PROSPERITY INSIGHTS

Monetary policy takes center stage; Global growth conditions continue to improve

The month of March-17 will be dominated by monetary policy with meetings of European Central Bank (ECB), US Federal Reserve (US Fed), Bank of Japan (BoJ) and Bank of England (BoE). The markets are penciling-in a 25bps hike in US Fed March policy, while BoJ, ECB and BoE are expected to remain on hold. The Fed rate hike is driven by broad-based pick-up in growth indicators, continuing improvement in labour market, pick-up in inflation levels and hawkish statements made by Fed officials. Broad-based pick-up seen in high frequency growth indicators such as ISM manufacturing index, factory orders and retail sales. Consistent labour market improvement indicated by initial jobless claims and nonfarm payrolls. On the inflation front, US core Personal Consumption Expenditure (PCE) inflation has risen gradually to 1.7%YoY from the 2015 low of 1.3%YoY, remaining below the Fed's target rate of 2%.

Growth conditions in other developed markets have also improved with Eurozone manufacturing PMI at 70 month high and Japan at 35 month high. However, both BoJ and ECB are expected to remain on hold due to lack of broad-based pick-up in inflation. Meanwhile, UK has seen a broad-based pick-up in inflation rising to 1.8% in Jan-17, a 31 month high. The BoE expects headline inflation to overshoot 2% target levels in 2017, at 2.7% in Q1 2018. However, monetary policy is expected to remain on hold due to moderation in pay growth and higher import prices negatively impacting real consumer expenditure. Uncertainty surrounding Brexit is also expected to impact growth momentum in 2017.

On the fiscal policy front the market got some indications regarding the fiscal policy under the new Trump administration. The US government will be allocating USD 1trn to infrastructure investment, reducing corporate tax rates and provide tax relief for the middle class.

Among Emerging Markets, growth conditions in China are expected to moderate with the government setting the target for 2017 GDP growth at 6.5% vs. 6.7% in 2016, as it focuses on rebalancing its economy from export-led to consumption-led. China is a major commodity importer and slower growth target could have a dampening impact on commodity prices which have started to rebound post the prolonged period of contraction.

In India, Q3FY17 GDP growth surprised significantly on the upside despite the quarter bearing the impact of currency swap (7.0%YoY vs. consensus 6.1%). For the month of Jan-Feb 2017 high frequency growth indicators continue to show nascent signs of recovery across sectors. Manufacturing PMI rose in Feb-17 (50.7 vs. 50.4 in Jan-17) with a pick-up in new orders, services PMI indicated positive growth for the first time after three months (Feb-17: 50.3 vs. 48.7 in Jan-17), car sales and two wheeler sales have rebounded.

In the coming fiscal year of FY18, we expect India's GDP growth to accelerate to 7.3% versus 6.7% in FY17, with recovery in growth led by consumption and followed by public sector led capex. Consumption is expected to be supported by 7th Central Pay Commission (CPC) payouts, lower interest rates and recovery in rural areas. Active participation from private sector in the capex cycle is unlikely to be forthcoming amidst presence of unutilized capacity and incomplete corporate sector deleveraging cycle. Inflation is expected to be on the uptick as support from ultra-low commodity and crude oil prices wanes. As a consequence we expect RBI to remain on a prolonged pause through FY18 as it focuses on achieving the 4% inflation target by Mar-19. Macro stability indicators are expected to remain in check with ongoing fiscal consolidation and current account deficit remaining within comfort range.

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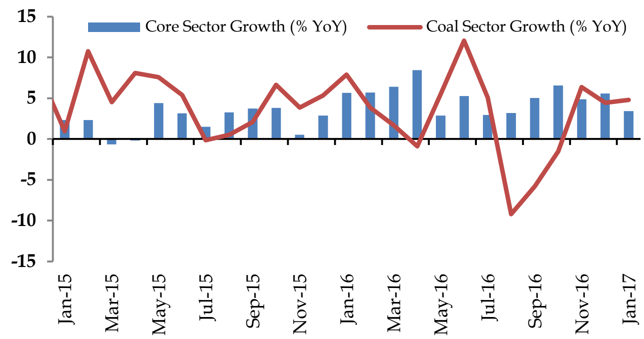
Domestic Market Macro Economics

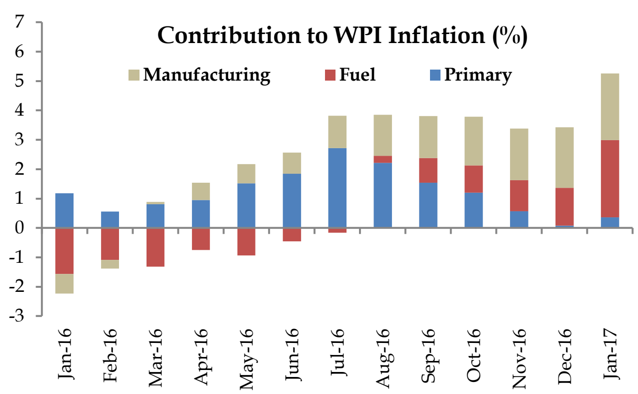
Snapshot of IIP Trend (% YoY)	Weight (%)	Oct-16	Nov-16	Dec-16	Apr-Dec FY16	Apr-Dec FY17
IIP	**100**	**-0.9**	**5.7**	**-0.4**	**3.2**	**0.3**
Sectoral Classification						
Mining	14.2	2.8	3.7	5.2	2.3	0.9
Manufacturing	75.5	-1.9	5.5	-2	3.2	-0.5
Electricity	10.3	3.2	8.9	6.3	4.5	5.1
Use Based Classification						
Basic	45.7	0.7	4.7	5.3	3.5	4.3
Capital	8.8	-18.6	15	-3	1.9	-17.3
Intermediate	15.7	1.5	2.6	-1.2	2	2.8
Consumer	29.8	3.2	5.2	-6.8	4	0.6
Durables	*8.5*	16.6	9.4	-10.3	*12.3*	*5*
Non-Durables	*21.3*	-2.7	2.5	-5	*-0.9*	*-2.3*

December IIP: Ends 2016 with a somber print

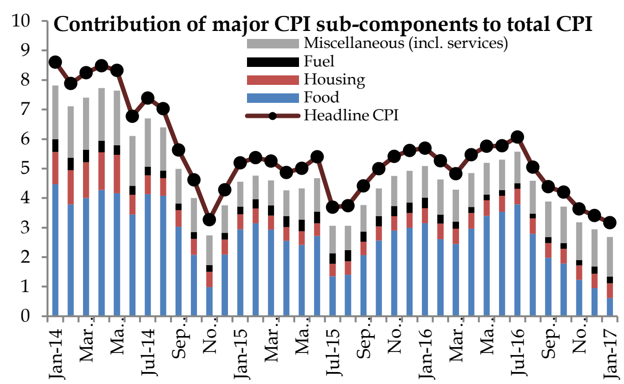


Core Growth slows to a 5-month low

- India's Manufacturing activity continued to remain in the expansion zone (at 50.7; Jan-17: 50.4) driven by rise in the new orders in Feb-17, indicating sector's recovery from Dec-16 downturn post 'currency swap'. Demand from both domestic and external markets improved.
- After contracting for three consecutive months, India Services PMI posted positive growth in Feb-17 (50.3; Jan-17: 48.7), reflecting recovery from the demonetization related disruptions.
- Growth of Non-food credit continued to decelerate further to a fresh low of 3.5%YoY in Jan-17 compared to 4.0% in Dec-16 and 9.8% in Jan-16 a year ago. Among the sub-sectors, the slowdown was led by heavy-weights of industry and personal loans (accounting for ~60% of overall credit).
- The combined growth of 8 core sector industries in Jan-17 slowed to 3.4%YoY from 5.6% in Dec-16. Weighing on headline growth was output of cement, refinery and fertilizers sectors – all of which recorded a contraction in Jan-17.
- India's industrial production, as measured by the IIP posted a contraction of 0.4% YoY in Dec-16 vis-à-vis a relatively robust expansion of 5.7% seen in Nov-16. While the headline index jumped by 4.4% MoM, it was feeble compared to the average sequential increase of 8.9% usually seen in the month of December. In fact, this is the lowest monthly increase observed during the month of December in the last 11-years



Jan-17 WPI: Above expectations, though in-line with global prices



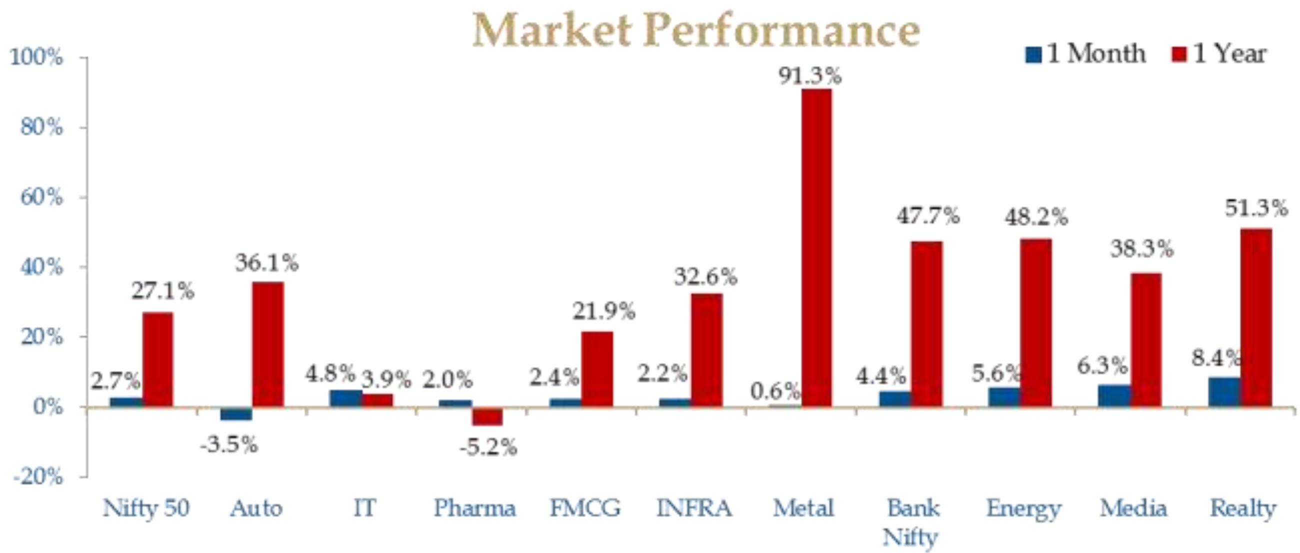
India Jan-17 CPI Inflation - Eases to an all-time low

We expect:

- We expect FY18 GDP growth at 7.3% versus 6.7% in FY17, with recovery in growth led by consumption and followed by public sector led capex. Post currency swap, growth conditions are expected to normalize from Q1FY18 onwards.
- We expect average FY18 CPI inflation at 5.2% in FY18 (vs. 4.6% in FY17), pick-up led by rise in commodity prices, 7th CPC allowances and slight impact due to GST.
- We see downside risks to our USDINR forecasts (70 by end-FY18), due to change in RBI monetary policy stance and the likelihood of limited USD gains. Nevertheless, we continue to forecast gradual depreciation for the pair going into FY18.

Equity Market Insights

- Indian markets ended the month of Feb-17 on a positive note. BSE Sensex closed at 28,743 while the Nifty closed at 8,879; up 3.9% and 3.7% respectively. Both midcaps as well as small caps outperformed with the Nifty Free Float Midcap 100 Index moving up by 6.9% while the Nifty Free Float Small cap 100 Index was down 6.4% during the month.
- During Feb-17, foreign investors invested USD 1.41bn in the Indian equity markets and USD 0.86bn into the debt markets taking the total tally to a net inflow of USD 2.27bn during the month. DII's were net buyers and ~ USD 0.14bn during the same period.



Factors to Watch

- Geopolitical developments particularly in the Eurozone and UK. Global investors would also be keeping a close watch on developments and policy announcements in US.
- Trajectory of interest rates in US.
- Progress on GST in India.

Outlook & Expectations

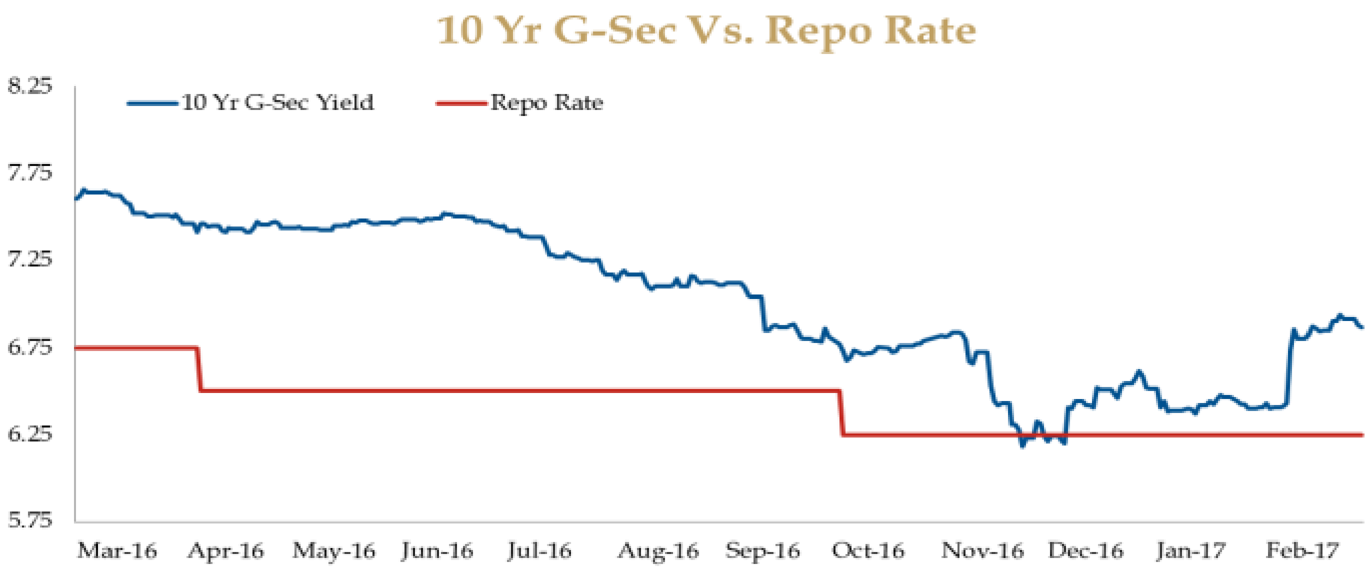
- Sensex and Nifty are trading a forward PE multiple of 20.3 x and 20.5 x respectively which is a tad stretched as compared to the historic valuations. As such, we believe that market momentum could continue in the near term on the back of revival in FII flows as well as continued interest from the DIIs.
- We believe that it is just a matter of time before the reforms and structural steps introduced by the Government start yielding results which in turn would help the laggard indicators to turn around and support growth both for the economy and consequently for the corporate earnings.
- The driver for long term would be a recovery in the earnings which in turn would depend on recovery in the economy which in turn is expected to be driven by higher consumption deriving from 7th Pay Commission payouts, lower interest rates and recovery in rural areas owing to better farm output. If we factor in a recovery in earnings growth (for reasons highlighted above) and continued momentum into FY18, valuations do not look expensive from a long term perspective.
- In terms of sectors, we remain positive on autos and auto ancillaries given that they enjoy a multiplier effect to economic growth; infrastructure and capital goods given the Government's focus in that area and agri stocks which would see a growth in demand on the back of good monsoons.
- 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 increased to a surplus of INR 4,036bn in Feb-17 from a surplus of INR 2,017bn in Jan-17 as banks continue to park excess funds at the reverse repo window. Demonetization has resulted in rise in a surge of deposits in the banking system.
- Average 10yr yield during Feb-17 increased to 6.7% from 6.4% in Jan-17 due to change in stance of RBI to neutral from accommodative.
- India's Wholesale Price Inflation (WPI) jumped to 5.25% YoY in Jan-17 (Dec-16: 3.39%), surprising significantly on the upside. Sequentially, WPI rose by 0.98% MoM (Jan-17: -0.16%), led by a sharp pickup in fuel and manufactured prices, and slower deflation in food prices.
- India's CPI Inflation eased in line with expectations in Jan-17 to a series low of 3.17%YoY from 3.41% in Dec-16. Food prices continued to contract in Jan-17 by 0.75%MoM, marking fifth month of correction in the previous six months. Core-inflation (i.e. stripping out volatile items of food and fuel from the headline index), a proxy for demand side inflation, rose above 5% level after a hiatus of 27 months.
- Fiscal deficit for Apr-Jan17 surpassed the RE (105.6% of RE), driven by lower revenue receipts, mainly on non-tax revenue (58% of RE) due to shortfall in spectrum auction, and step up in revenue expenditure (82% of RE). On the tax revenue front, the gross tax revenue stood at 17.7% YoY versus 21.3% last year corresponding period. Tepid pace of growth in collections from corporate tax, customs and lower collection from excise and services vis-à-vis last year led to slower growth in gross tax revenue. Income tax increased to 19.7% YoY in Apr-Jan 17 vis-à-vis 12.6% during Apr-Jan16.

Outlook and Expectations

- We expect average FY18 CPI inflation at 5.2% in FY18 (vs. 4.6% in FY17), pick-up led by rise in commodity prices, 7th CPC allowances and slight impact due to GST.
- We expect monetary policy to remain on a prolonged pause (through FY18) so as to work towards achieving the 4% inflation target by Mar-19.
- We expect 10Y g-sec yield to trade in the range 6.70-7.20% in 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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