PROSPERITY INSIGHTS

Global headwinds exacerbating; Domestic fundamentals to support

The month of June was marked by heightened turbulence in global financial markets on account of one of the most closely awaited global risk events for 2016 i.e. UK's referendum to decide to remain or part with the European Union. With UK opting to vote out of the EU as opposed to market expectations of remain; political and economic disorder ensued.

While increased concerns about global economic recovery have dominated the global risk sentiment since the start of 2016, the Brexit vote has amplified these concerns. IMF has recognized that Brexit would have negative repercussions that would spread beyond the UK and EU. The risks are expected to arise mainly from macroeconomic and financial market impact of a sizable increase in uncertainty, especially about the future relationship between the UK and EU; which is expected to dampen near term global growth prospects. The tepid June global PMI readings suggest that the weak onset to the year has penetrated well into the second quarter, which is expected to only worsen as markets digest the impact of Brexit.

Meanwhile on the domestic front, the incremental lead indictors reflect a continued uneven improvement in growth. Data indicated resilience in domestic consumption demand with personal loans continuing to outperform, strong auto sales numbers for June with manufacturing PMI at a three month high; led by an uptick in consumer goods segment. However, on the downside, stagnation in June PMI services and moderation in core sector output to a four month low in conjunction with tepid credit growth to industrial sector poses a cause of concern.

Going forward, India's economic recovery is expected to gain traction as benign inflation, increase in disposable incomes following 7th CPC outgoes on higher pays and pension, an above-normal monsoon and continued monetary policy accommodation are expected to engender both urban and rural demand, along with a gradual uptick in investment trajectory. As such, we expect recovery to gain a more sustained character and FY17 GVA growth to improve to 7.8% from 7.2% in FY16.

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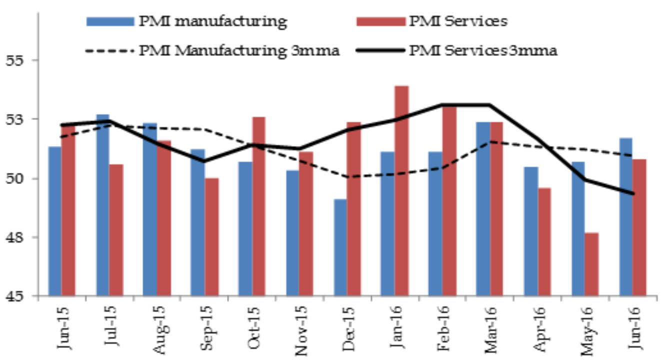
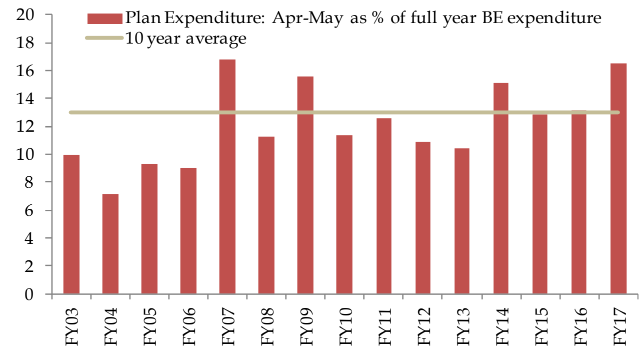
Domestic Market Macro Economics



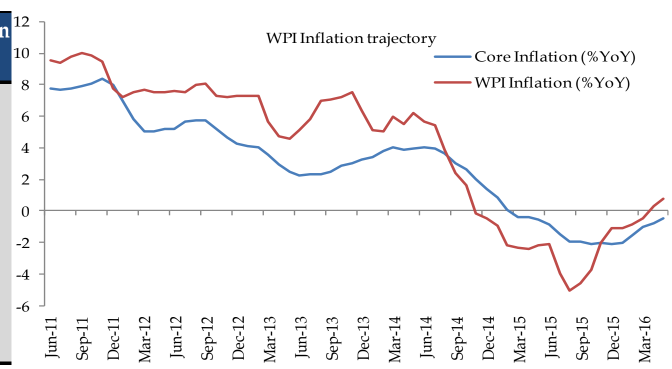
PMI: Manufacturing bouyant, services stagnates



Plan to non plan ratio improving

- In line with the moderation in most other lead indicators in April (PMI, exports, auto sales), IIP growth slipped into negative territory, contracting by 0.8% on an annualized basis compared to a near flat albeit upward revised growth of 0.3% in March (earlier 0.1%)
- India's fiscal deficit for the first two months of FY17 stood at 42.9% of Budgeted Estimate (BE) higher than 37.5% over the same period last year, owing to a sharp rise in plan expenditure so far this year.
- Credit growth in May slipped further to 8.0%YoY from 8.4% in the previous month, led by a contraction in food credit. As such, growth in non-food credit remained unchanged at 8.4%YoY in May vis-à-vis previous month but lower than 9.0% growth in May last year.
- Growth in core sector moderated to a four month low of 2.9%YoY in May-16 after catapulting to a four-year-high of 8.4%YoY in Apr-16 (on account of a favorable base).
- Reflecting improvement in the pace of manufacturing sector, NIKKEI India Manufacturing PMI surged to a three month high of 51.7 in Jun-16, (as compared to 50.7 in May-16).
- The Cabinet approved 16% hike in pay and 24% increase in pensions but the recommended 63.5% hike in allowances including a 138% increase in HRA (House Rent Allowance) has been decided to be deferred as yet.

%YoY	April	May	June	Apr-Jun FY16	Apr-Jun FY17
CPI	**5.47**	**5.76**	**5.77**	**5.09**	**5.67**
Food	6.29	7.2	7.38	5.43	6.96
Pan & Tobacco	8.04	7.66	7.28	9.53	7.66
Clothing	5.56	5.37	5.01	6.12	5.31
Housing	5.37	5.35	5.46	4.59	5.39
Fuel	3.03	2.94	2.92	5.77	2.96
Misc	4.26	3.96	3.85	3.75	4.02
Core	4.89	4.67	4.55	4.57	4.7

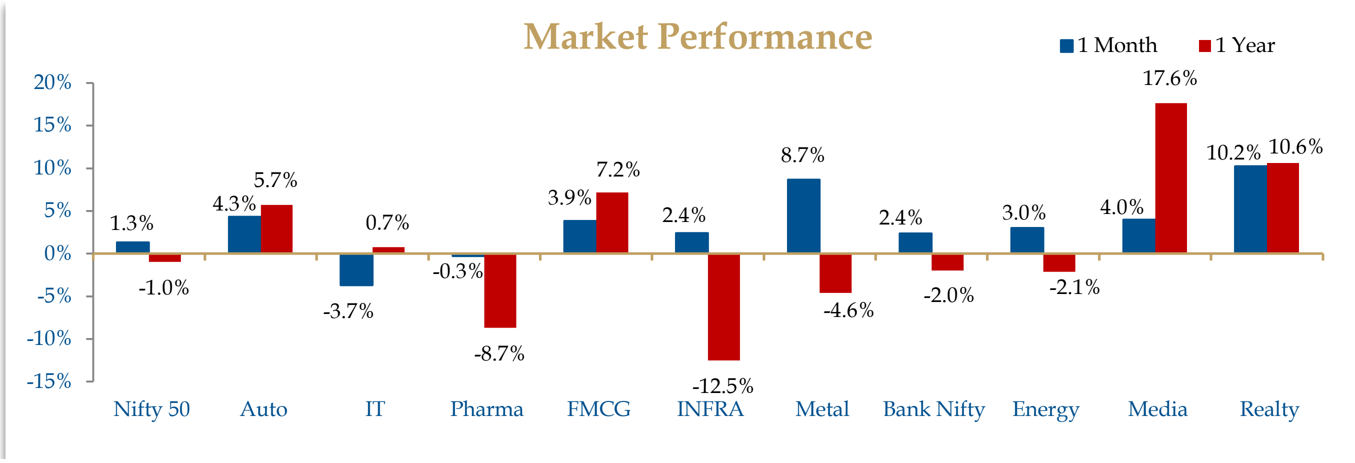


We expect:

- Our FY16 current account forecasts remain at a comfortable 1.1% GDP. For FY17, we see a higher but still subdued CAD of 1.3% of GDP translating into USD 29bn
- For FY17, we foresee an upside to our earlier 7.8%YoY GDP estimate. We estimate GDP growth in FY17 could stand closer to 8.1%YoY as –
- A surplus monsoon outturn (assuming a favorable spatial and inter-temporal distribution) is likely to support agriculture output and rural demand to a greater extent. Impetus to consumption gets further entrenched with anticipated revision in wages for government employees. Visible return in investment appetite by the end of the year.
- We expect USDINR to remain weak in the range 67-69 due to continued global headwinds such as monetary policy uncertainty from central bank actions and financial volatility; though strong domestic macros would keep sharp depreciation pressures contained.

Equity Market Insights

- The Indian markets ended the month of June on a positive note despite the turmoil in the global markets caused by UK voting to opt out of the EU. BSE Sensex closed at 26,999.72, higher by 1.24% for the month while the Nifty closed at 8,287.75; up by 1.56% during the same period. The CNX Mid-Cap and CNX Small-cap indices outperformed with returns of 3.94% and 11.43% respectively during the month.
- During June, foreign investors remained optimistic on the equity markets but were net sellers in the debt markets. There was an inflow of US$ 0.09 bn in the equity markets and an outflow of US$ 0.15 bn in the debt markets taking the total tally to a net outflow of US$ 0.06 bn during the month. DII's were net buyers and bought $ 1.0 bn during the same period.



Factors to Watch

- Update on GST and other reforms: The Government has been trying to draw consensus for the clearing of GST. If the Bill is cleared during the monsoon session of the Parliament, it would be viewed as a major positive by the market participants.
- Monsoon update: As of now the forecasts have been that the monsoons should be above normal and a lot is dependent on not just the quantum of rains but also the geospatial distribution of the same. This would have an impact on consumption as well as on inflation which has started to trend up in recent times. Therefore any delay/adverse news related to monsoons would result in a sharp decline in the markets.
- Corporate earnings
- Global events: Key global events which investors would be watching out for includes, the outcome of the referendum related to Britain's continuance/exit from EU and the course of interest rate hikes by the US Fed.

Outlook & Expectations

- In terms of valuations, the Sensex is trading at a trailing twelve month PE multiple of 19.2 times which is slightly above its long term historic average of 18.2 times. On a forward earnings basis the Sensex is trading at a multiple of around 15.3 times, which suggests that markets are not expensive at current levels. Building an assumption of a robust improvement in earnings in FY17, we believe that the markets are still attractive from a longer term perspective, i.e. for 2 to 3 years.

- The major issue for corporate India would be the turnaround in the top line which would depend on two things: (i) Monsoons: With 2 consecutive years of poor monsoons, the demand from the rural side which forms a significant chunk of the economy, has all but vanished. In the event of good monsoons this year, this segment would see a revival and drive consumption which in turn would lead to better demand for the companies. (ii) Reforms: As reforms (announced till date) start to gain traction, it would help in better execution which in turn would help drive the top line growth for the companies.

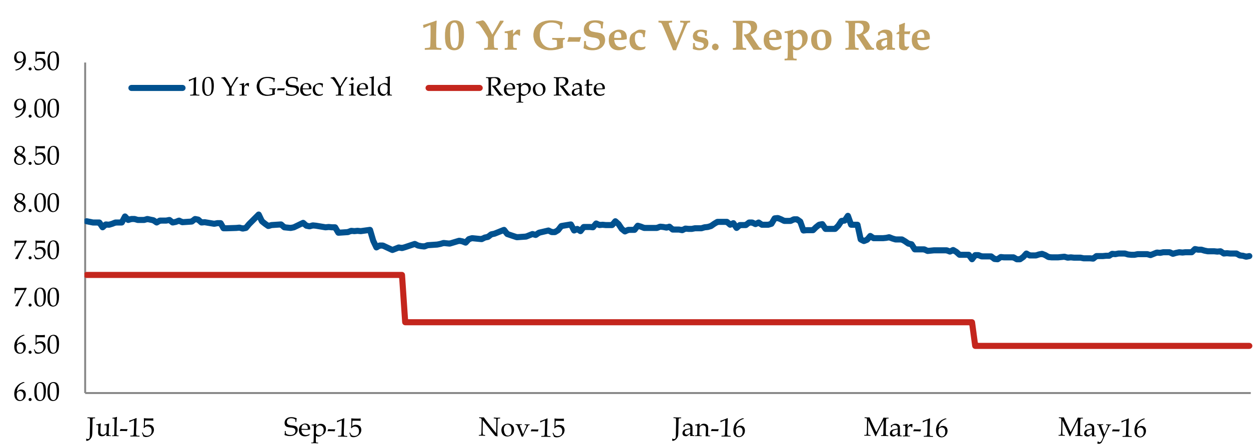
- We recommend equity investments through a Systematic Transfer route with a minimum investment horizon of 36 months.

Debt Market Insights

- The average systemic liquidity deficit in June reduced to an INR 354 bn as compared to INR 961 bn in May as government spending accelerated and cash leakage eased. RBI also conducted OMOs worth Rs 100 bn.
- Average 10 yr yield during June rose to 7.48% from 7.45% amid rising concerns on inflation.
- Unlike the April policy review where the RBI highlighted a timeline of close to 2-years for complete transition to the neutral liquidity framework, the central bank now eschewed from mentioning a specific timeframe.
- India's external debt as of Mar-16 stood at USD 485.6 bn, recording an increase of 2.2% from the Mar-15 levels and 1%QoQ sequential increase from Dec-15 levels. Increase in debt levels was broadly on account of a rise in NRI deposits.
- After a sizeable jump in April, retail inflation climbed further in May to 5.76% on YoY basis (Bloomberg consensus: 5.60%; YBL expectation: 5.67%) led yet again by continued rise in food prices.

Outlook and Expectations

- In the backdrop of two high prints on inflation, we now expect RBI to ease policy repo rate by 25 bps in Q3FY17 with most of the anticipated disinflationary impact expected only in Q2FY17.
- While we continue to anticipate room for incremental 25 bps monetary easing, with most of the anticipated disinflationary impact now expected only in Q2, the rate cut call has been pushed to Q3 FY17.
- With deferment of implementation of HRA hike of 138% under 7th CPC, the risk of immediate upside on the headline CPI on account of higher housing inflation has ebbed. Stripping out the impact of higher HRA, we continue to expect FY17 CPI inflation to average 5.1% in FY17.



Model Portfolios – April 2016

Asset Class	Conservative	Cautious	Moderate	Growth	High Growth
I) Debt (%)	95	70	50	25	10
Ultra Short Term Funds	20	15	15	5	-
Dynamic /Income Funds	35	30	20	15	5
NCD/ Bank Deposit	40	25	15	5	5
II) Equity (%)	-	15	30	45	55
Large Cap	-	15	25	30	35
Mid cap	-	-	5	10	15
Sector/ Thematic	-	-	-	5	5
II) Alternate (%)	5	15	20	30	35
Gold ETF	5	5	10	10	10
Structured Products	-	10	10	10	10
PE/ Real Estate Funds	-	-	-	10	15
Total (%)	**100**	**100**	**100**	**100**	**100**

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.

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About YES BANK

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