2018: A year of wide gyrations

In the penultimate month of 2018, the global economy continued to remain mired in geopolitical headwinds from US-China trade conflicts, Italy's budget deadlock with EU and disappointing progress on UK's Brexit deal.

However, all was not bad! The biggest comfort came from the continued decline in crude oil prices, with Brent variant easing to a 9-month low of USD 59.04 after hitting a peak of USD 85.89 in early Oct. The comfort on crude, transpired to financial markets, with EM currencies including Rupee posting an appreciation (INR appreciated by ~6% in Nov).

The spate of comforting news has continued into Dec-18. To begin with, a truce has been struck between US-China at the recently held G20 meeting with both the sides agreeing to not impose incremental tariffs on each other for 90 days. In addition, breaking the deadlock, Italy has yielded to pressure as PM Conte has accepted to revise the budget deficit targets to bring them in line with EU's recommendations and avoid Excessive Deficit Procedure that stipulated a fine of 0.2% of Italy's GDP in case of non-compliance.

From a macro perspective, US economy continued with a strong economic momentum, reinforcing its divergent growth trajectory versus other advanced economies. Eurozone systematically defies expectations of a recovery, with preliminary Q3 GDP growth disappointing at 1.7%YoY, with the region headed to end its QE program in Dec-18.

UK's economic fate continues to hang on Brexit, which has hit a political deadlock even as PM May is trying to defend the Brexit deal amidst a spree of resignations from prominent cabinet ministers and intense opposition from her own party members. The Government has also been found in violation of Parliament proceedings as it hid the full legal advice on Brexit leading to a strong momentum of a vote down on the proposed exit plan.

In addition, market will also be watching Fed's December meeting on 19th Dec. While the last rate hike for the year is largely priced in, guidance for 2019 will be gauged, especially after the recent comments from Chairman Powell which seemed to indicate a softening of stance.

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Global Macro Developments

- IMF warned that the global economy was facing imminent threats which would render conventional fiscal and monetary policies ineffective. IMF cited the trade war between the US and China as the biggest risk which might culminate into 0.75% loss in global GDP by 2020.
- OECD projected a slowdown in the global economy from 3.7% in 2018 to 3.5% in 2019 and 2020 (previous- 3.7%) citing downward pressure from trade conflicts, high-interest rates, Brexit outcome, and Italy's debt burden.
- China eased trade tension with the US, as it resumed buying of soybeans from the US. China imported 1.5 to 2 MT of soybean as per US Soybean Export Council, marking a softening of stance in its trade wars with the US
- PBoC (People's Bank of China) Governor Yi Gang stated that economic growth was nearing its full potential with downside risks weighing heavily on the economy.
- ECB President Mario Draghi stated that the central bank has decided to keep the main refinancing rate unchanged at 0% till summer of 2019 and confirmed the end of its USD 2.96 tn asset purchase program while reassuring the stimulus support to the economy via reinvestment of principal payments from maturing securities. Meanwhile, ECB policymaker Francois Villeroy de Galhau stated that the bank will approach a flexible policy after the end of its current QE programme, to face any uncertainty in the region.
- EU agreed to provide new tariff rate quotas (TRQs) to other WTO members primarily for the agriculture products. The new quotas will be implemented after the scheduled exit of UK from the EU on 29th March 2019.
- EU-Japan Free Trade deal will take into effect on 1st Feb 2019 after the lawmakers of both the countries ratified the deal. EU Trade Commissioner Cecilia Malmstrom asserted that the deal will be highly beneficial for EU firms and farmers as it will increase the markets access to them.

Events and Data Calendar

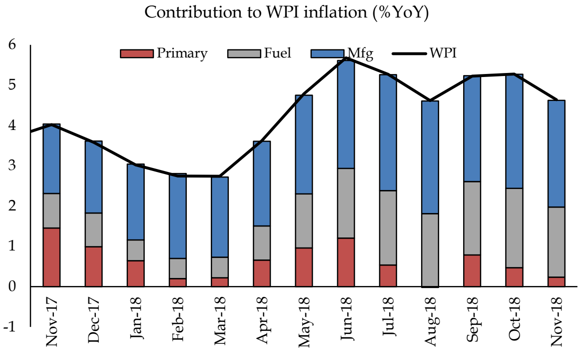
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
China	30-Nov-2018	Manufacturing PMI	Nov	50.20	50.00	50.20	⇩
	14-Dec-2018	IIP	Nov	5.90%	5.40%	5.90%	⇩
	9-Dec-2018	CPI (YoY)	Nov	2.40%	2.20%	2.50%	⇩
UK	14-Nov-2018	Industrial Production YoY	Oct	-0.10%	-0.80%	0.00%	⇩
US	5-Oct-2018	Unemployment Rate	Nov	3.70%	3.70%	3.70%	⇨
	11-Oct-2018	CPI YoY	Nov	2.20%	2.20%	2.50%	⇩
Japan	14-Dec-2018	Industrial Production YoY	Oct F	--	4.20%	4.20%	⇨

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

COMMODITY

- Gold prices increased by 0.4% MoM in November vs. an increase of 1.4% MoM in October amid a stronger dollar. Dollar demand increased due to heightened uncertainty around the US-China meeting which was scheduled for end of November.
- Brent prices contracted by 18.54% MoM in November vs. an increase of 2.04% MoM in October as Saudi Arabia increased oil production during the month. Additionally, US crude stockpiles increase dampened oil prices along with concerns regarding global oil demand slowdown.

Domestic Market Macro Economics



India November WPI

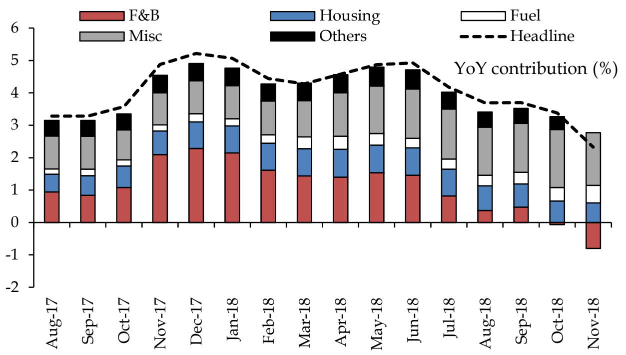
%YoY	Weights(%)	Jul-18	Aug-18	Sep-18	Oct-18
IIP	100	6.5	4.7	4.5	8.1
Sectoral Classification					
Mining	14.4	3.4	-0.5	0.1	7.0
Manufacturing	77.6	7.0	5.1	4.6	7.9
Electricity	8.0	6.6	7.6	8.2	10.8
Use Based Classification					
Primary goods	113.1	6.8	2.5	2.6	6.0
Capital goods	93.4	2.3	9.3	6.5	16.8
Intermediate goods	115.4	1.3	2.8	1.5	1.8
Infrastructure/ construction goods	119.6	9.2	8.0	9.3	8.7
Consumer durables	120.6	14.1	5.3	5.2	17.6
Consumer non-durables	113.5	5.3	6.5	6.1	7.9

Oct IIP: Growth sustains

- ✓ Composite PMI rose to a 2 year high of 54.4 in Nov-18 vs. 53.0 in Oct-18, a level last seen in the month before demonetization. Activity in both manufacturing and services sectors expanded, receiving an additional fillip in the festive months.
- ✓ Core sector growth accelerated to 4.7%YoY in Oct-18 (Sep: 4.3%) led by a healthy expansion in Cement, Electricity and Coal sectors whereas Crude, Natural gas and Fertilizer sectors acted as drags.
- ✓ In a reflection of festive demand continuing to support tax collections, GST revenues for Nov-18 stood at Rs 976 bn. Though collections eased from Rs 1007 bn in Oct, but were significantly higher than May-Sep average run-rate of Rs 948 bn. However, GST collections continue to lag the estimated monthly run-rate of Rs 1 tn, which is likely to put pressure on Government finances. While Government officials have indicated confidence in meeting the budgeted GST revenue targets, as per media sources, the Government is mulling at the option of tapping into GST Compensation Fund prematurely as a one-off.
- ✓ India's industrial production growth rose to an eleven month high of 8.1% YoY in Oct-18 vis-à-vis 4.5% in Sep-18. However, it should be noted that the growth in IIP is buoyed by a favorable base. The base month of Oct-17 recorded slowdown in manufacturing activity as factories were closed for the festival of 'Diwali' which leads to lower working days. This acceleration in growth was in line with the other leading indicators like PMI Manufacturing, automobile production and core infrastructure sector growth.
- ✓ India's retail inflation corrected sharply in November falling to its lowest level in 17-months with the headline CPI inflation printing at 2.33% on annualized basis. This now happens to be the seventh consecutive downward surprise (vis-à-vis market expectations) in inflation and the fourth consecutive month of undershooting with respect to RBI's medium term target of 4.

%YoY	Jun-18	Jul-18	Sep-18	Oct-18
Overall	7.6	6.6	4.26	**4.7**
Coal	11.8	9.7	6.50	**10.6**
Crude Oil	-3.4	-5.4	-4.24	**-5.0**
Natural Gas	-2.7	-5.1	-1.89	**-1.0**
Refinery Products	12.1	12.3	2.53	**1.3**
Fertilizers	0.9	1.3	2.56	**-11.6**
Steel	3.4	6.0	3.24	**2.2**
Cement	13.3	10.7	11.85	**18.5**
Electricity	8.5	4.8	8.24	**11.3**

CORE Sector



India Nov CPI - Lowest in 17 months

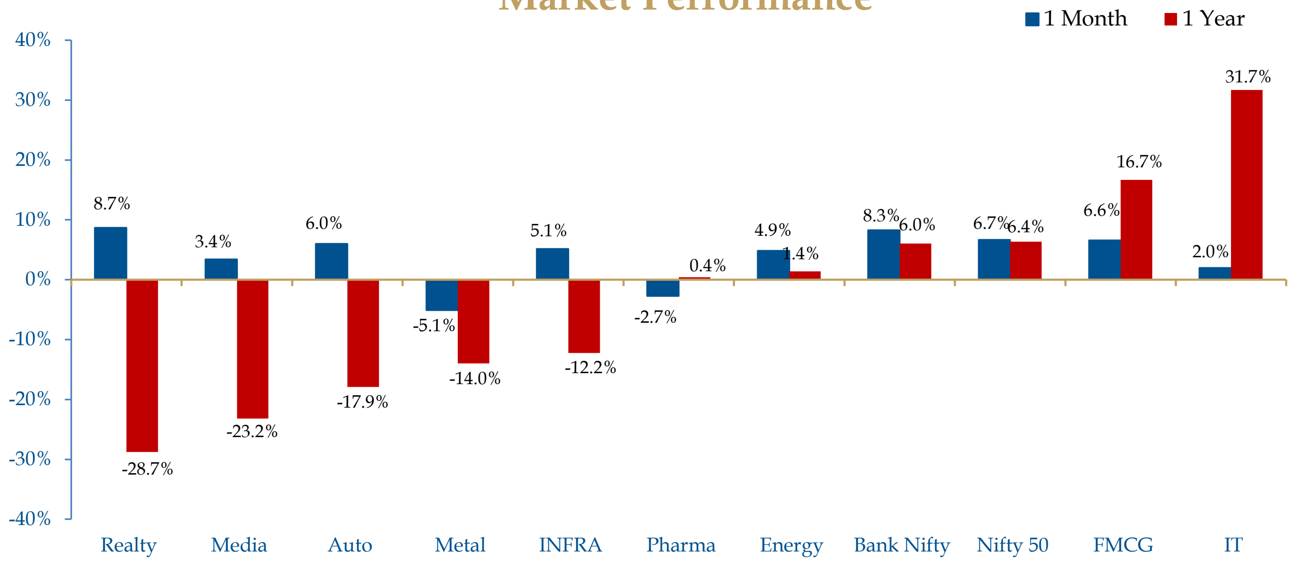
We expect:

- ✓ FY19 GDP growth to accelerate to 7.3% % (vs. 6.7% in FY18) aided by twin-engines of consumption (supported by 7th CPC and state commission payouts, rural oriented government expenditure) and capex recovery.
- ✓ We expect average CPI inflation below 3% in FY19 (vs. 3.6% in FY18) assuming food prices likely to remain subdued and oil prices stabilizing around USD 60 per barrel levels.

Equity Market Insights

- Sensex ended the month higher by 6.8% led by higher inflows following a decline in oil prices and stable INR. The Nasdaq and Hang Seng on the other hand gained by 1.6% and 7.8% respectively in November while other markets gained by about 2-4%
- Over the past year, the Indian markets remain one of the few to give positive returns. From a year ago, Sensex is higher by ~10.2%, while the Dow Jones is up by 4.6%.
- In terms of institutional activity, major reversal was seen after seven months with net inflow of INR 106 bn by foreign investors. The DII activity slowed down with an inflow of INR 49 bn as against inflow of INR 240 bn in October. In the year till date, DIIs have invested a net amount of INR 1,104 bn. FPIs on the other hand have turned negative with a net outflow of INR 266 bn, averaging to an outflow of INR 24 bn per month.

Market Performance

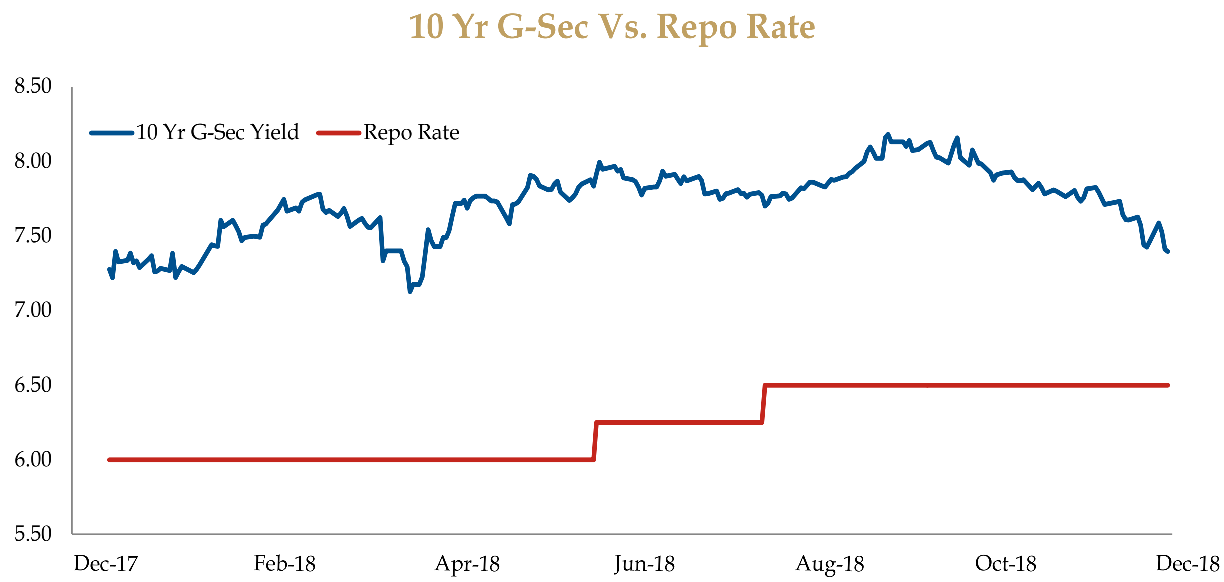


Outlook & Expectations

- Crude prices cooled off sharply during the month, which lent strength to the INR and supported inflows into the domestic markets. At the same time, corporate financial results in Q2FY19 were in line with expectations; earnings in the next quarter is likely to come in favor of companies led by the recent cool off in raw material prices, coupled with price hikes taken by companies.
- For the markets, apart from the result seasons, the focus over the next few quarters will be on the near-term state elections in FY19, General Election (Lok Sabha) in early FY20 and election results. To get favor from voters, the government could turn populist and could provide incentives which may not be favourable for the earnings of the companies. Further, aspects like persistent tighter domestic financial conditions on the back of NBFC stress could affect near term consumption growth; slower than anticipated investment cycle revival amid fiscal slippage risks that may limit the support to public capex; and escalating trade tensions may have an adverse impact on exports in addition to the ongoing tightening of global financial conditions.
- In such a scenario, markets are expected to remain volatile which could provide long term investors opportunities to accumulate quality stocks to build their portfolios. While equities still remain our preferred bet for long term gains, diversification into safe haven bets like gold and steady income instruments in the fixed income space is recommended to cushion against the expected volatility in the equity markets.
- Notwithstanding the weaker than expected GDP growth number in Q2FY19, we remain optimistic on the macro outlook for India. We expect growth to be driven by consumption which is expected to remain key driver for growth supported by pay commission implementation by Centre and State governments, near normal monsoon and rural oriented Government expenditure. In addition to this, gradual capex recovery supported by rise in capacity utilization and ongoing insolvency resolutions would also lend support to the growth outlook and to the long term structural uptrend in the Indian capital markets.

Debt Market Insights

- The average systemic liquidity maintained a deficit of INR 794 bn in November from a deficit of INR 570 bn in October.
- The average 10 yr G-sec bond yield during November moderated to 7.7% from 7.9% in October because crude oil prices corrected from USD 86 pb in October to USD 60 pb in November. OMO purchases by RBI also aided in higher bond prices.
- With November's inflation print breaching RBI's recently revised H2 FY19 projected range of 2.7-3.2%, it strengthens our belief in MPC reverting to its 'neutral' policy stance in its next policy review in Feb-19 from 'calibrated tightening' currently. In fact, the market chatter could soon gravitate towards the possibility of a rate cut given the size and persistence of undershooting in inflation. The recent inflation print along with the near term outlook has created a non-trivial probability of monetary easing, a sharp swing from a rate hike expectation just two months ago.



Outlook and Expectations

- The RBI has conducted INR 1360 bn OMO purchases until Nov-18 with another INR 400 bn scheduled for Dec-18, taking total OMO purchases close to our earlier forecast of INR 1800 bn for FY19. We now expect FY19 OMO purchases to get scaled up to INR 2400-2600 bn to offset the rising pressure on liquidity and financial conditions.
- We revise our H2 FY19 forecast for 10Y G-sec yield from 7.80-8.30% to 7.5% (Dec-18) and 7.7% (Mar-19) after taking into account the possibility of no RBI rate hikes in the remainder of FY19, lower room for Fed's incremental hikes, and higher than expected supply absorption by the RBI.

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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