Debit Market Commentary

Indiabulls MUTUAL FUND

September 2016

30th September	Month Opening	Intra Month High	Intra Month Low	Month Closing
Overnight Rate (NSE MIBOR)	6.50	6.55	6.49	6.50
10 year Gsec	6.97	6.97	6.78	6.81
3 month CDs	6.60	6.60	6.50	6.50
6M CDs	6.88	6.88	6.70	6.70
12 month CDs	7.20	7.20	6.90	6.90
Currency	66.95	67.03	66.37	66.56
10 Year US Treasury	1.57	1.73	1.54	1.60

Inflation

Retail inflation as measured by CPI (consumer price index) for August 2016 witnessed a sharp fall and came at 5.05% (lowest since march) as compared to July number of 6.07%. Steep fall in food prices caused such a sharp fall in inflation. Food inflation slowed to 5.91% from 8.35% per cent, with high pulses prices being offset by weak vegetable prices. Core inflation slipped to 5.0%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 of cpi, however one of the major risk to this could be any unexpected uptick in oil prices. Wholesale price index (WPI)-based inflation rose to a two-year high of 3.74% in August, from 3.55%in July. This was the fifth straight month of WPI inflation after continued deflation for over a year. The opposite trend in the headline numbers was despite the fact that food inflation declined in both. This was because the food index has lower weightage of about 14%, as against about 45% in CPI.

Macros

India's fiscal deficit during the April-August 2016 stood at Rs 4.08 lakh crore or 76% of the budget estimates for 2016-17. The deficit was 66.5% during the same period a year ago. India's trade deficit narrowed to $7.67 billion in August 2016 from $12.4 billion in the same month last year. Exports performed better in August 2016, led by sectors such as engineering goods, pharmaceuticals, gems & jewellery and readymade garments. Imports declined and much of the decline came from non-oil imports falling 8.5%, while non-oil imports were down 15.6% led by a 77.4% decline in gold imports. Industrial production contracted by 2.4 % in July registering the worst performance in eight months mainly on account of declining output in manufacturing and capital goods sectors. The previous low was witnessed in November last year when the factory output shrunk by 3.4 per cent.

Liquidity and Rates

The Reserve Bank of India's (RBI's) liquidity window witnessed net lending of approximately Rs 40,000 crore in September vis-à-vis net lending of approximately Rs 27000 crore in the previous month. Rates were pretty stable with repo/reverse repo auctions being conducted by RBI at regular intervals. Outflows pertaining to advance tax payments also led to rise in the rates to a certain extent. 2-3 months assets were flattish, with a good amount of movement seen in 6-12 month segment. 10 year gsec also witnessed a good rally to close at 6.81. 3-5 year psu bonds also enjoyed a rally of nearly 10 bps. Overall markets were enjoying strong momentum in run-up to policy.

RBI Policy

In a unanimous decision, the Reserve Bank of India, under the leadership of the new Governor Urjit Patel and the newly formed 6-member monetary policy committee, cut the policy rate by 25bps today, while keeping all other key policy rates unchanged. The statement and subsequent follow-up by the Governor confirmed that monetary policy will remain accommodative and the central bank will continue to keep money market liquidity in a neutral zone. RBI expects that 5% CPI target being met, however some upside risks cannot be completely ruled out. Additionally, RBI maintained its real GDP growth forecast at 7.6% for FY17. RBI also mentioned that since global potential growth and neutral interest rates had been falling, it is willing to work with a lower real interest rate (around 1.25%) than preferred by the previous governor (1.5-2.0%). So depending on evolving dynamics, there is a room for another 25 bps cut eventually.

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 Diwali led cash withdrawal from systems. However that should not be a huge worry, since RBI won't let liquidity scarcity situation prevail. 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.

Malay Shah
Head – Fixed Income

September 2016

Key Domestic News

* In the first MPC-driven policy meeting, the RBI surprised with a 25 bps repo rate cut to 6.25%, against consensus expectations of no change. All six MPC members voted in favour of a cut. The RBI lowered the real rate target to 1.25% from 1.5-2.0% earlier, based on the argument that globally neutral real rates have moderated.
* Government's income declaration scheme, got total decelerations worth ₹ 652 bn (0.4% of GDP), which implies approximately ₹ 294 bn (0.2% of GDP) in additional revenues.
* Monsoon season ended with normal rains, 3% below LPA. Rains were well distributed across the country, barring some small pockets in Gujarat & Karnataka. We expect rural incomes to rise and give major fillip to rural demand.
* India – Pakistan border tension escalated as Indian Army conducted 'surgical strikes' across the Line of Control in Pakistan-occupied Kashmir, following the terror attack on a military base in Uri.

Key Domestic Economic Data

* India's manufacturing PMI came in at 52.1 in September dropping from a 52.6 reading in August, indicating that growth lost some momentum. However, manufacturing activity continue to expand for 9th straight month, helped by new orders.
* India's services PMI dropped to 52 in September from a reading of 54.7 in August, indicating that service activity lost steam in September after touching a three year high last month.
* India CPI inflation eased sharply to 5.0% y-o-y in August from 6.1% y-o-y in July, below consensus expectations of 5.2%, driven largely by base effects and lower food prices (vegetables and pulses)..
* India's Industrial production (IP) growth fell sharply to -2.4% y-o-y in July from 2.0% in June, significantly below consensus expectations of +1.5%, indicating that economic recovery continues to be patchy.

Key Global Events

* Contrary to expectations, the ECB didn't add to or extend its stimulus program at its policy meeting in September. ECB President Mario Draghi stated that the ECB will monitor developments and will provide accommodative policy with all available instruments, as necessary.
* The US FOMC kept policy rates unchanged, in line with expectations. Three members dissented from the decision not to hike rates, which is very rare. The dot plot from the economic projections shows only three members on the FOMC expect no change in policy for CY16, while 14 expect higher rates.
* Economic data from China on Industrial output, retail sales, fixed asset investments etc suggests that its economic activity is picking up. It now appears less at risk of a hard landing than feared in 2015.

Outlook

* India continues to offer one of the best long term investment opportunities to yield starved global investors, plush with liquidity. Favorable demographics, huge untapped economic potential, pro-business government and improving macro environment make India a compelling story. 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 flare up of tension on India-Pakistan border is the key risk over immediate term. Faster than expected US fed rate hikes and reversal in commodity prices are other key risks to the outlook.

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