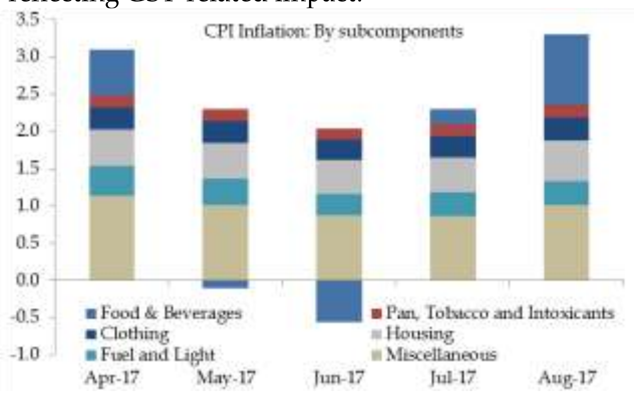
| % YoY | Weights(%) | May-17 | Jun-17 | Jul-17 | FY17 | FYTD18 |
|---|---|---|---|---|---|---|
| **IIP (new base)** | 100 | 2.80% | -0.20% | 1.20% | 4.60% | 1.70% |
| **Sectoral Classification** | | | | | | |
| Mining | 14 | 0.20% | 0.40% | 4.80% | 5.30% | 2.00% |
| Manufacturing | 78 | 2.60% | -0.50% | 0.10% | 4.30% | 1.30% |
| Electricity | 8 | 8.30% | 2.10% | 6.50% | 5.80% | 5.60% |
| **Use Based Classification** | | | | | | |
| Primary goods | 34 | 3.70% | -0.20% | 2.30% | 4.90% | 2.20% |
| Capital goods | 8 | -1.40% | -6.60% | -1.00% | 3.20% | -3.50% |
| Intermediate goods | 17 | 0.40% | -0.30% | -1.80% | 3.30% | 0.40% |
| Infrastructure/ construction goods | 12 | 0.20% | 0.10% | 3.70% | 3.90% | 2.10% |
| Consumer durables | 13 | 0.80% | -2.40% | -1.30% | 3.00% | -0.90% |
| Consumer non-durables | 15 | 9.50% | 4.70% | 3.40% | 8.00% | 6.60% |

**July IIP: GST-transiiton impact reduces**

- ✓ Monsoon ended the month of August with a cumulative deficit of 4% (deviation from LPA), remaining within normal range. Spatial distribution remained positive with 80% of country area receiving normal to excess rainfall on a cumulative basis.
- ✓ PMI for the manufacturing sector rebounded in Aug-17 to a 3-month high of 51.2 from a GST induced sharp contraction to 47.9 in Jul-17. The uptick was led by a new orders and output, with the recovery being broad based across sub-sectors of consumer, intermediate and capital goods.
- ✓ PMI for services sector contracted for second consecutive month in Aug-17 on concerns over onset of GST.
- ✓ India's industrial production expanded by 1.2%YoY in July vs. 0.2% contraction in June (revised from -0.1%), coming lower than consensus and our expectation (Bloomberg consensus: 1.6%; YBL estimate: 1.5%). On a sequential basis, seasonally adjusted momentum remained weaker than the usual momentum seen for the month of July, indicating some impact of GST-transition related disruption.
- ✓ Conforming to expectations, Aug CPI inflation rose to the highest level 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.
- ✓ India wholesale price index inflation recorded its first uptick in last 6 months in Jul-17 to 1.88%YoY from 0.90% in Jun-17, to beat market expectations by a fair margin (YBL: 1.29%, Bloomberg consensus: 1.40%). However, it did conform to our prognosis of Jun-17 inflation print being the trough in the current sequence of deflation, due to an adverse base now kicking-in.
- ✓ India's trade deficit reduced to USD11.4bn in July vs. USD 13.0bn in June, lower than our and consensus projections (YBL: USD12.5bn, Bloomberg consensus: USD12.0bn). Imports contracted at a faster pace relative to export on a sequential basis (Imports: -USD2.5bn, Exports: -USD1.0bn). The contraction in imports is due to non-oil non-gold led by pearls and precious stones, reflecting GST-related impact.




**PMIs: Manufacturing - Getting back to its feet;**
**Services - Continues in reverse gears**



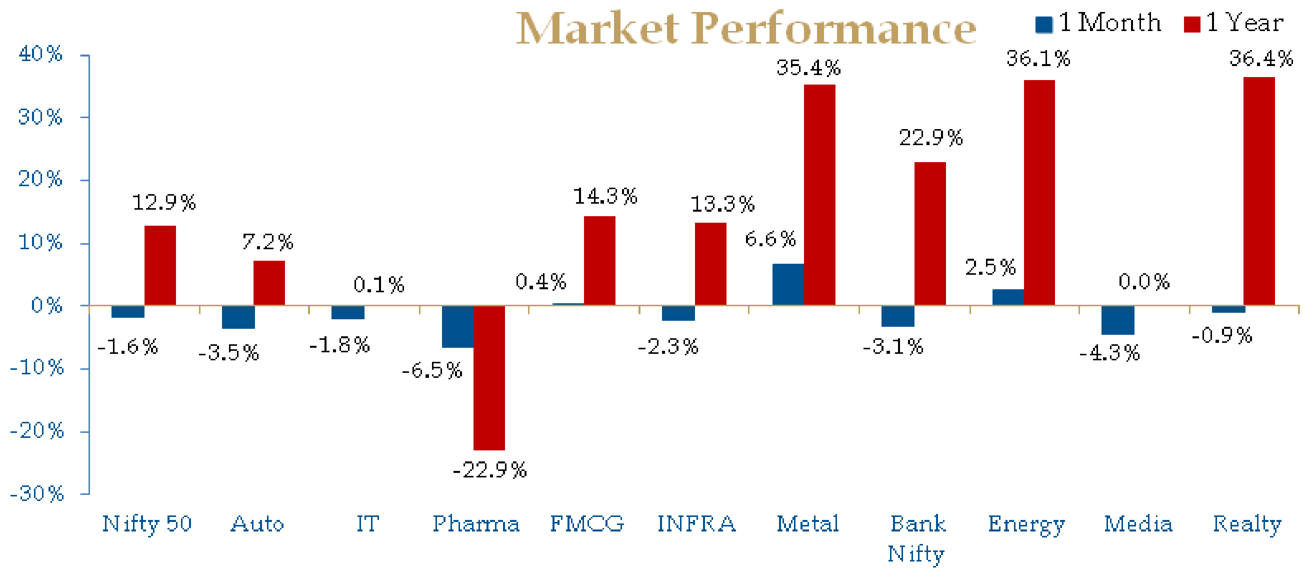

**India August CPI - Depleting comfort**

**We expect:**

- ✓ We revise down our FY18 estimate to 7.1% from 7.4% previously, due to weaker Q1 numbers, likely moderation in government expenditure and weaker export growth.
- ✓ We expect average FY18 CPI inflation at 3.5% in FY18 (vs. 4.5% in FY17), on the back of normal monsoon, minimal impact from GST, rupee appreciation and commodity prices providing comfort on imports.

## Equity Market Insights

- The Indian equity markets witnessed a bout of profit booking in the month of August. While the Nifty ended the month at 9,884, the Sensex closed at 31,646; down 1.9% and 2.7% respectively. The Nifty Free float Midcap 100 and the Nifty Free float Smallcap 100 indices were down by 1.6% and 1.9% respectively during the same period.
- During August, foreign investors withdrew USD 1.59 bn from the Indian equity markets and invested USD 2.19 bn into the debt markets taking the total tally to a net inflow of US$ 0.60 bn during the month. DII's were net buyers and ~ USD 2.56 bn during the same period.




**Factors to Watch**

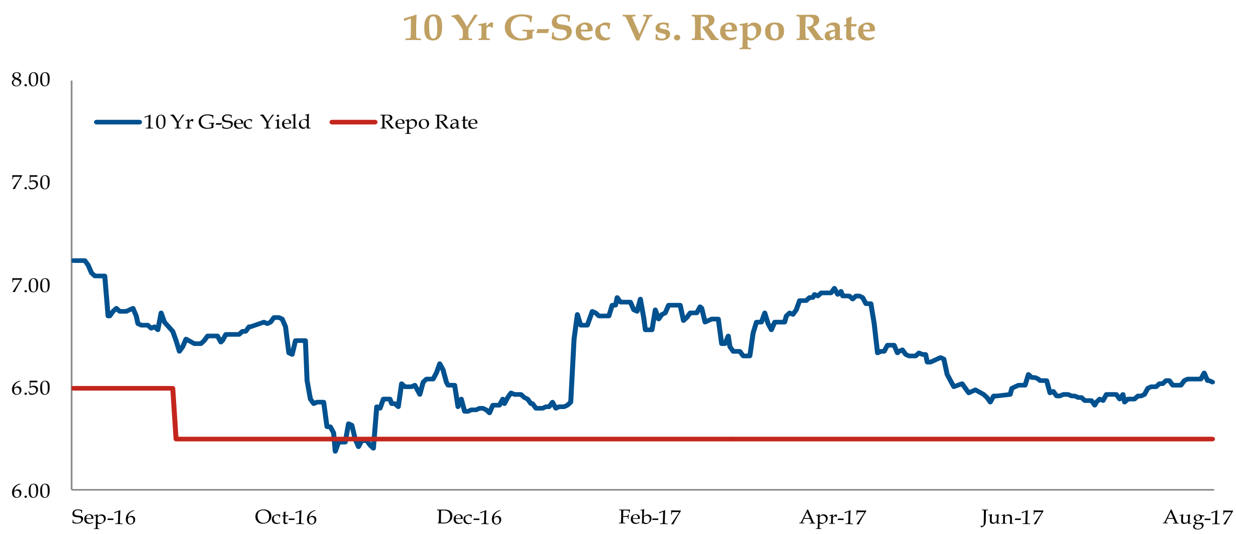
- Geopolitical developments particularly in the US and North Korea. Global investors would also be keeping a close watch on developments and policy announcements in US.
- Action in the primary markets: With a huge host of IPOs lined up in the coming months, we could see some part of the fund flows getting directed towards the primary markets thereby capping gains in the secondary markets.

**Outlook & Expectations**

- In terms of valuations, Sensex and Nifty are trading at a forward PE multiple of 20.9 x and 20.4 x 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.
- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.

## Debt Market Insights

- The RBI's Monetary Policy Committee published the minutes of its meeting held over Aug 1-2, 2017. This meeting was followed by the central bank's decision to cut repo rate by 25 bps to 6.00%. Notwithstanding some individual differences with respect to macroeconomic assessment and expectations, the overall tone appears neutral amidst ambiguity on durable price signals with respect to transient (monsoon related) and long lasting (GST, HRA, fiscal risks, etc.) factors. The MPC has once again reverted to neutral territory after sounding relatively hawkish in previous policy reviews in Feb-17 and Apr-17.
- The average systemic liquidity in the banking system reduced to a surplus of Rs. 2,765 bn in August vs. Rs. 3,017 bn in July.
- 10 yr G-sec yield during August rose to 6.50% from 6.48% in July. In September, yields have held around 6.50% level. FII inflows into debt reduced marginally to USD 2.4 bn in August from USD 2.9 bn in July.




**Outlook and Expectations**

- On the monetary policy front, we would monitor the September and October CPI prints, which will further provide clarity on the impact of 7th CPC (which can be seen as one-off) and also the expected monsoon support to food prices. Any favorable surprises to that front, especially with respect to deeper magnitude of food disinflation than anticipated would have a larger bearing on policy decisions. The space for reduction in repo rates is diminishing and if at all could potentially open up in Q3FY18 if inflation undershoots RBI's projected trajectory.
- 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**