Political stability bodes well for India

The month of May was in focus for the outcome of general elections. In line with the exit polls, the BJP led alliance, NDA, garnered 353 seats, an improvement over the tally of 336 seats in 2014 general election. From an economic standpoint, the election outturn is unambiguously positive as a stable government formation will ensure policy continuation with limited room for political distractions. The full majority gives NDA government a significant political capital. It also reinforces the belief in some of the policies undertaken during their last term; particularly the actions to keep the inflation contained and focus on social security net.

On the global front, the US and China trade negotiations stumbled yet again. The US threatened China with a fresh levy of 25% on Chinese goods import worth at least USD 300 bn and an increased levy from 10% to 25% on imports worth USD 200 bn. The tensions got exaggerated further with the US declaring a ban on Chinese telecommunications giant Huawei Technologies Co. In retaliation, China raised duties on US imports, levied fines on a few US companies for antitrust violations in China and issued an advisory for its citizens against travel to the US. Adding to the uncertainty, another unexpected blow came from the proposed US tariffs on imports from Mexico, US's second largest trading partner last year. US had announced a levy of 5% tariffs on all imports from Mexico, starting 10 June, in a move to instigate Mexico to take actions against illegal immigration into the US. The tariffs, which finally got averted, was supposed to be incrementally increased until they reach 25% on 1 October.

Across the Atlantic, another dimension of uncertainty stemmed from the Brexit and the European elections during 23-26 May. After failing to deliver on Brexit, PM Theresa May had resigned last month. Reportedly, the UK's conservative party is likely to choose a new prime minister by end July. At the European parliamentary elections, while Pro-European parties won however their seat share was limited due to gains secured by Eurosceptic opponents.

Amidst these concerns, oil market volatility has continued to swerve the markets. US sanctions on Iran and Venezuela, removal of waivers by the US on imports from Iran, volatility of US crude inventories, Middle East tensions and US-China trade tensions have heightened concerns about further slowdown in the global economic growth momentum and in turn the global oil demand.

With worsening of global economic growth outlook, major central banks including the US Federal Reserve have turned cautious. Recently, the US Fed acknowledged growing risks due to trade tensions and indicated a likelihood of easing rates in case global economic conditions worsen any further. Citing similar reasons, OECD trimmed its global growth forecast to 3.2% for 2019 (earlier forecast released in March: 3.3%), down from 3.5% growth registered last year.

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Global Macro Developments

- China raises anti-dumping duties (between 57.9% and 147.8%), on some steel tubes and pipes from the US and the EU.
- According to the Fed's Beige Book, economic activity showed a slight improvement during Apr to mid-May spring quarter, with growth and inflation expanding at a modest pace, but there are signs of tempered consumer spending. Meanwhile, Fed chairman Powell said that the bank is willing to take "appropriate" action to sustain economic growth, fueling expectations of a rate cut sooner than later.
- According to Japan's mid-year policy roadmap, the government is set to hike sales tax as planned in October and stands ready to take macroeconomic policy steps if risks to the economy materialize.
- G20 finance leaders expressed concerns over risks on improving global growth amidst geopolitical tensions. G20 leaders said in a communique issued, "Global growth appears to be stabilizing and is generally projected to pick up moderately later this year and into 2020. However, growth remains low and risks remain tilted to the downside. Most importantly, trade and geopolitical tensions have intensified. We will continue to address these risks and stand ready to take further action".
- According to IMF's Managing Director, Lagarde, IMF does not currently see the threat of a global recession due to a widening US-China trade war and potential US tariffs on Mexico goods. That said, current and any further US-China trade tariffs could slash economic growth by 0.5% in 2020.
- The OECD cut its forecast for the world economy on the backdrop of China-US trade war tensions. It trimmed its forecast for global growth to 3.2% this year from 3.3% earlier.
- China and EU regulators have signed two landmark aviation agreements. Under the deals, civil aviation authorities will facilitate the recognition of each other's evaluation and certification for aeronautical products.

Events and Data Calendar

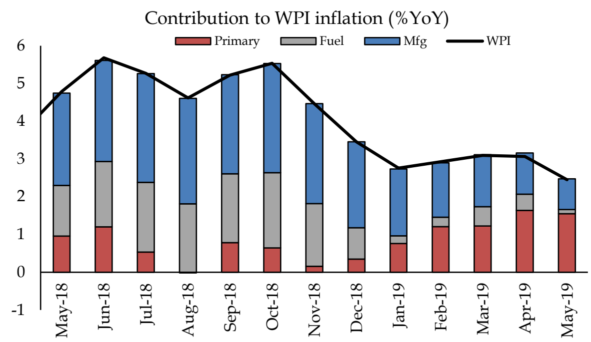
Region	Date	Event/Data	Period	Forecast	Actual	Prior	Change
UK	22-May-2019	CPI YoY	Apr	2.20%	2.10%	1.90%	⇧
	10-Jun-2019	Industrial Production YoY	Apr	0.90%	-1.00%	1.30%	⇩
US	30-May-2019	GDP Annualized QoQ	1Q S	3.00%	3.10%	3.20%	⇩
	7-Jun-2019	Unemployment Rate	May	3.60%	3.60%	3.60%	⇨
	12-Jun-2019	CPI YoY	May	1.90%	1.80%	2.00%	⇩
China	31-May-2019	Manufacturing PMI	May	49.90	49.40	50.10	⇩
	12-Jun-2019	CPI YoY	May	2.7%	2.7%	2.5%	⇧
	14-Jun-2019	Industrial Production YoY	May	5.40%	5.00%	5.40%	⇩
Japan	26-Apr-2019	Industrial Production YoY	Feb F	--	-1.10%	-1.00%	⇩
	26-Apr-2019	Industrial Production YoY	Mar P	-3.80%	-4.60%	-1.10%	⇩

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

COMMODITY

- Gold prices contracted by 0.1% MoM in May vs. a contraction of 1.2% MoM in April amidst rise in demand for gold bullion due to weak US economic data and escalation of trade tensions between US and China.
- Brent prices contracted by 0.7% MoM in May vs. an increase of 7.0% MoM in April as US sanctions on Venezuela and Iran, volatility in US crude inventories, tensions in Middle East, US-China trade tensions and possible tariffs (now averted) on US imports from Mexico heightened concerns about further slowdown in the global economic growth momentum.

Domestic Market Macro Economics



India March WPI

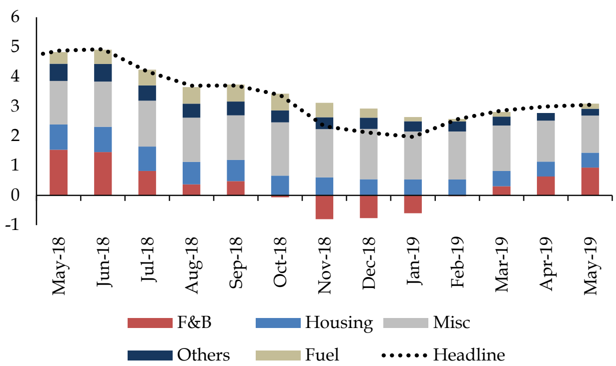
%YoY	Weights(%)	Jan-19	Feb-19	Mar-19	Apr-19
IIP	100	1.6	0.1	0.4	3.4
Sectoral Classification					
Mining	14.4	3.8	2.2	0.8	5.1
Manufacturing	77.6	1.3	-0.4	0.1	2.8
Electricity	8.0	0.9	1.3	2.2	6.0
Use Based Classification					
Primary goods	34.0	1.4	1.3	2.6	5.2
Capital goods	8.2	-3.6	-8.9	-8.4	2.5
Intermediate goods	17.2	-2.8	-5.0	-2.5	1.0
Infrastructure/construction goods	12.3	6.4	2.1	6.4	1.7
Consumer durables	12.8	2.5	1.2	-3.1	2.4
Consumer non-durabl	15.3	3.8	4.2	1.0	5.2

April IIP

- Manufacturing PMI ticked up to 52.7 in May-19 from 51.8 in Apr-19, indicating the strongest improvement in three months while services sector activity eased to a one-year low of 50.2 in May, from 51 in Apr-19 led by slowdown in new orders.
- Core sector growth moderated to 2.6% YoY in Apr-19 from 4.8% in Mar-19. Barring electricity and refinery, all sectors either registered a decline or a slower pace of increase in production.
- Gross GST revenue collection rose by 6.7% YoY to Rs 1.0 tn in May-19, crossing Rs 1 tn mark for the 3rd consecutive month.
- GDP growth for Q4FY19 slowed to a 5-year low of 5.8% YoY (vs. 6.6% in Q3), led by moderation in private consumption and gross fixed capital formation. Incorporating the latest print, the full year GDP growth estimate for FY19 now stands revised downwards to 6.8% from 7.0% earlier.
- India's industrial production registered a sharp pickup to 3.4% YoY in April from an upwardly revised print of 0.4% in March (earlier: -0.1% YoY), albeit supported by a favorable base.
- India's retail inflation inched up to 3.05% YoY in May-19 from 2.99% in Apr-19 (revised up from 2.92% earlier). The May-19 CPI inflation marks the first 3%+ print after an interval of six months. Nevertheless, CPI inflation continues to remain well below RBI's medium term target of 4% for the tenth successive month.

%YoY	Feb-19	Mar-19	FY18	FY19
Overall	1.5	2.2	4.8	2.6
Coal	2.0	7.4	9.1	2.8
Crude Oil	-4.4	-6.2	-6.2	-6.9
Natural Gas	6.2	3.7	1.3	-0.7
Refinery Products	-2.6	-0.7	4.3	4.4
Fertilizers	10.5	2.5	4.2	-4.4
Steel	5.5	4.9	6.7	1.4
Cement	11.0	8.0	15.8	0.7
Electricity	0.8	1.2	2.2	5.8

CORE Sector – Muted Performance



India March CPI

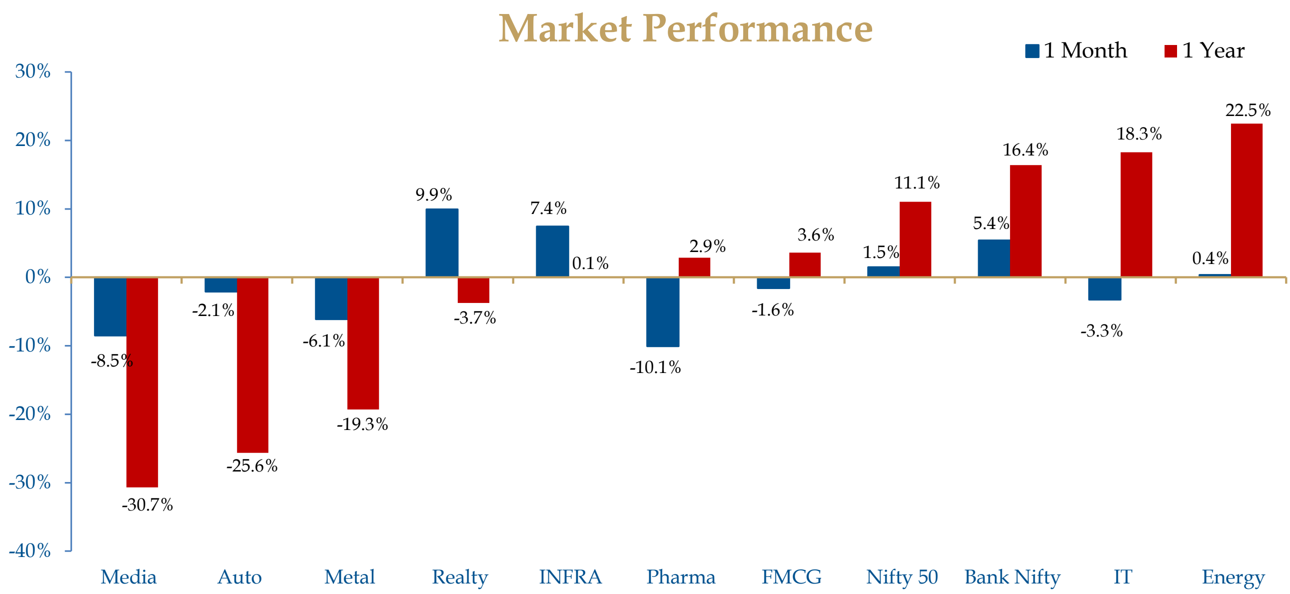
We expect:

- GDP growth to rise to 7.0% vs. 6.8% in FY19, with recovery to be back-loaded in H2FY20 as 1) Current consumption slowdown may prove to be cyclical, as support from direct income payout to farmers and increase in disposable incomes of urban households 2) Investment recovery to remain gradual and a function of NCLT resolution, anticipated moderation in real interest rates and provision of sufficient liquidity this year. Government' limited fiscal space may restrain pace of public capex.

- Inflation to average at 3.5% vs. 3.4% in FY19, assuming crude oil price at USD 65-70 per barrel, on account of reversal of benign food inflation and moderation in core price pressures.

Equity Market Insights

- Indian equity market continued to move up for the third consecutive month in May and has risen 9.8% YTD.
- A stable government bodes well for the market especially as it could push through pro-growth policies with greater ease. For the foreign investors, India also provides an added advantage of being a natural hedge against the adverse growth impact of US- China trade dispute.
- Emerging markets are back in the reckoning, with foreign portfolio investors pouring net US$11.3bn into Indian equities so far this calendar year, when compared with an outflow of US$4.5bn in 2018. Reversal in Fed's policy stance has reignited the appetite for higher yields in emerging markets. Moreover, a strong political mandate at the Centre has made India an attractive avenue among the foreign portfolio investors.



Outlook & Expectations

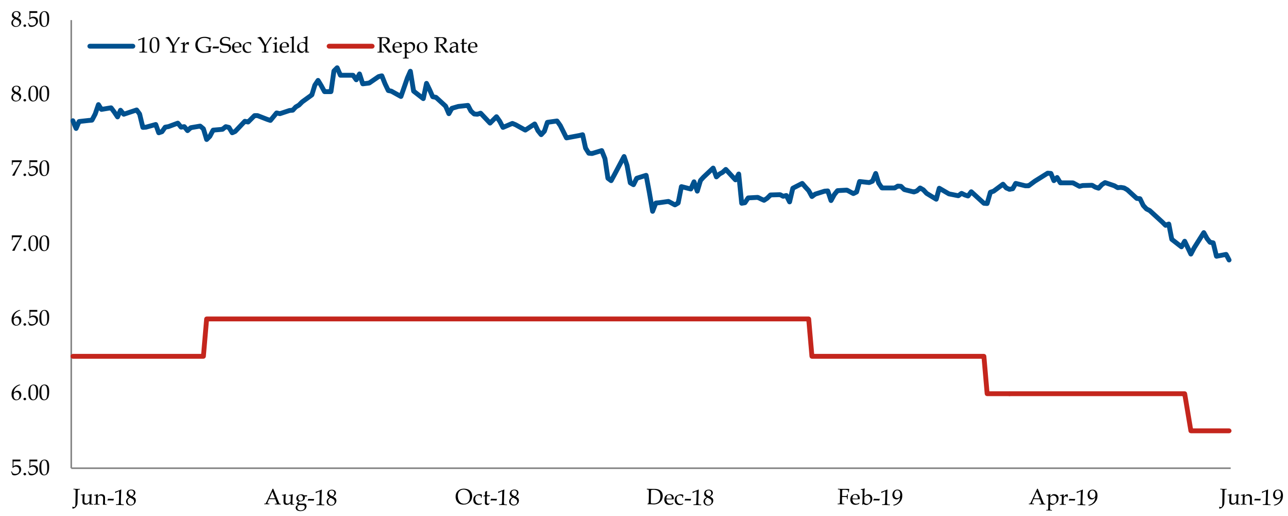
- Broader equity indices have done well in the last 5 years despite subdued earnings growth. In fact, equity returns have outperformed other asset classes like Gold and Property, with 5yr CAGR return of 12-13% on Nifty. Broader indexes have also fetched 14% returns in 5 years. For a major part of these five years, there was no long-term capital gains (LTCG) tax on equities and therefore, the post-tax return was significantly better than Indian fixed income investments as well.
- Equities would have possibly done even better had corporate earnings supported. We've now had a decade of sub-par earnings growth. The weak commodity cycle meant that companies linked to these sectors, didn't report strong numbers. In the last 12-15 months, PSUs did poorly even as the domestic facing private sector was on a recovery path. There has been over-reliance on the service sector to keep pushing GDP upwards. Demonetization, a gutsy move, clean in intent, was tardy in implementation and has not allowed GDP growth to rise to full potential. Likewise, with GST. However, we believe that, with teething troubles out of the way, these two mega initiatives will ably support higher growth of the formal economy going forward.
- We sense that the equity markets are transiently undergoing a consolidation phase, though structural upside in equities is very much intact. As seen with market cycles historically, it could be the case that after a period of consolidation in indices, the second half of the Bull Run may offer much higher returns compared to the first half. Markets to witness consolidation phase this year and next market rally to begin post 2020. Top-line

growth has done reasonably well in the last quarter, while earnings are poised to recover after a lost decade. We remain overweight on equities, with emphasis on large cap stock. In case of aggressive portfolios with 3-5 years horizon, we recommend staggered investments in mid and small caps.

Debt Market Insights

- The average systemic liquidity maintained a deficit of Rs. 343 bn in May from a deficit of Rs. 702 bn in April.
- The average 10yr G-sec bond yield moderated to 7.30% in May from 7.39% in April tracking moderation in US Treasury yields. Decline in crude oil prices, the election related positive sentiment, strength in INR and FPI flows and comments from Government sources that RBI was in favor of steering liquidity into a surplus mode further buoyed the sentiment.
- As we continue to expect headline CPI inflation to remain moderate at 3.5% in FY20 (3.4% in FY19). This would be the third consecutive year of below target inflation outturn for the Indian economy and is likely to continue to provide comfort to RBI's Monetary Policy Committee. Hence, we continue to expect the MPC to deliver another 25 bps rate cut in the next monetary policy review in Aug-19, taking the cumulative monetary easing to 100 bps in the current cycle. The road thereafter would get data dependent with monsoon outcome, sustainability of the recent softness in global commodity prices, global trade outlook, and signals from the upcoming FY20 Union Budget (to be presented on Jul 5).

10 Yr G-Sec Vs. Repo Rate



Outlook and Expectations

- The RBI has been proactive in providing primary liquidity in Q1 FY19 with cumulative infusion estimated to be around Rs. 1,000 bn. Liquidity infusion in Q1 FY20 (so far) has come about via USD 5 bn FX swap and Rs. 400 bn OMO purchases. Going forward, we expect RBI to deploy both FX swaps and OMOs to infuse primary liquidity into the system – as per our estimates, the economy would need a cumulative of Rs. 1,700 bn primary liquidity in FY20. This would carry upside risk if RBI switches to a surplus liquidity framework, given that RBI has constituted a group to review its Liquidity Management Framework (report expected by mid Jul-19).
- Assuming US bond yields to persist at current levels, FY20 Union Budget to retain fiscal deficit at 3.4% of GDP, and incorporating one incremental rate cut from the RBI, our fair value model now indicates a range of 7.0-7.1% for the 10Yr yield. As such, we now lower our earlier projected trading band for the 10Yr yield to 6.75-7.25% from 7.2-7.6% provided earlier for remaining part of FY20. A dovish global environment (led by US rates) along with the shift in RBI’s policy stance to accommodative is likely to provide further leg to the recent rally in bonds. While OMO based liquidity support could drive yields lower further, reliance on FX swaps could end up shifting the yield curve higher.

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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