How long will the optimism last?

The month of December ended on a positive note with optimism around US-China trade deal and Brexit. After nearly 18 months of trade spat between US and China, Phase One trade deal was agreed upon. The deal reduced US tariffs, implemented on September 1, on USD 120 bn of Chinese imports from 15% to 7.5%. It postponed tariffs on USD 16 bn of Chinese imports which were scheduled for December 15. However, 25% tariffs on USD 250 bn of Chinese goods were retained. China agreed to increase US agricultural imports by USD 32 bn over a two-year period with a target toward USD 50 bn annually. The signing of the Phase One trade deal is scheduled for January 15.

Amidst easing of trade tensions and Brexit uncertainty, the point in question remains if the market cheer will sustain during the year. While January remains a crucial month for Phase One trade deal and the Brexit from a global lens, both these events are now largely priced in by the market. The start of the Phase Two negotiations and US tariffs on USD 250 bn of Chinese imports continue to remain on a slippery turf ahead of US Presidential elections and amidst geopolitical concerns related to Hong Kong. Similarly, the trade negotiations with the EU is likely to be an eventful affair swinging the market during the period leading to the December 2020 deadline.

Notwithstanding the two major events, Middle East tensions have flared up yet again with US and Iran conflict coming to the fore. This along with the OPEC+ production cut of 500,000 bpd for Q1 2020 have started to show a meaningful impact on oil prices that managed to cross USD 70 pb level, first time since April-19.

On domestic data front, lead indicators for the months of November-December stand mixed vis-à-vis the previous month. As per the first advance estimate, India's FY20 GDP and GVA growth got pegged at 5.0% and 4.9% respectively. This officially corroborates the much talked about ongoing economic slowdown, which highlights a sequential deceleration in GDP growth momentum by 180 bps. As far as our outlook on growth is concerned, we continue to stick to our forecast of 4.9% for GDP growth in FY20 (like the official estimate) as we believe government spending might see some pruning due to substantial shortfall in tax revenue collection. Alongside, the soft data indicators for Q3 FY20 suggest further weakness in India's growth slowdown. Accordingly, we expect FY20 GDP growth to print 4.9%. We expect CPI inflation to average ~4.2% in FY20 after considering the delayed supply response in key food items and incorporating about 10 bps of average impact from the recent hike in telecom tariffs. Going forward, inflation is expected to average ~4.5% in FY21. Hence, we don't see much room for further rate cuts from the RBI at least until Sep-19.

Shubhada M. Rao
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Global Macro Developments

- The US Senate Finance Committee approved the US-Mexico-Canada Agreement, moving the revamped North American trade deal a step closer to a final Senate vote in the coming days or weeks.
- French Economy Minister Bruno Le Maire warned the US that if it decides to impose sanctions against the new digital tax service then France would retaliate.
- According to a survey conducted by BoE, British businesses in Dec-19 have turned less gloomy about Brexit's eventual impact even though they expect the uncertainty to persist for longer. The proportion expecting an eventual sales boost from Brexit rose to 17% from 13% in November, the highest since May 2018.
- The PBoC said that it will cut reserve requirement ratio (RRR) by 50 bps bringing down the level for big banks to 12.5% and 10.5% for smaller banks. The Central Bank has now cut RRR eight times since early 2018 to free up more funds for banks to lend as economic growth slows to the weakest pace in nearly 30 years.
- US President Donald Trump said that Phase 1 of trade deal with China would be signed on 15th Jan at the White House, though considerable confusion remains about the details of the agreement.
- Britain's MPs have backed Prime Minister Boris Johnson's plan for the UK to leave the EU on 31st January with a majority in the favour of the EU (Withdrawal Agreement) Bill which would ban an extension of the transition period beyond December 2020.
- The World Bank said its board adopted a new plan to aid China with USD 1-1.5 bn in low-interest loans annually through June 2025, despite the objections of US Treasury Secretary Steven Mnuchin and several US lawmakers

Events and Data Calendar

Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
US	11-Dec-2019	CPI YoY	Nov	2.00%	**2.10%**	1.80%	↑
	20-Dec-2019	GDP Annualized QoQ	3Q T	2.10%	2.10%	2.10%	→
UK	10-Dec-2019	Industrial Production YoY	Oct	-1.20%	-1.30%	-1.40%	↑
	18-Dec-2019	CPI YoY	Nov	1.40%	1.50%	1.50%	→
	20-Dec-2019	GDP YoY	3Q F	1.00%	1.10%	1.00%	↑
Japan	13-Dec-2019	Industrial Production YoY	Oct F	--	-0.08	-0.07	↓
	27-Dec-2019	Industrial Production YoY	Nov P	-8.10%	-8.10%	-7.70%	↓
China	31-Dec-2019	Manufacturing PMI	Dec	5010.00%	5020.00%	5020.00%	→

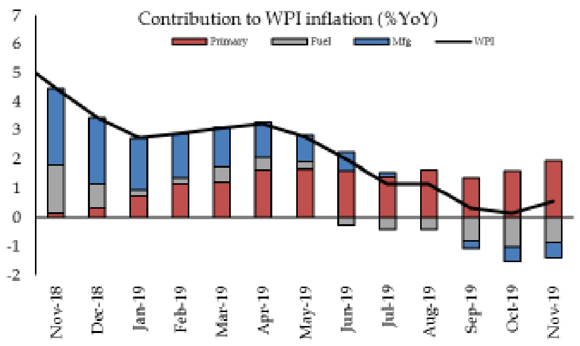
P* – Provisional Estimates F* - Final Estimates A* - Advanced Estimates T*- Third Estimates

COMMODITY

- Gold prices increased by 0.6% MoM in December vs. a contraction of 1.5% MoM in November due to increase in geopolitical tensions end of the month.

- Brent prices increased by 5.0% in December vs. an increase of 5.7% in November due to optimism over US-China trade deal

Domestic Market Macro Economics



India WPI Inflation

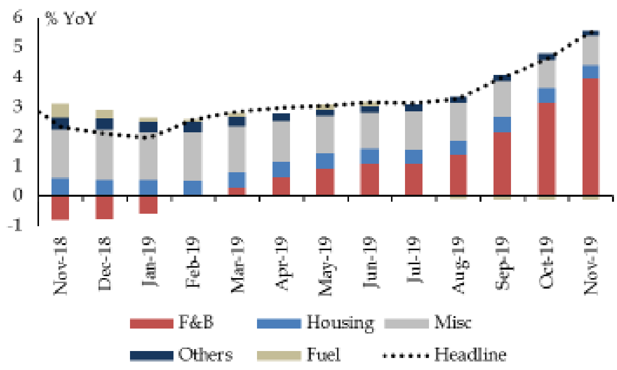
%YoY	Weights(%)	Jul-19	Aug-19	Sep-19	Oct-19
IIP	100	4.9	-1.4	-4.3	-3.8
Sectoral Classification					
Mining	14.4	4.9	0.0	-8.6	-8.0
Manufacturing	77.6	4.8	-1.6	-4.0	-2.1
Electricity	8.0	5.2	-0.9	-2.6	-12.2
Use Based Classification					
Primary goods	34.0	3.6	1.0	-5.2	-6.0
Capital goods	8.2	-7.0	-21.4	-20.3	-21.9
Intermediate goods	17.2	15.7	6.9	7.0	22.2
Infrastructure/ construction goods	12.3	2.9	-4.8	-6.8	-9.2
Consumer durables	12.8	-2.4	-9.1	-9.9	-18.0
Consumer non-durables	15.3	8.5	3.1	-0.4	-1.1

Sep IIP

- Softer expansion in manufacturing sector along with contraction in services sector pushed the composite PMI to over a two-year low level of 49.6 in October from 49.8 in the previous month.
- Growth in core sector contracted by a record low of 5.2%YoY in September from -0.5% in August with seven out of eight sectors posting a decline in the output.
- Auto sales in October continued to remain under pressure on annualized basis despite the onset of festive season due to overall weak market sentiment. On sequential basis, passenger vehicles and two wheelers sales showed marginal improvement while commercial sector continued to face headwinds.
- Gross GST revenues as a % of budget estimate (BE) eased to 42.5% compared to 49.6% a year ago because moderation in CGST and refunds under IGST
- India's retail inflation accelerated to a 16-month high of 4.62% YoY in Oct-19 from 3.99% in Sep-19. On sequential basis, CPI inflation increased by 0.96% MoM in Oct-19, the sharpest in the last 23-months. This is the first time in 15-months that headline CPI inflation breached the 4% target. The strong upward momentum was led by food prices vegetables (+8.8% MoM), Egg (+2.1% MoM), Fruits (+1.0% MoM), and Spices (+0.9% MoM).
- India's industrial production contracted sharply by 4.3% YoY in September, lowest in the series, from a downwardly revised print of -1.4% YoY recorded in August. On sequential basis, the headline index contracted by 2.3% after a contraction of 4.0% last month. The print is much below the average run rate of 1.1% seen in September over the last five years.
- Non-food credit growth in September decelerated to 8.1% YoY from 9.8% in August marking the second consecutive month of single digit growth since March 2018. The decline in non-food credit growth since the beginning of FY20 is led by deceleration in credit disbursal to industries and services sector

%YoY	Sep-19	Oct-19	Nov-19
Overall	-5.1	-5.8	-1.5
Coal	-20.5	-17.5	-2.5
Crude Oil	-5.3	-5.1	-6.0
Natural Gas	-4.9	-5.7	-6.4
Ref. Products	-6.6	0.3	3.1
Fertilizers	5.5	11.8	13.6
Steel	-1.5	-1.7	-3.7
Cement	-1.9	-7.7	4.1
Electricity	-2.6	-12.4	-5.7

CORE Sector –Recovers a tad



India CPI Inflation

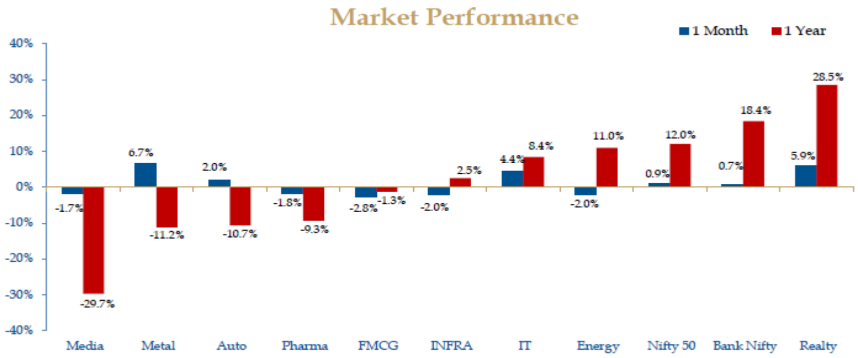
YES BANK

We expect:

- We continue to stick to our forecast of 4.9% for GDP growth in FY20 (like the official estimate) as we believe government spending might see some pruning due to substantial shortfall in tax revenue collection. Alongside, the soft data indicators for Q3 FY20 suggest further weakness in India's growth slowdown. Accordingly, we expect FY20 GDP growth to print 4.9%.
- Inflation is expected to average at 4.2% in FY20 after considering the delayed supply response in key food items and incorporating about 10 bps of average impact from the recent hike in telecom tariffs

Equity Market Insights

- Global markets ended the year on a strong note. MSCI World ended up 25.2% in 2019. Central banks' easing stoked the risk- on sentiments in the later part of 2019. All asset classes delivered positive returns in 2019. Within equities, the gain was led by developed markets where US market delivered nearly 29% returns.
- Indian markets delivered small gain in December as Sensex gained 1.1% M-o-M. The broad market underperformed in December. Foreign Portfolio Investors (FPIs) inflows continued for the fourth consecutive month with net inflows of US$1.1 bn in Indian equities.
- The current economic slowdown and the growth apprehensions must a large extent resulted in polarized equity markets with returns being concentrated in few index heavyweights. However, there are some early indicators of potential improvement like rise in Nikkei India Manufacturing PMI, GST collections crossing Rs. 1 tr mark for 2nd straight month, improving interest rate transmission etc. This along with Government policy support like Rs 102 lakh crore infrastructure drive, corporate tax rate cuts have created platform for a likely revival over the medium term



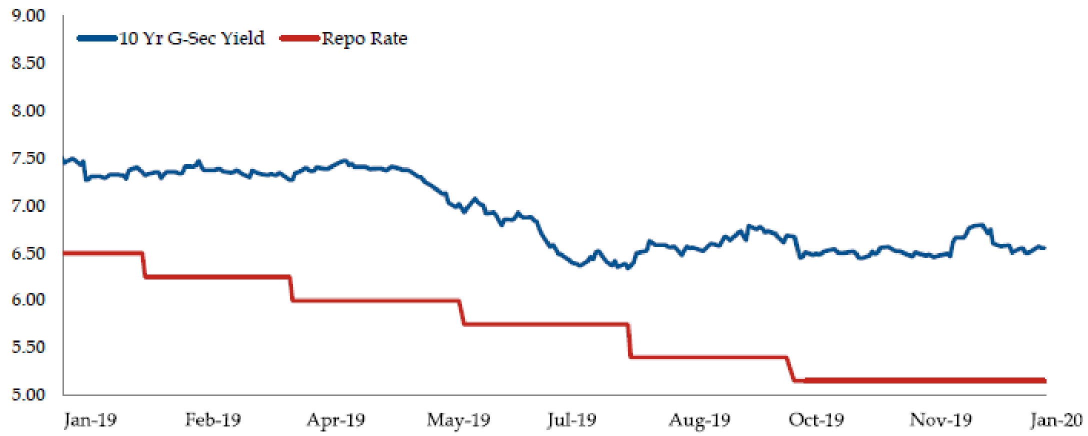
Outlook & Expectations

- We're in the final phase of consolidation for Indian equities. Mid-to-late 2020 or early 2021 will mark a fresh secular journey for Indian equities. Many headwinds should recede in the next 12-15 months. A gradual recovery in economic growth, so also an improved access to credit in the months to come, a pickup in bad asset resolution following the Essar Steel settlement, a bumper Rabi crop and swift government measures pertaining to ease of doing business, structural reforms and less government in business, would take shape.
- While scope for demand-side stimulus through fiscal policy is limited, measures from RBI to support growth, given the dire circumstances, cannot be ruled out. RBI has already engaged in 'operation twist', to buy long-dated paper, while selling short term securities, an exercise which has not been rupee neutral totally, so far. Further, once existing rate cuts are fully transitioned and with, holding of rates at low-to-mid levels, if core inflation is under control, would have a sizeable positive rub-off.
- Attractive earnings yield, lackluster alternate asset classes, our view on benign long-term oil prices and a supportive global risk-on trade are other positives for equities.
- As the key index inches upwards, allocation to large caps makes sense at this juncture. But we also note that consumption is in a cyclical downtrend now, the economy has slowed and liquidity issues remain. Therefore, we believe that a systematic withdrawal (SWP) approach is equally warranted. A staggered approach to investing would be a better one, given the present state of equities.

Debt Market Insights

- The average systemic liquidity maintained a surplus of INR 1,271 bn in September vs. a surplus of INR 1,408 bn in August
- The average 10yr G-sec bond yield widened to 6.67% in September from 6.50% in July with risks to fiscal emerging as the Finance Minister announced a quantum reset in India's corporate tax structure
- For FY20, we continue to expect inflation trajectory to remain benign with average annual inflation at 3.5%, marking the third consecutive year of undershooting vis-à-vis RBI's 4% target. With the current state of negative gap in both inflation and GDP, we continue to expect the MPC to opt for incremental monetary accommodation with another 25-40 bps scope for rate cuts in the remaining part of FY20, as the RBI remains watchful of incoming data along with the degree of anticipated revival in domestic growth momentum, global trade outlook, and movements in currency and commodity markets

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

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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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