PROSPERITY INSIGHTS

Global growth on an upswing; India's Ease of Doing Business ranking improves

The month of October was marked by continued improvement in growth momentum across major advanced economies. In US, macro data continued to be largely positive with upbeat ADP nonfarm private employment jobs (235K; Sep: 110K), increase in ISM manufacturing and robust Q3 GDP at 3.0%. Similarly, economic data from Eurozone was also robust. PMI manufacturing and economic sentiment rose to multiyear high and Q3 GDP expanded at a faster pace, rising by 2.5%YoY. In addition, inflation and unemployment slowed to 1.4%YoY and 8.9%YoY respectively. Likewise, UK's GDP growth for Q3 was reported at 1.5%YoY, higher than the market estimates of 1.4%YoY. In a validation of strengthening global recovery, IMF in its latest World Economic Outlook upgraded its global growth forecast for 2017 to 3.6%YoY, up from 3.5% earlier.

In addition to synchronized improvement in growth, the global economy also witnessed beginning of the convergence of monetary policies. Among the advanced economies, joining the bandwagon, the Bank of England hiked its rates by 25 bps to 0.5% (with a 7-2 vote) for the first time in a decade, while signaling at least two more 25 bps hikes by 2020. While Fed kept policy rates on hold in November, it indicated expectations of inflation to stabilize around 2% target in the medium term, amidst solid economic activity and strengthening labor market conditions. Fed remains on course to affect the widely anticipated 25 bps hike in Dec, probability of which currently stands at 92%.

On the domestic front, most incremental lead indicators released over the months of Sep-Oct fared better, indicating continued normalisation of macro conditions post GST onset. Both PMI manufacturing and services indices remained in expansion zone in Oct-17, with the former easing to its 3-month low level while the latter rose to a 3-month high. Meanwhile, core sector growth continued to improve in Sep, non-food credit growth improved to a 5-month high at 6.1%YoY in Sep vs. 5.5% in Aug. Meanwhile auto sales normalized in Oct-17 as increase in cess had led to pre-buying ahead of the festive season demand.

Adding to the positive news on the macro front, World Bank announced an improvement in India's position by 30 notches to a rank of 100 for the first time on its Ease of Doing Business parameters. Significant traction on the sub-indices of - resolving insolvency, paying taxes, protecting minority investors, getting credit and enforcing contracts parameter led the improvement. However, GST, India's largest tax reform, which was implemented post June-17 - i.e. after the cut-off period for this year's ranking consideration, is likely to propel India's rank higher up in the coming year, with consolidation of indirect taxes.

A key domestic development is the government's INR 2.1tn PSU bank recapitalization plan spread over FY18-FY19 was announced in Oct. The recap will be mainly funded through recapitalization bonds worth INR 1.35tn, the remaining amount funded through market issuances and on-budget expenditure. While the detail modalities of the bond issuances are yet to be released, we don't expect it to impact FY18 central fiscal deficit as the on-budget allocation under the Indradhanush plan remains unchanged. We expect this step to be supportive to the capex recovery in the medium-term by addressing balance sheet issues.

We remain optimistic on growth outlook with the recent uptick in lead indicators reinforcing our expectation of recovery in growth in H2 FY18, aided by a favorable base. Key growth factors in H2 are continued recovery in consumption aided by 7th Pay Commission allowances by Centre and awards by select states amidst rising real incomes and support from exports amidst an improving global environment.

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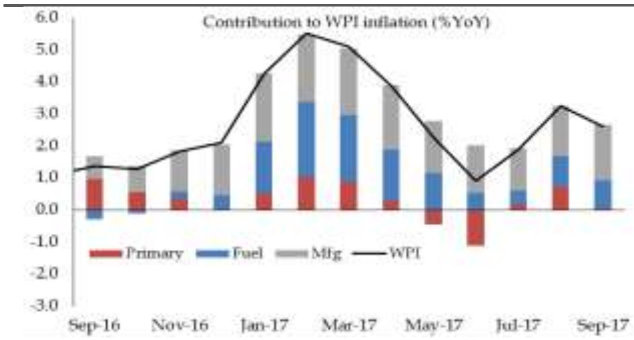
Domestic Market Macro Economics

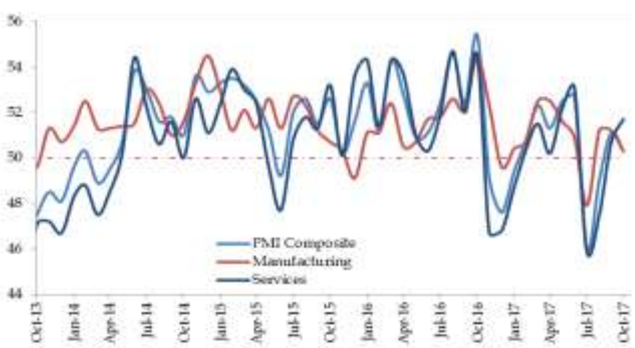


India September WPI: The Fourth Cheer!

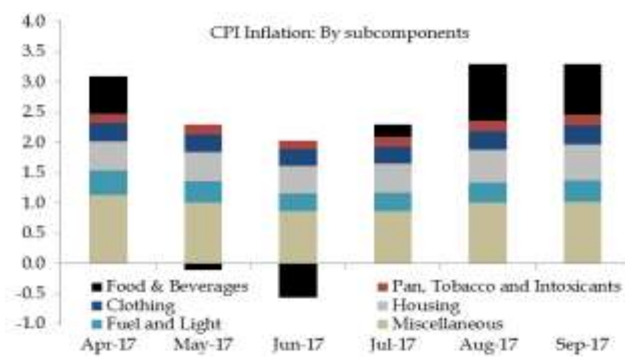
%YoY	Weights(%)	Jun-17	Jul-17	Aug-17	Apr-Aug FY17	Apr-Aug FY18
IIP	100	-0.2	0.9	4.3	6	2.2
Sectoral Classification						
Mining	14.4	0.4	4.5	9.4	3.9	3.3
Manufacturing	77.6	-0.5	-0.3	3.1	6.2	1.6
Electricity	8	2.1	6.6	8.3	6.7	6.1
Use Based Classification						
Primary goods	34	-0.2	2.2	7.1	5.6	3.1
Capital 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%), significantly higher than consensus and our expectation (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 schedule as supply chains resume restocking post GST and after two months of inventory liquidation.
- ✓ PMI for the manufacturing sector remained in the expansion zone for the third consecutive month in Oct-17 coming in at 50.3, albeit lower than previous month's reading (51.1); suggesting that manufacturing activity is yet to recover fully from GST related disruptions.
- ✓ Performance of core sector continued to improve in Sep-17, best so far this fiscal year, as aggregate growth of 8 sub-industries surged to 5.2%YoY compared to 4.4% in Aug-17. Focusing on Sep-17, growth in all sub-industries barring fertilizer was positive. Robust expansion was recorded in coal sector output, electricity, and natural gas and refinery products.
- ✓ Growth of non-food credit surged to a 5-month high of 6.1%YoY in Sep-17 from 5.5% in previous month, driven by a strong monthly expansion in credit ahead of the festive season.
- ✓ India's monthly trade deficit narrowed significantly to USD 9.0 bn in September (vs. USD 11.6bn in August) a seven month low, positively surprising us and consensus (YBL: USD11.0bn, Bloomberg consensus: USD11.7bn). The sharp sequential reduction in trade deficit was driven by USD 4.8 bn jump in exports, which is the largest sequential rise in three and half years, representing normalization of supply chains post the transient GST-related disruption.
- ✓ Replicating the downside in retail prices, WPI inflation for September eased to 2.60% YoY from 3.24% in August. On a sequential basis, the headline index printed at 0.44% MoM, the first contraction in 3 months and the sharpest since Aug-16 led by contraction in food prices.



PMIs: Manufacturing - Eases in Oct; Services - Remains in Expansion



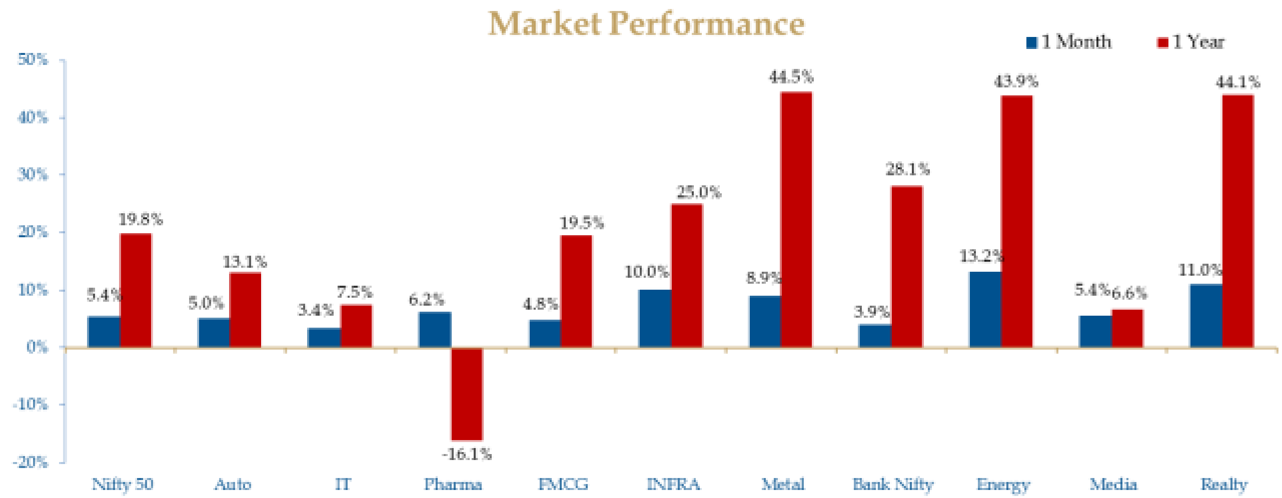
India September CPI - Unchanged CPI inflation masks favorable changes

We expect:

- ✓ We estimate FY18 GDP growth at 6.8%, with growth conditions expected to pick-up in 2H, supported by consumption growth and normalization of growth conditions.
- ✓ We expect average inflation to moderate to 3.5% in FY18 (4.5% in FY17) driven by moderate food prices, benign commodity/exchange rate outlook and excess capacity

Equity Market Insights

- Indian equity markets ended October on a strong note with the Nifty closing at 10,335.3, while Sensex closed at 33,213.33; up 5.4% and 6.2% MoM, respectively. The Nifty Freefloat Midcap 100 and the Nifty Freefloat Smallcap 100 indices were up by 8.1% and 12.7% MoM, respectively.
- During October, foreign investors were net buyers in the equity markets, buying US$ 0.3 bn into the markets. However they invested US$ 2.7 bn into the debt markets taking the total tally to a net inflow of US$ 3 bn during the month. DII's were net buyers of ~ $5.9bn during the same period.



Factors to Watch

- The surge in oil prices off late remained on the radar of investors. Comments and change in projections by the major oil producing nations should keep this commodity volatile in the short to medium term.
- Action in the primary markets: With a 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 secondary market.
- Quarterly earnings season: The earning season is likely to remain tepid with some sectors like energy, retail focused NBFCs and auto 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 and traction during the festive season

Outlook & Expectations

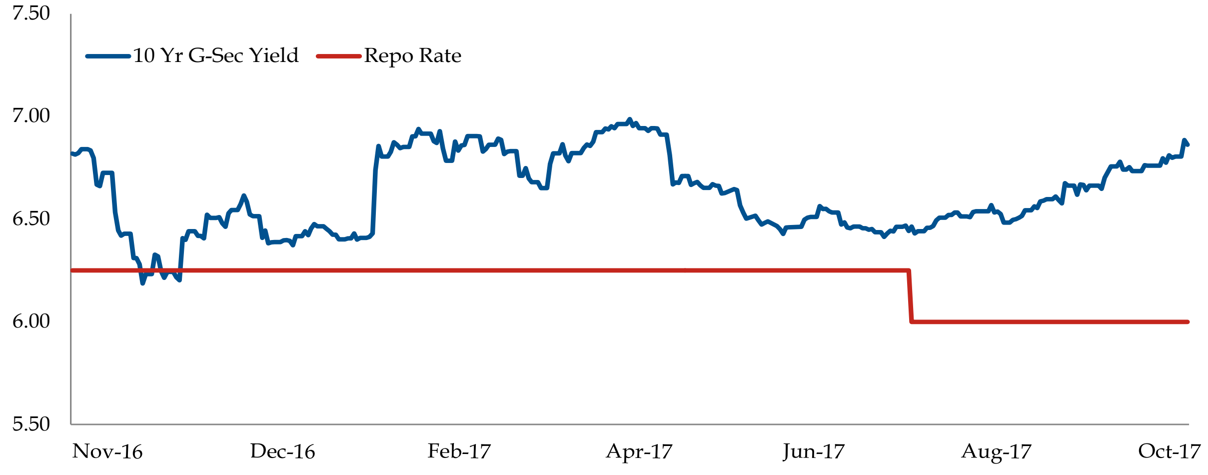
- In terms of valuations, Sensex and Nifty are trading at a 1 year forward PE multiple of ~21 x respectively, which is a tad bit stretched as compared to historical valuations. Given the elevated valuations of the benchmark indices, we do believe that the current environment is not for one to expect broad based returns. And thus, it becomes imperative for investors to take up a bottom up approach i.e. invest in a stock specific manner.
- With strong inflows coming in from domestic investors, the markets are flush with liquidity. However, companies with poor fundamentals trading at valuations that they do not deserve will be the first ones to see sharp correction when their earnings do not justify the multiples they are commanding.
- While we do expect fundamentals to get better 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. We do think that markets would continue to trend upwards over the long term, however there could be some aberrations due to global and other uncertain events. But as seen earlier too, the Indian markets are quick to recover during such times as the domestic growth story remains intact.

- In terms of sectors, we remain positive on infrastructure (given the Government's focus towards the same), sectors linked to affordable housing, and consumption led sectors. We thus recommend investments in quality names in these spaces. We also like select names from the auto and auto ancillary sectors. The consumer durables sector is also an interesting space, particularly those companies which have a long runway of growth (due to lower penetration levels) and are slated to benefit from the lower share of the organized market (effect of GST implementation).
- We recommend equity investments through a STP 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 1401 bn in October vs. Rs 2236 bn in September, on the back on increased festival related demand for cash.
- Average 10 yr G-sec bond yield during October rose to 6.77% vs. 6.59% in September. Yields have been trading higher post the announcement of the bank recapitalization bonds and the pick-up in crude oil prices, averaging at 6.88% (Oct 25 to till date). FII inflows into debt rose to USD 2.8 bn in Oct vs. USD 0.2 bn in September.
- 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) 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.
- India's headline CPI inflation remained unchanged at 3.28% YoY in September (August print revised lower to 3.28% from 3.36% reported earlier). On a sequential basis, the headline index printed at -0.15% MoM, the first contraction in 8-months. While the annualized rate of core-core (CPI ex food, fuel, and jewellery related items) inflation inched higher to 4.59%, the sequential momentum moderated to 0.50% MoM in September compared to the average momentum of 0.73% MoM seen during Jul-Aug 2017.

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- We estimate FY18 GDP growth at 6.8%, with growth conditions expected to pick-up in 2H, supported by consumption growth and normalization of growth conditions.
- We expect average inflation to moderate to 3.5% in FY18 (4.5% in FY17) driven by moderate food prices, benign commodity/exchange rate outlook and excess capacity.
- 10 yr G-sec bond yields have been trading higher post the announcement of the bank recapitalization bonds and the pick-up in crude oil prices, averaging at 6.88%. As a result we see upside risk to the upper-end of our trading range of 6.40%-6.90% for the remainder 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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