Debt Market Commentary

Indiabulls MUTUAL FUND

October 2016

31st October	Month Opening	Intra Month High	Intra Month Low	Month Closing
Overnight Rate (NSE MIBOR)	6.50	6.50	6.24	6.24
10 year Gsec	6.77	6.79	6.68	6.79
3 month CDs	6.65	6.65	6.60	6.65
6M CDs	6.85	6.85	6.80	6.80
12 month CDs	6.93	6.93	6.88	6.88
Currency	66.58	66.94	66.46	66.78
10 Year US Treasury	1.63	1.86	1.63	1.84

Inflation

Retail inflation as measured by CPI (consumer price index) for September 2016 witnessed a fall and came at 4.31% (year low) as compared to August number of 5.05%. Steep fall in food prices caused such a sharp fall in inflation. Food inflation fell by nearly 200 bps and came at 3.88% from 5.91%. Above average monsoon and active steps taken by government especially in removing the bottlenecks on the supply side should help rein in the food inflation in coming months, and consequently cool off cpi, however one of the major risk to this could be any unexpected uptick in oil prices. Wholesale price index (WPI)-based inflation rose a bit slowly by 3.57 % as compared to 3.74% in September, this is a minor reversal in seven month up-trend in WPI.

Macros

India's trade deficit narrowed to $8.33 billion in September 2016. Exports increased 4.6% to $22.8 billion in September 2016. Imports fell 2.5% to $31.2 billion, slower than 14.1% in August 2016. India's fiscal deficit came in at Rs 4.48 lakh crore for the six-month period ended September 2016, accounting for 83.9% of the Rs 5.34 lakh crore budgeted for the entire year. Industrial growth as measured by the Index of Industrial Production (IIP) contracted for the second consecutive month. IIP was down 0.7% in August 2016.

Liquidity and Rates

The Reserve Bank of India's (RBI's) liquidity window witnessed net lending of approximately Rs 5,000 crore in October vis-à-vis net lending of approximately Rs 40,000 crore in the previous month. Rates were pretty stable with repo/reverse repo auctions being conducted by RBI at regular intervals. Interbank call money rates remained below the repo rate for most of the days. Additionally open market operations near to the end of the month added to the liquidity. Outflows pertaining to part repayment of FCNR (B) deposits, and telecom spectrum auction payments led to draining away of liquidity albeit temporarily, in addition to sporadic reverse repos. Money market instruments had a muted month with most papers and maturities in money markets witnessing no to flat trajectory. Gilts advanced this month also. Dipping inflation in September 2016, weak US non-farm payrolls, and continued RBI's open market operation bond auction kept the demand and momentum continuing. However the gains were somewhat tempered by apprehensions on account of the result of US Presidential elections and regular profit booking by participants.

Outlook

Inflation will trend further downwards and will be at lower range of trajectory till December. Bond demand/supply dynamics will make sure that the momentum continues for markets. Add to this continued OMOs by RBI and the strength in prices will be continuing. However we might witness temporary liquidity tightness/rates volatility over next couple of months due to FCNR bond redemptions, and global events especially us president elections and anticipated us fed hike.. However that should not be a huge worry, since RBI won't let liquidity scarcity situation prevail-infact, more than before, RBI is more into liquidity management. Long duration investors are advised to stay invested albeit with part profit booking and moving to accrual based funds. For new investors short term fund offers a wonderful vehicle to earn high constant accrual and a chance to participate in rate action led capital appreciation. Liquid and ultra short term fund, as always will be vehicles for smart utilisation of temporary surpluses.

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Key Domestic News

- The government has allowed 100% foreign direct investment (FDI) in 'other financial services' carried out by non-banking finance companies (NBFCs), continuing with the liberalization of the overseas investments regime.
- To tackle the issue of stressed assets in power, steel and shipyards, the central government has now decided to allow banks to take over some stressed assets and hand these over to established public sector undertakings for an interim period.
- The Centre has proposed four slabs for the goods and services tax (GST) in addition to a cess on sin and luxury goods that will help it mop up close to Rs500bn to compensate states for any possible revenue loss under the new tax regime. At a meeting of the GST Council, the Union finance ministry proposed slabs of 5%, 12%, 18% and 28%.
- Pushing ahead on its ambitious waterways project, the government augmented the process of development for 36 waterways in the first phase and will soon float tenders to invite bids for the project.

Key Domestic Economic Data

- India's manufacturing PMI rose to 54.4 in October, a 22 month high, from 52.1 reading in September. This was led by stronger rise in new orders and output in consumer goods space.
- India's services PMI jumped to 54.5 in October from a reading of 52 in September, led by strong jump in new orders.
- India's CPI for September dropped to 4.3%, below consensus expectation of 4.6%, attributed largely to sharply lower food inflation. On mom basis, inflation contracted by 20bps, highest in the last seven months.
- India's industrial production contracted by 0.7% in August, due to fall in mining and manufacturing sector production and a steep decline in capital goods. The IIP contracted by 0.3% in the April-August period this year, in contrast to 4.1% growth last year.

Key Global Events

- US government's first estimate of Q3 GDP growth came in at a very strong 2.9% vs. 2.5% expected. This is the strongest quarterly growth in last 10 quarters. This strong print increases the probability of December rate hike by US Fed.
- China's official manufacturing PMI came in at 51.2 for October, snapping two months of flat readings. The government's official services PMI also soared to 54.0, strengthening the hopes of stabilization in economy.
- In line with expectations, ECB didn't make any policy changes in its October meeting. Surprisingly, Mario Draghi stated that there was no discussion on extending the QE beyond the nest year. Thus raising speculation that even ECB was getting ready for some QE taper.

Outlook

- Over short term, we expect markets to turn volatile on concerns on US elections, Italy's referendum & US fed rate hike in December.
- Our core investment thesis of India being one of the best plays in the world remains intact and continues to strengthen further. We believe that ongoing structural reforms are creating bedrock for stable, higher economic growth trajectory. We remain positive on the Indian equities over medium to long term.
- Over short term, valuations do appear a bit rich. However, expected demand pick up due to normal, well distributed rains, benefits of 7th Pay Commission & OROP, focused government spending on infrastructure, expected pick up in corporate capex over next few quarters & benign global liquidity should continue to support the current valuation premiums.
- Any negative surprise in US elections is a key near term risk.

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