Debt Market Commentary

February 2017

28th February	Month Opening	Intra Month High	Intra Month Low	Month Closing
Overnight Rate (NSE MIBOR)	6.25	6.25	6.04	6.05
10 year Gsec	6.43	6.93	6.40	6.87
3 month Cds	6.35	6.50	6.26	6.26
6M Cds	6.40	6.55	6.40	6.40
12 month Cds	6.50	6.65	6.50	6.65
Currency	67.47	67.47	66.69	66.69
10 Year US Treasury	2.48	2.51	2.31	2.36

Inflation

Retail inflation as measured by CPI (consumer price index) for January 2017 was a two year low. It dipped by nearly 25 20 bps and came at 3.17% as compared to 3.41% of December. Steep fall in food prices caused fall in inflation. According to Consumer Price Index (CPI) data released by the Central Statistics Office (CSO). Food inflation is at a 5 year low aided by high base effect and good supply management. Food inflation was only 0.53% as compared to 1.37% in December. With rising prices of petrol and diesel and WPI (Wholesale Price Index) for January went up to 5.25% from 3.39% in December. WPI rise is in contrast to a fall in the Consumer Price Index (CPI) for the month. The index composition is the reason for divergence, both the indices have different weightage for food and fuel. The concerning part is the core inflation which is proving to be sticky. Core inflation is stuck in a range and infact rose to 5.1% in January as compared to 5.00% previous month.

Macros

India's trade deficit narrowed further and came at to approx $9.84 billion as compared to $10.37 billion previously. Exports rose by 4.30% YoY, while imports grew by 10.70%. Oil imports which rose by more than 60% in January 2017, led to spike in imports. India's fiscal deficit-difference between revenue and expenditure, for the April-January period stood at Rs 5.64 lakh crore, or more than 105% of 2016-17 Budget estimates (BE), which is at 5.34 lakh crores. The fiscal deficit stood at 95.8 % in the corresponding period of previous year as per then 2015-16 BE. India's factory output for December 2016, as measured by the IIP, dipped and showed negative growth of -0.40% as against 5.7% in November. November was an aberration, mainly due to lower base effect of previous year and abnormal jump in certain segments. MSME segment which acts as a crucial cog of the manufacturing segment, had borne the brunt of demonetization led cash crunch- and that is showing effect- although they seem to be transient in nature. For quater of Oct – Dec 2016, India's GDP grew by 7.0% as against an expectation of less than 6.5%. The annual GDP as estimated by CSO (Central Statistical Office) was 7.1% for 2016-17, as compared to 7.9% growth witnessed in 2015-16.

RBI Monetary Policy

RBI in its policy meet on February 8, kept the rates unchanged. In a surprising move it changed the stand from accommodative to neutral. The change in stance is due to caution its exercising for achieving inflation target of 4% in medium term.

Liquidity and Rates

Excess of surplus liquidity in the system led to banks parking nearly 4 lakh crores with RBI for the month of February. Even interbank call market rates were persistently lower than the overnight rate of 6.25%. 3 month CDs after touching a high of 6.50 rallied and closed at nearly 6.25%. The change in stance had a massive impact on the bond markets. The entire yield curve shifted upwards. 10 year benchmark sovereign spiked to 6.93 and settled at 6.87%- which is a rise of more than 40 bps as compared to 6.43% level at start of month.

Outlook

Post the change in the policy stance from neutral to accommodative, market sentiments have turned bearish. With RBI's focus firmly on containing inflation, a official pause is on the cards. Add to that global uncertainty in terms of elevated oil prices and high probability of hikes by US Fed, markets don't have immediate positive triggers for a sustainable rally on the long end of the curve. Liquidity looks to be comfortable, with bank being flush with substantial deposits post demonetisation. This will keep the short end of the curve constantly bought and hence offers a sweet spot. For new investors short term fund offers a wonderful vehicle to earn high constant accrual. Benefit in terms of constant high accrual and effective vehicle as compared to bank fixed deposit (in light of lower and lower rates of FDs in banks) make short term fund a very attractive fund. Liquid and ultra short term fund, as always will be vehicles for smart utilisation of temporary surpluses.

Malay Shah
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Equity Market Commentary

Indiabulls MUTUAL FUND

February 2017

Key Domestic News

- RBI's monetary policy committee left the policy repo rate unchanged at 6.25%, against consensus expectation of a 25bp cut and shifted monetary policy stance to neutral from accommodative. RBI cited sticky core inflation and sees upside risk to its inflation projection due to higher oil prices, currency volatility and HRA payments seventh pay revision.
- India's Q4CY16 GDP growth slowed only marginally to 7% y-o-y from 7.4% in Q3, significantly above consensus expectations of 6%. Private consumption, fixed investment and industrial output growth all accelerated in Q4, with only the services sector witnessing a slowdown. The growth numbers are looking high as official data is not capturing the actual growth in unorganized sector but is more of extrapolation, thus underestimating the impact of demonetisation on growth.

Key Domestic Economic Data

- India's manufacturing PMI came in at 50.7 in February up from 50.4 in January, indicating that the manufacturing sector is gradually recovering from effects of demonetisation. More importantly, the Services PMI rose to 50.3 in February from 48.7 in January, the first expansion in four months for India's key service sector.
- India's CPI inflation came in at 3.2% in January from 3.4% in December in line with expectations, led by a sharp moderation in food price. However, core inflation rose to 5.1% in January from 4.9% in December.
- IIP growth moderated to -0.4% y-o-y in December from 5.7% in November, below consensus expectations of 1.2% growth, due to a sharp decline in production of consumer goods. The cumulative IIP growth for April-December came in at 0.3% against 3.2% for the same period in 2015.
- Fiscal deficit in the first 10 months to January was Rs5.64tn or 105.7% of the budgeted target for the fiscal year ending in March 2017. This limits the government's ability to support growth in remaining two months.

Key Global Events

- Minutes of the last US FOMC meeting suggest that many member believe the Fed Funds rate should be boosted "fairly soon", should incoming labour and inflation data be in line or stronger than current expectations. This has been further corroborated by many Fed governor's speeches suggesting a move in March is far more likely than markets had anticipated just days ago. The odds of a move in March meeting have jumped to more than 75% from less than 30% a fortnight ago.
- China has lowered its annual economic growth target to "around" 6.5%, compared to last year's range of 6.5% to 7%. "At present, overall systemic risks are under control," Premier Li Keqiang told the National People's Congress. "But we must be fully alert to the build-up of risks, including risks related to non-performing assets, bond defaults, shadow banking and Internet finance."

Outlook

- Ongoing remonetization, Government's infrastructure spending, lower lending rates, state-level implementation of pay commission recommendation, disbursements of HRA hike and recovery in rural spending should strengthen the economic recovery going ahead.
- We remain cautiously optimistic on equity markets. Concerns around Trumponomics, multiple general elections in Europe, France in particular and China are a key overhang. UP elections can be a key trigger for the markets.
- The valuations may appear stretched. However, given the impending economic recovery, expected earnings growth, abundant liquidity, TINA factor, and robust macros make a compelling case for medium to long term investment in India equities.

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