PROSPERITY INSIGHTS

US dollar index losses ground in July; all eyes on India's GST implementation impact

At the global level, the month of July saw currency moves from the previous month getting reinforced as the DXY index continued to lose ground. July marked the fifth consecutive month of Dollar weakness; taking cumulative depreciation to ~8.5% since Mar-17 - a complete reversal of ~7.0% gains recorded last year around the US Presidential elections. However, the downside in Dollar has transpired despite broadly positive US economic data including Q2 GDP (2.6%YoY vs. 1.2% in Q1), housing starts (8.3%MoM in Jun), durable goods orders (6.5%MoM in Jun) and more than expected addition to Non-farm payrolls (at 209k in July).

The Federal Reserve acknowledging the healthy economic recovery underway, while decided to maintain status quo in July policy, did indicate that it expects to begin normalizing its balance sheet relatively soon. While the Fed Chair has indicated in recent speeches that further gradual tightening remains on anvil, markets remain skeptical so far (Dec-17 rate hike probability pegged at 42%) amidst persistent undershooting of inflation print vis-à-vis central bank's target. US July CPI inflation came lower than consensus expectations, resulting in two Fed members calling for a pause to assess inflation trajectory.

On the other hand, EUR led the major currencies advance against the USD, appreciating by close to 3.6% in Jul. The uptick in the common currency also found support in strengthening Euro zone growth and as ECB appears to be closer to deciding if the economy is strong enough to reduce its QE later in the year. Reinforcing the Euro zone recovery, IMF in its latest economic update, while retaining global growth forecast for 2017 and 2018 unchanged at 3.5% and 3.6% respectively, further upped Euro zone growth forecast for 2017 to 1.9%. In similar vein, GBP too strengthened last month, albeit to a lower extent by 1.5% as risks and uncertainties related to Brexit and sluggish economic growth continued to weigh on the currency sentiment.

Outside the G-10, key Asian currencies including INR also gained in the month, with the extent of appreciation varying between 0.3-2.3%, broadly mirroring the broad weakness in USD amidst better incoming data. INR recorded an appreciation of 0.6% after recording a mild depreciation in Jun. The support to commodity prices amidst lower USD also aided some of the commodity related currencies.

On the domestic front, incremental lead indicators released for the months of Jun-Jul were mixed, with some of the key indicators beginning to capture impact of GST implementation. Survey indicators of PMIs slumped into contraction zone in Jul-17, with the manufacturing index posting its steepest contraction since Feb-2009 and services activity index easing to its lowest level since Sep-13. IIP index contracted in June, the first negative print in the last four years, evidence of pervasive destocking across industries ahead of the implementation of GST, seemed to have weighed upon industrial activity in general.

On the monetary policy front, RBI cut the repo rate by 25 bps in its August monetary policy meeting, in line with consensus expectation. The decision was an explicit acknowledgment that upside risks to inflation had either reduced or not materialized to the extent expected, which, in combination with a negative output gap, warranted further policy easing. More importantly, the tone of the policy statement appeared more balanced, making future action data dependent. July CPI inflation moved towards a more normalized trajectory with a rise in food inflation and on-boarding of GST. We would prefer to monitor the August and September CPI prints, which will incorporate the impact of 7th CPC and also the expected monsoon support to food prices. Any surprises to that front would have a larger bearing on policy decisions. If any, the space for reduction in repo rates could potentially open up in Q3 FY18 if inflation undershoots RBI's projected trajectory.

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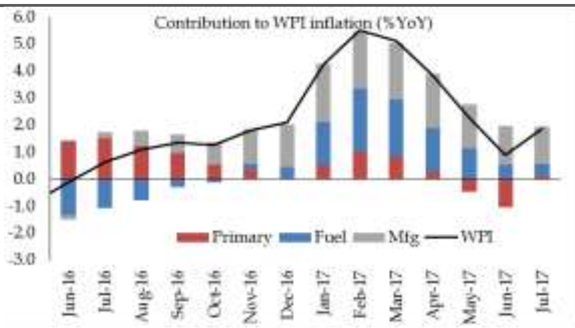
Domestic Market Macro Economics



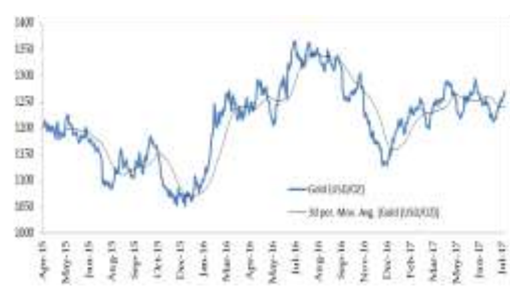
India July WPI: A lopsided increase

%YoY	Weights(%)	Mar-17	Apr-17	May-17	Apr-May	Apr-May
IIP	100	3.8%	2.8%	1.7%	7.3%	2.3%
Sectoral Classification						
Mining	14.4	10.3%	3.2%	-0.9%	6.2%	1.2%
Manufacturing	77.6	2.4%	2.3%	1.2%	7.1%	1.8%
Electricity	8.0	6.2%	5.4%	8.7%	10.3%	7.0%
Use Based Classification						
Primary goods	34.0	5.9%	3.1%	3.4%	8.6%	3.2%
Capital goods	8.2	9.6%	-2.9%	-3.9%	11.0%	-3.4%
Intermediate goods	17.2	2.8%	4.2%	0.7%	2.3%	2.4%
Infrastructure/construction goods	12.3	0.9%	5.2%	0.1%	4.1%	2.6%
Consumer durables	12.8	-3.9%	-5.4%	-4.5%	14.2%	-5.0%
Consumer non-durables	15.3	6.2%	8.4%	7.9%	6.3%	8.2%

May IIP: Anaemic industrial growth

- ✓ Monsoon ended the month of July with a cumulative surplus of 2% (deviation from LPA). Spatial distribution remained positive with 80% of country area receiving normal to excess rainfall on a cumulative basis. Sowing of Kharif crops as of end-July registered a 3.3% increase on YoY basis, likely to support softer food price momentum in the post harvest period post Sept-17
- ✓ Manufacturing activity, as seen from the NIKKEI PMI, contracted to an 8.5 year low of 47.9 in Jul-17 (from 50.9 in Jun) weighed down by the implementation of GST and slow-down in demand. New orders and output contracted for the first time in six months, registering the steepest decline since Feb-09.
- ✓ The headline IIP growth in June came at -0.1% on annualized basis. On FYTD basis, IIP growth is currently tracking 2.0% during Apr-Jun FY18, significantly weaker compared to 7.1% growth seen in Apr-Jun FY17. The contraction was led by the heavy weight manufacturing sector.
- ✓ Marking an end to the consecutive downtrend over the past three months, July CPI rebounded to 2.36% YoY, from a series-low in June. The print was significantly higher than our and consensus expectations (Bloomberg Consensus: 2.05%, YBL: 1.78%), as underlying monthly inflationary momentum rose sharply- to the highest since July 2014- nearly thrice of the previous month.
- ✓ 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 our and 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 - slips to lowest level since 2009 on GST related uncertainties; Services - Reversal in expansion trend



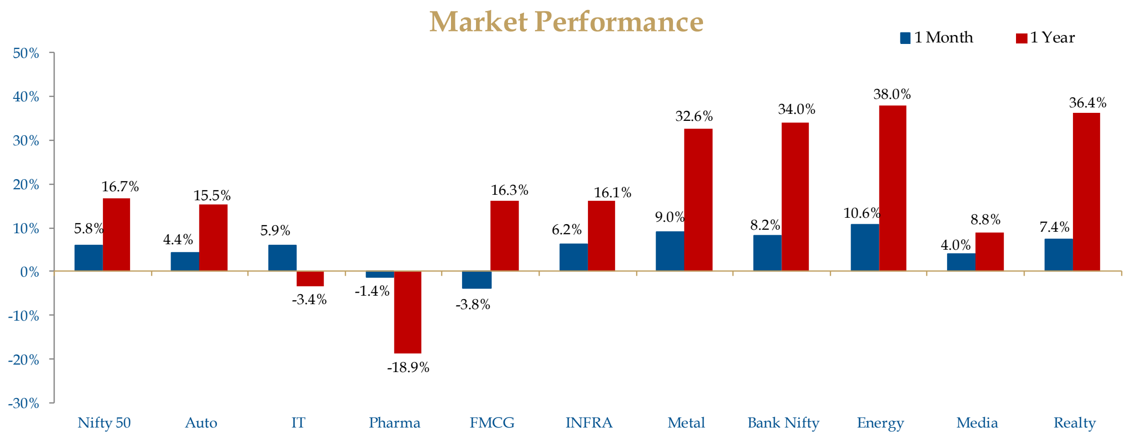
Gold Price Movement (USD/OZ)

We expect:

- ✓ We expect FY18 GDP growth at 7.4% (vs. 7.1% in FY17), with growth supported by consumption, public sector led capex cycle and export growth.
- ✓ We revise down our USDINR forecast to reflect lower global and domestic risks (12-month forecast range: 63.5-65.5; Previous: 64.0-66.5). However, the likelihood of a sharp downside remains limited

Equity Market Insights

- The Indian equity markets rallied to hit highs in the month of July. While the Nifty ended the month of July at 10,077, the Sensex closed at 32,515; up 5.8% and 5.2% respectively. The Nifty Free float Midcap 100 and the Nifty Free float Small cap 100 indices were up by 4.4% and 6.7% respectively during the same period.
- During July, foreign investors invested US$ 0.88 bn into the Indian equity markets and invested US$ 2.89 bn into the debt markets taking the total tally to a net inflow of US$ 3.78 bn during the month. DII's were net buyers and ~ $0.74bn during the same period.



Factors to Watch

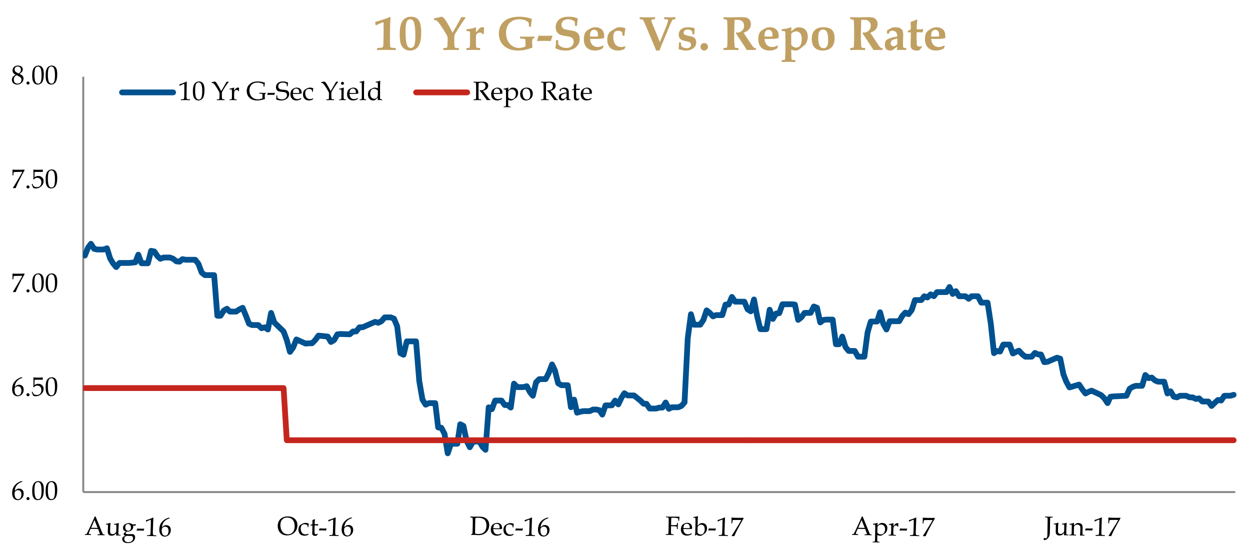
- Result announcements: The June quarter results announced so far have largely met expectations and in some cases has even beaten expectations. The IT pack was a disappointing in terms of the management commentaries which continued to be cautious with regards to the deal pipelines and demand environment. However commentaries from the other sectors were more positive. For the balance part of the results, we believe that the export oriented sectors- IT and Pharma – are expected to be negatively impacted by the persisting structural issues and currency movements. However, it is expected that sectors like housing finance, cement, etc. that are directly or indirectly linked with affordable housing should post better numbers.
- Geopolitical developments particularly in the Euro zone and UK. Global investors would also be keeping a close watch on developments and policy announcements in US

Outlook & Expectations

- In terms of valuations, the Sensex and Nifty are trading at a forward PE multiple of 19.6x and 18.1x 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.
- 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 average systemic liquidity in the banking system reduced to a surplus of Rs 3017bn in July vs. Rs 3132bn in June.
- In line with market expectations, the RBI cut the repo rate by 25 bps in its August monetary policy meeting. The decision was an explicit acknowledgment that upside risks to inflation had either reduced or not materialized to the extent expected, which, in combination with a negative output gap, warranted further policy easing.
- More importantly, the tone of the policy statement appeared more balanced, making future action data dependent. We concur with the RBI stance, agreeing that monetary policy decision can be kept open-ended at this juncture, basis the play-out of incoming inflation prints..
- Average 10yr yield during July reduced to 6.48% vs. 6.52% in June. In August yields have held around the 6.47% level post the RBI meeting, when the central bank cut policy rates by 25bps.



Outlook and Expectations

- 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 imported inflation.
- On the monetary policy front, we would monitor the August and September CPI prints, which will incorporate the impact of 7th CPC and also the expected monsoon support to food prices. Any surprises to that front would have a larger bearing on policy decisions. If any, the space for reduction in repo rates could potentially open up in Q3 FY18 if inflation undershoots RBI's projected trajectory.
- We expect the 10Y g-sec yield to trade in the range 6.40-6.90% over the remaining months of 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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