Dear Friends,

The month of January 2018 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain 5.60% and 4.72% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 shed 1.65% during the same period.

On the global front, the US GDP slowed from an annualized rate of 3.16% in the third quarter CY 2017 to 2.55% in the fourth quarter. Consumption and investment both made strong contributions to growth, while weaker exports and government spending dragged growth down. The US Federal Reserve (Fed) in its FOMC meet kept the interest rates unchanged while the market participants interpreted the Fed's statement as somewhat hawkish, confirming expectation of a March interest rate hike. Meanwhile, the other global central banks, European central bank (ECB) and Bank of Japan (BoJ) both met and left policy unchanged. The ECB is expected to continue its asset purchase program at €30 billion per month until September, as previously announced. The BoJ, for its part, will continue its asset purchase program at ¥80 trillion per year.

On the domestic front, the Union budget FY 2019 was able to maintain a fine balance of stimulating rural economy, boosting job creation and improving the quality of infrastructure while delivering reasonable fiscal consolidation. The fiscal deficit of FY 2018 was estimated at 3.5% and that for FY 2019 was projected at 3.3%. The government has broadly remained in the path of fiscal consolidation despite the pressures on the government revenues in FY 2018 due to the nascent issues pertaining to the GST rollout. Moreover, given the fact that FY 2019 would be a pre-election year, the government has still continued the glide path of fiscal consolidation.

The Union budget is expected to boost rural incomes through rural infrastructure, increasing rural credit, improving market access to farmers with specific initiatives for increasing the cultivation of fruits and vegetables. The government has unveiled an ambitious healthcare policy aimed at covering 100 mn families bringing in around 500 mn individuals into the health insurance fold. The Union budget expects buoyancy in GST collections as the compliance levels improve as implementation issues get addressed. The personal income tax collection is expected to be buoyant on the back of efforts of the tax authorities to identify large cash deposits post demonetisation. The government has been reasonably modest in budgeting disinvestment proceeds.

The Monetary policy committee (MPC) of the RBI in its sixth Bi-monthly monetary policy decided to keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6%, consistent with the neutral stance of monetary policy in consonance with the objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2%, while supporting growth.

The total GST revenue for December 2017, up to January 24th has been ₹867 bn. Under GST around 10 mn tax payers have registered till January 24th of which 1.7 mn are composition dealers.

The Economic survey estimated the GDP growth for FY 2018 at 6.75%, higher than the CSO estimate of 6.5%, implying 7.5% growth in the second half FY 2018. It has pegged the FY 2019 growth at 7.0-7.5% on the back of strengthening exports due to better global growth outlook, rebound in private investment albeit contingent on progress of bank recapitalization and resolution through the Insolvency & Bankruptcy code even as sustained increase in oil prices is a key risk for real incomes and spending and may lead to a tighter monetary policy stance and higher real rates. The Economic survey highlights action on solving the twin balance sheet problem and addressing the issues around sustained macro stability. The Economic survey emphasises the need for accelerating employment generation, quality education & augmenting agricultural incomes.

The Consumer Price Index (CPI) inflation for December 2017 came in at an elevated 5.21%, higher than the market expectation of around 5.1% and higher than the November CPI inflation print of 4.88%. Wholesale Price Index (WPI) inflation for December 2017 unexpectedly softened to 3.58% on a year on year basis, lower than market consensus of 4% and lower than the 3.93% registered in the prior month. The CPI inflation is expected to remain elevated on the back of adverse base effects and higher global commodity prices.

Rabi (winter crop) sowing as of February 2nd was 1.5% lower than prior year. The acreage of wheat was 5.4% lower than last year while pulses acreage was 5.3% higher than last year. The acreage under Coarse cereals was 1.7% lower and oilseeds acreage was 4.9% lower than last year.

With the domestic growth outlook improving, we believe that further benefits of the far reaching reforms will accrue in the medium term and that the equity market offers a reasonable entry point for a long-term investor with a 3-5 year view.

Team Investment

TATA AIA LIFE

DEBT MARKET OUTLOOK

Debt market in the month of January 2018 saw the erstwhile benchmark 10 year Government security (G-sec) close the month at 7.59%, hardening by 27 bps over the month. The new 10 year has been issued at 7.17% and closed the month at 7.42% hardening by 25 bps. The 30 year G-sec hardened by 24 bps over the month to close at 7.72%. On the corporate bond side, the 10 year AAA corporate bond closed the month at around 8.00%, hardening by 28 bps over the month. In the month of January, the Foreign Portfolio Investors (FPIs) remained net buyers of Indian debt.

The Indian fixed income market has been under sustained pressure in the month of January on the back of rising CPI inflation in December, the surge in international crude oil prices, the overhang from the announcement of the additional G-sec borrowing on account of the expected fiscal slippage, which was subsequently rolled back in a staggered fashion. The Union budget estimated the fiscal deficit of FY 2018 at 3.5% and projected the fiscal deficit for FY 2019 at 3.3%.

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The MPC had projected inflation in the range of 4.3-4.7% in the second half of FY 2018, including the impact of increase in HRA in its previous monetary policy in December. The MPC highlighted that the headline CPI inflation averaged 4.6% in the third quarter, driven primarily by an unusual pick-up in food prices in November with food prices in December reflecting a less than usual moderation. Moreover, petrol and diesel prices rose sharply in January, reflecting lagged pass-through of the past increases in international crude oil prices. Considering these factors, the MPC estimated inflation at 5.1% in the fourth quarter fiscal 2018, including the HRA impact.

The MPC was of the view that the inflation outlook beyond the current year was likely to be shaped by international crude oil prices, non-oil industrial raw material prices and the onset and progress of the monsoons. The MPC estimated the CPI inflation for FY 2019 in the range of 5.1-5.6% in the first half, including the diminishing statistical HRA impact of central government employees, and 4.5-4.6% in the second half, with risks tilted to the upside. The MPC opined that the projected moderation in inflation in the second half was on account of strong favourable base effects, including unwinding of the 7th CPC's HRA impact, and a softer food inflation forecast, given the assumption of a normal monsoon and effective supply management by the Government.

The MPC projected the GVA growth for FY 2018 at 6.6%. The MPC was of the view that beyond the current year, the growth outlook was expected to be influenced by the stabilization in GST implementation, the revival in investment activity as reflected in improving credit offtake, large resource mobilization from the primary capital market, and improving capital goods production and imports. Moreover, it expected the process of recapitalization of public sector banks and the resolution of the large distressed borrowers referenced for resolution under the Insolvency and Bankruptcy Code (IBC) to improve credit flows further and create demand for fresh investment. The MPC expected the export growth to improve further on account of improving global demand even as elevated commodity prices, especially of oil, could act as a drag on aggregate demand. Overall, the MPC projected the GVA growth for FY 2019 at 7.2%, in the range of 7.3-7.4% in the first half and 7.1-7.2% in the second half with risks evenly balanced.

The MPC noted that the inflation outlook was clouded by several uncertainties on the upside such as the staggered impact of HRA increases by various state governments, a pick-up in global growth exerting further pressure on crude oil and commodity prices, the proposed revised guidelines for arriving at the minimum support prices (MSPs) for Kharif (summer crop) and the proposed increase in customs duty on a number of items and fiscal slippage. The MPC expressed concern that the fiscal slippage had broader macro-financial implications on the economy-wide costs of borrowing. Moreover, the MPC believed that the confluence of domestic fiscal developments and normalization of monetary policy by major advanced economies would further adversely impact financing conditions and undermine the confidence of external investors. The MPC highlighted the mitigating factors to inflation such as subdued capacity utilization and moderate growth in rural real wages. Overall, the MPC was of the view that the nascent recovery needed to be carefully nurtured and growth put on a sustainably higher path through conducive and stable macro-financial management.

The fixed income market has under pressure in recent weeks from higher than expected December CPI inflation print, normalization of the global monetary policy and the fiscal slippage in FY 2018. The monetary policy of the RBI has been balanced and is expected to be well received by the market, especially given the benign projection of CPI inflation in the second half fiscal 2019. We believe that the RBI has actually guided a long pause in interest rates unless there are meaningful upside risks to its projected inflation trajectory. We would be constructive on the Indian fixed income markets.

EQUITY MARKET OUTLOOK

The month of January 2018 saw the benchmark indices S&P BSE Sensex and Nifty 50 gain 5.60% and 4.72% respectively. The Mid-cap index, Nifty Free Float Mid-cap 100 shed 1.65% during the same period.

The Indian equity market performance in the month of January 2018 was mixed as the benchmark indices witnessed robust gains while the performance of the mid-cap index was muted. The markets took note of improvements in the Index of Industrial Production (IIP) and Purchasing Manager's Index (PMI) prints even as elevated CPI inflation and rising global crude oil prices were key concerns. The FII's were net buyers in the month of January.

The third quarter FY 2018 earnings thus far has been largely better than expectations. The Financial sector saw a pick-up in loan growth along with a trend of improving asset quality. Many sectors benefitted from a strong volume growth on the back of stabilization of the GST regime as well as the favourable base of the demonetization quarter in the prior year. These trends were clearly visible in the Consumer staples and the Consumer discretionary sectors. Robust global growth outlook has ignited expectations of higher IT spends going forward even as the earnings of many companies in the Technology sector have been broadly in line with estimates. Incumbents in the Telecom sector continue to be under pressure on account of the higher competitive intensity in the sector. Some companies in the Oil Refining & Marketing space have seen large inventory gains, shoring up their third quarter earnings.

The government announced its capital infusion into the PSU banks through ₹800 bn as recapitalization bonds and ₹81.4 bn as the budgetary support. The recapitalization plan was accompanied by a reforms package aimed at increasing customer responsiveness, delivering responsible banking, improving the credit off-take, MSME focus, deepening financial inclusion & digitalization, and developing quality personnel. The extent of capital infusion would be contingent on performance of PSU banks on these parameters with the whole-time directors assigned these themes for ensuring implementation.

In the Union budget, the government increased the expenditure in the rural sector through increased allocations in key initiatives such as employment guarantee scheme, irrigation, rural roads & connectivity and social welfare schemes targeted towards women and children while marginally reducing the allocation to various rural housing schemes. The Union budget is expected to boost rural incomes and hence increase the purchasing power of rural consumers. The initiatives of the government to catalyse faster job creation in a slew of sectors will also enable higher consumer spends.

The government has provided a reasonable thrust to capital expenditure directing the expenses towards defence, railways, renewable energy, roads and urban development. In the past three years, the government has announced several large-scale infrastructure programs such as Bharatmala, Railway Electrification, Smart Cities, AMRUT and UDAN, which continue to boost its efforts to create quality infrastructure as well as augment the existing infrastructure.

The impact of the imposition of long-term capital gains tax on equity investments in the Union budget has been largely cushioned due to the grand-fathering clause. With the overhang of the Union budget out of the way, the equity investors will shift their focus back to the earnings growth.

Some high frequency indicators in manufacturing such as the growth of IIP in November, the cement production growth in the months of November & December, sustained growth in steel production and acceleration of infrastructure goods production in November reflect an up-tick in the economic activity. The growth in the commercial vehicle sales registered an eight-year high in December. Moreover, the manufacturing PMI expanded for the sixth consecutive month in January led by new orders. The cargo carried by sea, rail and air registered higher growth in November, but showed mixed performance in December. Other indicators such as domestic and international air passenger traffic and foreign tourist arrivals grew at a fast pace in the months of November and December. The services PMI expanded sequentially in December and January on the back of higher business activity.

With the domestic growth outlook improving, we believe that further benefits of the far reaching reforms will accrue in the medium term and that the equity market offers a reasonable entry point for a long-term investor with a 3-5 year view.