HDFC Life

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MONTHLY UPDATE

DECEMBER 2018

December 2018

"Optimism is the faith that leads to achievement. Nothing can be done without confidence and hope"

- *Helen Keller*

Equity markets

Indices	30th Nov 2018	31st Dec 2018	1 Month Return (%)	1 Year Return (%)
BSE Sensex	36,194.30	36,068.33	-0.35	5.91
S&P CNX Nifty	10,876.75	10,862.55	-0.13	3.15
BSE 100	11,119.17	11,161.02	0.38	1.19
BSE Mid Cap	15,039.35	15,438.45	2.65	-13.38
BSE Small Cap	14,427.16	14,706.69	1.94	-23.53

Source: Bloomberg

Broader Indian equity markets were almost flat during Dec'18; Sensex was down 0.35% m-o-m in Dec'18 whereas Nifty was down 0.13%. Performance of Mid and small cap indices were better than the large cap indices; BSE mid cap index was up 2.65% while BSE small cap index was up 1.94% during the month.

The Sensex is up 5.91% on a y-o-y basis whereas Nifty is up 3.15% y-o-y as at the end of Dec'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 13.38% y-o-y and BSE small cap index is down 23.53% y-o-y.

All the major global equity indices posted negative returns during the month of Dec'18 with indices declining in the range of 2.49% to 10.45%. HangSeng index declined the least while Nikkei declined the most.

For the month of Dec'18, Power sector gained the most at 4.60% followed by Oil and gas sector at 3.79%. Healthcare sector followed by IT sector declined the most by 2.86% and 1.45% respectively.

FIIs remained net buyers to the tune of Rs2,426cr of equities while quantum of DII's investment lowered to Rs376cr. Among DIIs, Mutual funds bought Rs2,730cr. In debt market, FIIs were net buyers of Rs5,805cr during the month. For YTD till Dec'18, FIIs have sold equities worth Rs50,236cr while DIIs have bought equities worth Rs84,833cr.

Macro Economic Data

RBI kept the repo rate unchanged at 6.50% in Dec'18 monetary policy. Consequently, the reverse repo rate under the LAF remained at 6.25%, and the marginal standing facility (MSF) rate at 6.75%. RBI has also reduced the SLR by 25 bps from 19.5% in Oct'18 to 19.25% in Dec'18.

Industrial output growthaccelerated to 8.1% in Oct'18, from 4.5% in Sep'18. The accelerationwas led by the rise in growth of manufacturing goods to 7.9% in Oct'18 from 4.6% in Sep'18 and ajump in capital goods output growth to 17% in Oct'18 from 6.5% in Sep'18. However, Infra and construction goods output growth moderated to 8.7% in Oct'18 from 9.3% in Sep'18.

Core sector output growth slowed down to3.5% in Nov'18, from 4.7% in Oct'18. The fall was majorly led by sharpdrop incoal output growth (3.7% in Nov'18 vs. 11.3% in Oct'18) and cement output growth (8.9% in Nov'18 vs. 18.5% in Oct'18). The electricityoutput growth slowed down to5.4% in Nov'18, following 10.8% growth in Oct'18.

CPI inflation eased to 2.3% in Nov'18 from 3.4% in Oct'18 as food category slipped further into deflation to -1.7% in Nov'18, from -0.1% in Oct'18. Among the categories in food basket, vegetable prices (Wt: 6%) declined by -15.6% in Nov'18, from -8.1% in Oct'18. Also, core inflation (excl. food & fuel) eased to 5.7% in Nov'18,downfrom 6.2% in Oct'18. Services inflation slightlyeased to 6.2% in Nov'18 from 6.7% in Oct'18 led by a fall in inflation for Transport & Communicationto 6.1% in Nov'18 as compared to7.7% in Oct'18.

Trade deficit narrowedto US$16.7bn in Nov'18,from US$17.1bn in Oct'18. Imports grew by 4.3% in Nov'18to US$43.2bnwhileexportsdeclinedby0.8% in Nov'18 to US$26.5bn. Gold imports increased by 15% to US$2.8bn in Nov'18, from US$1.7bn in Oct'18. Core imports i.e. non-oil & non-gold imports droppedby 5.8% yoy to US$26.9 bn in Nov'18, following 11.7% growth in Oct'18.Non-oil & non-gold trade deficit narrowed to US$8.4bn in Nov'18 from to US$9.2bn in Oct'18.

The current 10-year benchmark yield declined to 7.37% as at end Dec'18 vs 7.60% as at end Nov'18.

Indian rupee depreciated slightly at 69.77 INR/USD in Dec'18 vs 69.58 INR/USD in Nov'18 led by moderated FPI flows and fall in crude oil prices.

Commodities (USD)	1 Month Return (%)	One Year Return (%)
Gold	4.90	-1.58
Silver	9.25	-8.53
Crude Oil	-9.02	-20.43
Copper	-3.77	-17.69
Primary Aluminum	-5.72	-18.61
Lead	2.54	-18.75
Nickel	-4.55	-16.22
Tin	5.84	-2.75
Zinc	-2.95	-25.67

Source: Bloomberg

The performance of major commodities was mixed during the month of Dec'18. Silver followed by Tin gained the most during the month at 9.25% and 5.84% respectively whereas Crude Oil declined the most by 9.02%. On a y-o-y basis, all major commodities posted decline.

Observations

RBI governor Urjit Patel resigned marking a rare event in the institution's history with the govt. announcing former bureaucrat Shaktikanta Das as his successor, a day later. RBI announced a slew of OMOs for next 3 months, taking the Jan-Mar quarter OMO to Rs. 1.5 trillion.

GST collections dropped to Rs. 947bn in Dec'18, down from Rs. 976bn in Nov'18.The government expects collections to improve further after the effective implementation of inter-state e-way bill and improving compliance.

The GST meet concluded with 6 items being removed from 28% tax bracket, while 28 items continue to remain in the slab. Automobile parts, consumer electricals, cement goods remained in the highest bracket

The NE monsoon has been deficient at -11% in 2018, mainly led by Andhra Pradesh (-26%). Five of the eight climate models predict the possibility of El Niño in 2019. If it pans out, it would be bad for rainfall in 2019.

As on Dec'18, total sown area under the Rabi season stood at 54.6mn hectares,down by 3.5% compared to the previous year. While the area under cultivation for Wheat (1%) witnessed increase, sowing of rice (-28%), coarse cereals (-17%), pulses(-6%)declined.

Outlook

The macro backdrop for India improved as crude oil prices corrected sharply during the month thus giving the much needed breather for the Indian economy.

On the global front, going by investor expectations, if US Fed goes slow on rate hikes in 2019, we can expect dollar index to weaken and flows to return to EMs. Given the challenging global growth outlook, export oriented EMs will be at a disadvantage to India, whose macroeconomic fundamentals are relatively strong and earnings recovery is on the cards. However, given the general election overhang till May, we can expect robust FPIs flows only in H2FY19.

With domestic indicators showing improving trend, however global trade related uncertainties have continued to haunt the markets. Commodity price fluctuations, risk of escalation of a global trade war and volatility in currency markets pose risks to the near term outlook.

Given an election heavy calendar and INR volatility, it is important to watch the trend with regards to net investments by institutional investors into equities as it will have a bearing on the overall liquidity conditions in the equity markets.

Despite the uncertainty in the short term, we believe that the medium term outlook of the Indian economy and consequently the equity markets is good. As the benefits of GST and cleanup of bank balance sheets start becoming clear, we should see improvement in growth indicators. Earnings are expected to grow at 19% CAGR over the next two years. Realization of anticipated earnings recovery, management commentary in the forthcoming 3QFY19 results will be the key catalysts, in our view. Indian 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.

Debt markets Update – January, 2019

December Highlights

- Bond markets continued to see the positive trends strengthen in December, supported by positive surprises in economic data. CPI inflation and trade deficit printed below the market expectations. Crude oil prices continued softening in December from its recent peak of $85.38 per barrel seen in October. Liquidity conditions, however, tightened substantially in December on the back of tax payments. To address the liquidity deficit, the RBI conducted longer tenure term repos and OMO purchase of government securities. After OMO purchases of Rs 500 bn in November, RBI bought another Rs 500 bn of GSecs in December. Bond yields softened across the curve. The GSec 10 yr benchmark bond yield fell from 7.60% to close at 7.37% in the month of December.
- The IIP for October came in at 8.1%, compared to 4.5% in September. The growth was helped by a favorable base ahead of the festive season. The mining index, came in sharply higher at 7.0% in October as compared to 0.2% in September. The manufacturing index for October also came in higher at 7.9% vs 4.6% in September. The electricity index came in at 10.8% vs 8.2% in October. On the use based index, basic goods also came in higher as compared to the previous month at 6.0%, while intermediate goods inched slightly higher from the previous month at 1.8% from 1.4% in October. Consumer durable goods came in positive at 17.6% in October, from 5.2% in September.
- Headline CPI inflation, for November, eased considerably and came in at 2.33% from 3.31% in October. The low print in the number was mainly due to a favorable base effect and easing of almost all the inflation components. The food index dipped further into negative territory at -1.69% in December versus -0.14% in October. Underlying the food inflation, vegetable inflation came in lower at -15.59% from -8.10% and the pulses inflation continued to stay in the negative zone at -9.22% as compared to -10.28% in the previous month. The fuel and light index, also fell to 7.39% from 8.55% and housing index showed a marginally lower print of 5.99% from 6.55%. The miscellaneous index, also eased and came in lower at 6.15% from 6.73% in the month of November. On a MoM basis the core inflation came in lower at 5.73% from 6.20% in the previous month.
- Headline WPI inflation came in lower, at 4.64% in November from 5.28% in October mainly due to the softening in the fuel index and food index. Primary articles inflation fell sharply from 1.79% in October to 0.79% in November. Food inflation fell further and came in at -3.31% from -1.49% in November. The manufactured products category was also lower in November at 4.21% vs 4.49% in the previous month. The fuel and power index, too, was lower, with a print of 16.28% as compared to 18.44%. Vegetable index showed a drastic negative print for the month of November at -26.98% vs -18.65% in the month of November. Similar to the CPI inflation prints, core WPI inflation, also came in lower at 4.88% in November vs 5.15% in October.
- In November, exports slowed to $ 26.5bn up by 0.8% YoY, while imports at $ 43.2bn were up 4.3% YoY. Consequently trade deficit came in softer at $ 16.67bn vs $ 17.1bn in the previous month.

Outlook

- The confluence of positive developments of falling oil prices, lower inflation and large OMO purchases by RBI have helped bond yields soften significantly from the peak levels seen in September. At the current levels, the yields have largely discounted these factors. We need to see a further meaningful correction in oil prices or a further weakness in global growth outlook and an easing in the developed market monetary policy stance to see further softening in domestic bond yields. Yields are likely to stay benign as expectations of a rate cut build up and the OMO purchases keep the demand-supply balance favourably tilted.
- However, a key concern for the markets will be the Government’s fiscal balances. The revenues from indirect taxes and non-tax sources have been short of budgeted estimates. After the loss of power in three heartland states for the ruling coalition, in December, the market fears that the Government could undertake some additional spending in the agricultural and rural sectors to assuage the disquiet in these sectors and shore up support before the general elections scheduled in 2019. These concerns are likely to temper any fall in yields in the near term.