Sar utha ke jiyo!

MONTHLY UPDATE

NOVEMBER 2018

November 2018

"A champion is defined not by their wins but by how they can recover when they fall."

- *Serena Williams*

Equity markets

Indices	31st Oct 2018	30th Nov 2018	1 Month Return (%)	1 Year Return (%)
BSE Sensex	34,442.05	36,194.30	5.09	9.19
S&P CNX Nifty	10,386.60	10,876.75	4.72	6.36
BSE 100	10,661.72	11,119.17	4.29	3.86
BSE Mid Cap	14,612.59	15,039.35	2.92	-11.10
BSE Small Cap	14,201.37	14,427.16	1.59	-20.86

Source: Bloomberg

Broader Indian equity markets were up strongly during Nov'18 following the steep declined registered during the previous two months. Sensex was up 5.09% m-o-m in Nov'18 whereas Nifty was up 4.72%. Performance of Mid and small cap indices were muted than the large cap indices; BSE mid cap index was up 2.92%, while BSE small cap index was up 1.59% during the month.

The Sensex is up 9.19% on a y-o-y basis whereas Nifty is up 6.36% y-o-y as at the end of Nov'18. Mid cap and Small cap indices continues to underperform large cap indices on a y-o-y basis. The BSE mid cap index is down 11.10% y-o-y and BSE small cap index is down 20.86% y-o-y.

Among the major global equity indices, performance was mixed. HangSeng index was up 6.11% during the month while FTSE100 declined the most at 2.07% respectively.

For the month of November, Consumer durable sector gained the most at 7.2% followed by Capital goods at 6.6%. Metals sector followed by Healthcare sector declined the most by 5.5% and 2.7% respectively.

FIIs turned net buyers to the tune of Rs4,616cr of equities, following 3 months of outflow while DII's invested Rs1,172cr. Among DIIs, Mutual funds bought Rs2,665cr. In debt market, FIIs were net buyers of Rs5,402cr during the month. For YTD till Nov'18, FIIs have sold equities worth Rs52,662cr while DIIs have bought equities worth Rs84,457cr.

Macro Economic Data

India's real GDP growth slowed down to 7.1% in Q2FY19 from 8.2% in Q1FY19. However, this is higher than 6.3% growth in Q2FY18. Private consumption, which decelerated to 7% in 2Q FY19 from 8.6% in 1QFY19, is the key cause for drop in overall GDP growth. The construction sector showed signs of revival as it grew 7.8% vs. 3.1% in 2QFY18, but it was down from 8.7% in 1QFY19. Mining activities declined by 2.4% and growth of manufacturing sector decelerated to 7.4% in 2QFY19.

Industrial output growthmarginally decelerated to 4.5% in Sep'18, from 4.7% in Aug'18. The drop was led by deceleration in growth of manufacturing goods to 4.6% in Sep'18 from 5.1% in Aug'18 and a drop in capital goods output growth to 5.8% in Sep'18 from 9.3% in Jul'18.

However, primary goods output growth inched up to 2.6% in Sep’18 from 2.5% in Aug’18 and mining output grew by 0.2% in Sep’18 against a decline 0.5% growth in Aug’18.

Core sector output growth slowed down to 4.3% in Sep’18 from 4.7% in Aug’18. The fall was majorly led by deceleration in steel output growth (3.2% in Sep’18 vs. 4% in Aug’18) and cement output growth (11.9% in Sep’18 vs. 14.7% in Aug’18). The natural gas output declined by 1.9% in Sep’18, following 1% growth in Aug’18.However, electricity output increased by 8.2% in Sep’18, from 7.6% in Aug’18.

CPI inflation eased to 3.3% in Oct’18 from 3.7% in Sep’18 as food deflation further decreased to -1.5% in Oct’18 from -0.2% in Sep’18. Among the categories in food basket, vegetable prices (Wt: 6%) declined by -8.1% in Oct’18 from -4.2% in Sep’18. However, core inflation (excl. food & fuel) increased to 6.1% in Oct’18,up from 5.7% in Sep’18. Services inflation increased to 6.7% in Oct’18 from 5.6% in Sep’18 led by increase in inflation for Household goods & Services to 6.1% in Oct’18 vs. 5.6% in Sep’18.

Trade deficit widened to $17.1bn in Oct’18 from $14bn in Sep’18. Imports increased by 17.6% in Oct’18 to $44.1bn and exports increased by 17.9% in Oct’18 to $27bn.Gold imports declined by 43% to $1.7bn in Oct’18 from $2.6bn in Sep'18. Core imports i.e. non-oil & non-gold imports grew by 11.8% yoy to $28.2bn, following 1.2% growth in Sep’18. Non-oil & non-gold trade deficit widened to $9.3bn in Oct’18 from $8.7bn in Sep’18.

The current 10-year benchmark yield declined to 7.60% as at end Nov’18 as against 7.85% as at end Oct’18.

After a sharp depreciation, Indian rupee appreciated in Nov’18, as it moved from 73.95 in Oct’18 to 69.58 at the end of Nov’18.Falling crude prices coupled with positive FPI flows aided the sharp appreciation of INR.

Commodities (USD)	1 Month Return (%)	One Year Return (%)
Gold	0.64	-4.11
Silver	-0.46	-13.71
Crude Oil	-20.88	-6.91
Copper	3.44	-8.34
Primary Aluminum	0.23	-4.39
Lead	2.44	-20.20
Nickel	-2.61	0.81
Tin	-3.66	-6.22
Zinc	1.97	-19.46

Source: Bloomberg

The performance of major commodities was mixed during the month of Nov’18. Copper followed by Lead gained the most during the month at 3.4% and 2.4% respectively whereas Crude Oil declined the most by 20.9%. On a y-o-y basis, except Nickel all other commodities posted decline.

Observations

GST collection after crossing Rs. 100,000cr in October has again come back to the Rs. 90-95,000cr per month range. This poses risks to the fiscal deficit target because the budgeted revenue number calls for a much higher runrate for the remainder of the year.

Trade deficit also has widened in the recent months, driven by continued strength in electronic imports and high crude prices. The recent correction in crude prices and consequent appreciation of the Rupee from recent lows should help going forward. Key, ofcourse, is going to be the extent of production cut OPEC decides to undertake and levels at which crude settles down on a more sustainable basis. Growth in some high frequency indicators like cement dispatches, steel production, petrol and diesel consumption continues to do well. However, auto sales including M&HCV have slowed down in recent months. Growth over the next two quarters should moderate a bit as the base has normalized. We, however, expect the growth to pick post that. 10-Yr yield has once again come down below 8%, driven by favorable developments on the macro front including lower crude prices, stable Rupee and lower inflation.

Q2FY19 results were satisfactory after a respectable Q1. While the headline numbers at the index level looked subdued because of continued higher provisioning by corporate banks, the underlying trends for other sectors looked encouraging. Auto sector earnings were impacted by higher commodity prices and INR depreciation. IT sector, at the same time, delivered good margin performance driven by Rupee gains.

Outlook

Global trade related uncertainties have continued to haunt the markets with no signs of a negotiated resolution visible yet. Thankfully for India, Crude oil prices had a sharp correction in November after an equally sharp rally in the earlier months. The recent correction has been driven by US imposing less stringent conditions on import of Iranian crude by eight largest importers. Emerging market currencies were stable after having seen a sharp depreciation earlier. Commodity price fluctuations, risk of escalation of a global trade war and volatility in currency markets pose risks to the near term outlook.

The bankruptcy resolution process has made decent progress with a few cases having been resolved and good visibility in a few other large accounts. However, the outlook on resolution is bleak on the second list. But with management changes being implemented in a few large corporate lenders, market in hopeful on their performance improving going forward.

While equity flows have remained positive despite a volatile market, the net amount has trended down with November inflows of Rs. 10,000cr in equity schemes of mutual funds. FII flows turned positive in November even though they remain net sellers on a YTD basis. Given an election heavy calendar and volatility in INR, this trend is important to watch as it will have a bearing on the overall liquidity conditions in the equity markets.

Despite the macro related uncertainty in the short term, we believe that the medium term outlook of the Indian economy and consequently the equity markets is quite good. As the benefits of GST and cleanup of bank balance sheets start becoming clear, we should see improvement in growth indicators. Earnings are, however, expected to grow at 20% CAGR over the next two years. Market valuations at 17x FY20 earnings are at historical mean levels. Given that we expect a cyclical recovery going ahead, these multiples should not be considered as very expensive. We continue to remain optimistic from a medium to long term point of view, despite our near term concerns.

Debt markets Update – December, 2018

November Highlights

- After the gains seen in October, November, too, was a positive month for the bond markets. Global Crude oil prices corrected markedly in November from its recent peak of $85.38 per barrel in October. Moreover, the data releases during the month also came in positive with CPI inflation and trade deficit coming below the market expectations. Liquidity conditions tightened substantially in November as cash withdrawals from banks picked up ahead of the festive season. To address the liquidity situation, the RBI conducted longer tenure term repos and OMO purchase of government securities. In November, the RBI conducted OMO purchases of Rs 500 billion and announced another Rs 400 billion of OMO purchases for December. Bond yields softened across the curve. The G-Sec 10 yr benchmark bond yield fell from 7.85% to finally close at 7.60% in the month of November.
- The IIP for September came in at 4.5%, compared to 4.3% in August. The index growth was helped by a favorable base due to the impact of GST introduction last year. The mining index came in at 0.2% in September as compared to -0.4% in the month of August. The manufacturing index for September, was flat at 4.6%. On the use based index, basic goods came in flattish as compared to the previous month at 2.6%, while intermediate goods inched down from the previous month at 1.4% from 2.4% in August. Consumer durable goods came in slightly lower at 5.8% in September, from 5.9% in August. Consumer non-durables sub-index, also, inched down to a print of 6.1% from 6.3% in August.
- Headline CPI inflation, for October, eased considerably and came in at 3.31% from 3.77% in October. The low print in the number was mainly due to a favorable base effect and lower food inflation. The food inflation came in lower at -0.14% in October versus 1.08% in September. Underlying the benign food inflation, vegetable inflation was lower at -8.10% from -4.15% and the pulses inflation continued in the negative zone at -10.28% as compared to -8.58% in the previous month. The fuel and light index, moved higher to 8.55% from 8.47% and housing index showed a marginally lower print of 6.55% from 7.07%. The miscellaneous index, came in significantly higher at 6.73% from 5.65% in the month of October. On a MoM basis the core inflation came in higher at 6.20% from 5.87% in the previous month.
- Headline WPI inflation came in higher, at 5.28% in October from 5.13% in September primarily due to the increase in the fuel index and manufacturing index. Primary articles inflation fell sharply from 2.79% in September to 1.79% in October. Food inflation fell further and came in at -1.43 from -0.21 in October. The manufactured products category was higher in October at 4.49% vs 4.22% in the previous month. The fuel and power index, too, was higher, and showed a double digit print of 18.44% as compared to 16.65%. Vegetable index showed a

drastic negative print for the month of October at -18.65% vs -3.83% in the month of October. Core inflation, meanwhile, came in higher at 5.15% in October vs 4.88% in September.

- In the month of October, Exports rose 17.90% to $ 27.0 bn, while imports rose 17.6% to $44.1bn resulting in trade deficit of $17.4bn compared with $14.0bn in the previous month. The sharp jump in oil imports was the main reason for the renewed rise in trade deficit.

Outlook

- Oil prices have a large bearing on India's economy. The lower oil prices have reduced the stress on the current account deficit, fiscal deficit as well as inflation. The Indian Rupee and bond yield movements reflect these changes.
- Going ahead, the direction of oil prices will play a large role in determining the direction for bond yields. Global growth, and consequently, oil demand is expected to slow down as the US – China trade war takes its toll on economic activity and trade. Meanwhile, oil supply is expected to stay ample as large producers continue to produce close to full capacity, helping the market to expect a benign trend on oil prices.
- Secondly, the continued OMO purchases by RBI is expected to support bond prices over the coming months. The large liquidity deficit and the lack of a BoP surplus is expected to lead to RBI buying more GSecs through OMO purchases. These purchases along with the lower oil prices are expected to favour lower bond yields.
- However, the key risks to the markets are from the Government's fiscal balances. A shortfall in key revenue sources – indirect taxes, dis-investment etc have made the likelihood of a fiscal slippage more probable.
- Political developments are another key factor for the markets. The election results in large states of Rajasthan, Madhya Pradesh and Chhattisgarh will be seen as a precursor to the trend in the general elections next year. Political uncertainty could also exacerbate concerns on economic and fiscal stability.
- Overall, we expect bond yields to stay soft if oil prices continue their benign trends, though uncertainties on the fiscal front are likely to add some volatility to bond yields.