

May 2017

31st May	Month Opening	Intra Month High	Intra Month Low	Month Closing
Overnight Rate (NSE MIBOR)	6.25	6.3	6.19	6.25
10 year Gsec (Old)	6.99	6.99	6.77	6.79
3 month Cds	6.37	6.43	6.37	6.38
6M Cds	6.50	6.63	6.50	6.60
12 month Cds	6.75	6.88	6.75	6.85
Currency	64.21	64.89	64.06	64.5
10 Year US Treasury	2.33	2.42	2.21	2.21
10 year Gsec (New)	N.A.	6.79	6.63	6.66

## Inflation & Macros

Led by falling food prices, retail inflation as measured by CPI (consumer price index) for April 2017 declined by 82 bps as compared to March 2017. April CPI came in at 2.99% as compared to 3.81% of March 2017. Inflation in pulses fell to -15.9% and in vegetables it dropped to -8.6%. WPI (Wholesale Price Index) under the new series with 2011-12 as base year, dropped sharply to 3.85% as compared to March number of 5.30%. India's GDP for Jan-Mar 2017 grew at 6.1% as compared to 7% of previous quarter. Revised IIP series with 2011-12 as base was released. IIP as per that came in at 2.7% for March 2017.

## RBI Monetary Policy

In the latest policy, as expected, there were no rate changes. RBI preferred to wait out to see the effects of fiscal slippages and core cpi inflation cooling. It however acknowledged that the upside risk to inflation might be waning, and lowered the inflation trajectory for the fiscal. Its choosing to err on side of caution is rightly being reactive than being proactive- since any premature actions would come with risks of possible surprise reversals.

## Liquidity and Rates

Excess of surplus liquidity in the system led to banks parking nearly 3.4 lakh crores with RBI for the month of May. This surplus liquidity was evident in April. Money markets were flat. However dated curve saw quite a bit of rally. Old 10 year saw a rally of 20 bps by moving from 6.99 to 6.79 at the end of month. Forecast of good monsoon, lower inflation estimates, good FPI flows in markets all these led to a bullish momentum. Aiding the rally was an outlier expectation of rate cut in the upcoming policy and markets saw a good moment.

## Outlook

Favourable macro economic factors like controlled deficits and lower inflation readings, coupled with expectations that GST implementation might not be inflationary will keep the market in positive momentum. However risks especially in form of global factors of US FED hike and euro volatility will keep the markets in a less than 100% optimistic mode. Going ahead there is a stronger case for rate cut in august policy. Basis all this duration products will be attractive, however they are suitable only for those investors who can digest volatility. On a ongoing basis, liquidity looks to be comfortable, with system being flush with funds. 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**  
Head - Fixed Income

May 2017

## Key Domestic News

- \* Reflecting the cascading effect of demonetization, India's Q4FY17 GDP growth slowed down sharply to 6.1% y-o-y from 7.0% in Q3 FY17 and below consensus expectation of 7.1% growth. This weak growth too was largely supported by 31.9% jump in Government spending. Adjusting for government spending, GDP growth was more muted at 4%. However, with remonetisation in full swing, expectation of good monsoon, stepped up Government spending, we expect strong recovery in economic activity in H2FY18.
- \* IMD upgraded its forecast for normal monsoon this year from 96% of LPA to 98%. Also, monsoon is likely to be fairly distributed, with all 5 zones expected to get at least 96% of the LPA. This augurs well for rural consumption, food production and inflation.
- \* Farm loan waivers are now becoming a populist measure. Maharashtra has become the third state to join the UP and Punjab bandwagon. With general elections due in 2019, many more states are likely to follow the suit. This has a potential to become a major overhang on the Indian markets.

## Key Domestic Economic Data

- \* India's Manufacturing PMI stood at 51.6 in May, compared to 52.5 in April led by weakness in export orders and drawdown of inventories. However, business optimism sub index rose to six months high, implying that the fall in PMI is transitory.
- \* CPI inflation came in at 3.0% in April below consensus expectation of 3.3% reading and below 3.9% print in March, driven by lower food price inflation, favorable base effects and fall in fuel prices. Core inflation fell to 4.4% from 5% last month.
- \* Under new series, March IIP growth stood at 2.7% vs. 1.9% last month (-1.2% in old series) and 5.5% a year ago. FY17 IIP growth came in at 5% vs 3.4% in FY16.
- \* Trade deficit for April 2017 rose to a 29-month high of US\$ 13.2bn vs. US\$ 10.4bn last month led by higher imports. Exports stood at US\$ 24.6bn (up 19.8% y-o-y). Imports jumped by 49% largely due to jump in import of oil & gold. Non-oil non-gold imports rose by 16% indicating improvement in domestic demand environment.

## Key Global Events

- \* US FOMC's latest meeting minutes indicated that it expected to raise rates "soon," building expectations that a June hike is very much on the table. "Although the data on aggregate spending and inflation received over the intermeeting period were, on balance, weaker than participants expected, they generally saw the outlook for the economy and inflation as little changed and judged that a continued gradual removal of monetary policy accommodation remained appropriate,".
- \* Moody's lowered China's credit rating to A1 from Aa3, with a stable outlook, citing Beijing's waning financial strength and rising liabilities. It marks the first time a major ratings agency has downgraded the country in more than 25 years.
- \* The Gulf region was again in news after Arab nations including Saudi Arabia, the United Arab Emirates, Egypt and Bahrain cut ties with Qatar, accusing it of destabilising the region with its support for Islamist groups.

## Outlook

- \* Prospects of a normal, well distributed monsoon augur well for rural consumption and should strengthen the economic recovery.
- \* However, prospects of farm loan waiver spreading to more states, is a dampener and has potential of becoming a major overhang on the markets.
- \* Global economic environment continues to be stable, with no major risk off event apparent in near term. Ample global liquidity and benign commodity prices too are supportive of risk on trade.
- \* We continue to expect strong economic recovery from H2FY18 onwards. Implementation of GST can lead to some short term disruption, but is a significant positive in long run.
- \* India is a strong, structural, long term story. 'Buy the Dips' should be the mantra.



**Sumit Bhatnagar, CFA**  
Head - Equity