MONTHLY UPDATE
FEBRUARY 2019

HDFC Life

Sar utha ke jiyo!

February 2019

"Great things in business are never done by one person; they are done by a team of people"

- *Steve Jobs*

Equity markets

Indices	31st Jan 2019	28th Feb 2019	1 Month Return (%)	1 Year Return (%)
BSE Sensex	36,256.69	35,867.44	-1.07	4.92
S&P CNX Nifty	10,830.95	10,792.50	-0.36	2.86
BSE 100	11,054.82	10,988.69	-0.60	1.14
BSE Mid Cap	14,560.09	14,318.36	-1.66	-13.55
BSE Small Cap	13,926.22	13,689.84	-1.70	-24.48

Source: Bloomberg

Broader Indian equity markets declined during Feb'19; Sensex was down 1.07% m-o-m in Feb'19 whereas Nifty was down 0.36%. Mid and small cap indices underperformed the large cap indices; BSE mid cap index was down 1.66% while BSE small cap index was down 1.70% during the month.

The Sensex is up 4.92% on a y-o-y basis whereas Nifty is up 2.86% y-o-y as at the end of Feb'19. 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 13.55% y-o-y and BSE small cap index is down 24.48% y-o-y.

All the major global equity indices posted positive returns during the month of Feb'19 with indices gaining in the range of 1.52% to 13.79%. Shanghai Composite index gained the most followed by CAC 40 index.

For the month of Feb'19, Auto sector gained the most at 1.68% followed by Oil and gas sector. Power sector followed by banking sector declined the most during the month.

FIIs turned net buyers to the tune of Rs15,328cr of equities while DII's were net sellers to the extent of Rs566cr. Among DIIs, Mutual funds bought Rs5,324cr. In debt markets FIIs were net sellers of Rs9,290cr during the month. For YTD till Jan'19, FIIs have sold equities worth Rs35,412cr while DIIs have bought equities worth Rs86,414cr.

Macro Economic Data

India's GDP growth decelerated to 1.5 years low of 6.6% in 3QFY19 against 7% growth in 2QFY19 and 7.7% growth in the year ago quarter. Notably, Govt. exp. growth declined to 6.5%, the lowest in over 2-years vs. 10.8% in 2QFY19 is the key issue of drop in overall GDP growth. On the supply side, Gross value added (GVA) growth moderated to 6.3% in 3QFY19 from 6.8% in 2QFY19 led by sharp decline in agriculture sector growth to 2.7% from 4.2% in 2QFY19. However, construction activities grew 9.6% in 3QFY19 vs. 8.5% in 2QFY19.Services growth marginally moderated to 7.2% in 3QFY19 from 7.4% in 2QFY19

Industrial output growth accelerated to 2.4% in Dec'18, from 0.3% in Nov'18. The acceleration was led by the manufacturing sector which grew by 2.7% in Dec'18, following 0.6% decline in Nov'18 and capital goods output rose by 5.9% in Dec'18 from a contraction of 3.1% in Nov'18. Notably, consumer durable ouput grew by 2.9% in Dec'18 from decline of 2.1% in Nov'18 and non-consumer output growth accelerated to 5.3% in Dec'18, following 0.6% decline in Nov'18.

Core sector output growth slowed down to1.6% in Jan'19, from 2.7% in Dec'18. The fall was majorly led by sharp drop in electricity output (-0.4% in Jan'18 vs. 4.4% in Dec'18). The petroleum product output growth fell to 2.6 % in Jan'19, following 4.8% in Dec'18. However, coal output growth (1.7% in Jan'19 vs 1.1 % in Dec'18) and steel output growth (10.5 % in Jan'19 vs -2.4 % in Dec'18).

CPI inflation eased to 2% in Jan'19, from 2.2% in Dec'18. The food category remained in deflation (-1.3 % in Jan'19 vs -1.6 % in Dec'18), continued to keep CPI low. This is mainly due to Pulses, Sugar, fruits and Vegetables, which are in sharp deflation at ~-8%.).Services inflation also moderated to 6% in Jan'19 from 6.4% in Dec'18, led by drop in inflation for Education (8% in Jan'19 vs 8.4% in Dec'18) and Entertainment (5.4% in Jan'19 vs 6% in Dec'18). Also, fuel inflation fell to 2.2% in Jan'19 vs. 4.5% in Dec'18. Notably, core inflation also moderated to 5.4% in Jan'19, from 5.6% in Dec'18.

Trade deficit widened toUS$14.7bn in Jan'19 from US$13.1bn in Dec'18.Imports marginally up by 0.02% in Jan'19to US$41.1bn, while exports grew by 3.7% in Jan'19 to US$26.4bn. Gold imports jumped by 38.2% to US$2.3bn in Jan'19, from US$1.7bn in Jan'18. Core imports i.e. non-oil & non-gold imports dropped by 0.8% yoy to US$27.5bn in Jan'19, following 1.9% decline in Dec'18.Non-oil & non-gold trade deficit marginally widened to US$6.7bn in Jan'19 from to US$6.6bn in Dec'18..

The old 10-year benchmark yield increased from 7.48% as at the end of Jan'19 to 7.59% as at end Feb'19. The yield of new 10-year instrument issued in Jan'19 (coupon for this instrument was set at 7.26%) was at 7.41% at the end of Feb'19.

Indian Rupee appreciated by 0.5% during Feb'19, as it closed at 70.7 in the end of Feb'19 from 71.1 at the end of Jan'19 per dollar.

Commodities (USD)	1 Month Return (%)	One Year Return (%)
Gold	-0.60	-0.38
Silver	-2.82	-4.92
Crude Oil	8.01	2.06
Copper	5.51	-6.09
Primary Aluminum	0.05	-10.37
Lead	1.85	-14.03
Nickel	4.57	-5.37
Tin	3.84	0.56
Zinc	2.17	-19.57

Source: Bloomberg

All the major commodities except Gold and Silver were up in Feb'19; Crude Oil followed by Copper posted the maximum gains. On a y-o-y basis, all the major commodities except Crude Oil and Tin posted negative returns. Zinc has declined the most by 19.57% followed by Lead at 14.03%.

Observations

RBI in it's Feb'19 bi-monthly policy reduced the repo rate by 25bps to 6.25% from 6.50%. Consequently, reverse repo rate adjusted to 6.0% and MSF rate at 6.5%.

GST collections for Feb'19 dropped to Rs.972bn down from Rs.1,002bn in Jan'19 on account of reduction in tax rates on 23 good and services

Fiscal deficit touched 112.4% of the full-year budget target of Rs 6.2tn at the end of December on account of lower revenue collections. The fiscal deficit between Government's expenditure and revenue, stood at Rs 7tn during Apr-Dec FY19

Outlook

Global equity markets have done well since the beginning of this year, driven primarily by a change in stance by the US Fed when they indicated a slower than expected hardening of rates. In addition, there seems to be some moderation in the US-China trade-related tensions with both sides making concessions and committing more time to eventually arrive at an acceptable solution. There has been some slowdown in global growth, especially in China and the EU, reflecting in lower commodity prices. Crude oil, however, has bounced back smartly to $65 levels, a result of supply discipline by the OPEC. Prices in the $60-70 per barrel range are manageable from India's point of view but a sustained increase beyond that will impact our macro fundamentals.

GST collections have failed to show a sustainable pickup with revenues once again falling short of Rs. 100,000cr. This makes meeting even the revised budgeted fiscal deficit target difficult unless the government cuts expenditure even more. Sops announced in the union budget will make fiscal maths for FY20 even more challenging unless GST revenues show a meaningful pickup. This will perhaps call for a much more stricter implementation of eWay bill and invoice matching post the elections. So while lower than expected inflation and a slower GDP print make a strong case for Repo rate cuts by the RBI, tough fiscal situation and consequently higher borrowing by the government rule out a significant softening in the bond yields. Auto sales continued to be subdued in Feb. Some of the other high frequency data like cement and steel sales, fuel consumption and port traffic, however, are not showing as significant a moderation.

Q3 results showed some impact of higher commodity prices in the margins of consumer and auto companies. Some of these commodities have cooled off subsequently which should reflect in Q4. Volume trend for FMCG companies was good but there was some evidence of downtrading. Corporate banks continued showing improvements in incremental slippages. IT companies showed encouraging top line and order booking. However, aggregate estimates have been cut with largest cuts in Automobiles.

Inflows in Mutual funds have been slowing down and that trend got reaffirmed in Feb with net equity inflows of only Rs. 5,000cr. FII flows on the other hand have turned positive after the US Fed turned slightly dovish triggering money flow into the emerging markets.

Despite the macro related and election driven 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 expected to grow at 20% CAGR over the next two years as per consensus estimates. 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 expensive. We continue to remain optimistic from a medium to long term point of view, despite our near term concerns.

Debt markets Update – March, 2019

February Highlights

- Bond yield curves steepened during February as the shorter maturity bond yieldssoftenedwhile the longer end continued to rise. Bondshad a poor start to the month after the Interim Budget confirmed a slippage in the fiscal deficit. Bonds, however, rallied soon after as the RBIdelivered a 25 basis points rate cut and lowered its stance of monetary policy to ‘neutral’ from ‘calibrated tightening’. RBI also continuedpurchases of bonds under open market operations to alleviate the liquidity deficit in the system. Bond prices, thereafter, resumed falling due to rising crude oil prices and excessive supply in the longer maturity segment.Crude oil prices rose from $61.89 per barrel, in January, to close the month at $66.03 per barrel, in February.Data releases, though, came in positive with CPI inflation and WPI inflation coming below the market expectations.The G-Sec 10-year benchmark closed the month at 7.41% hardening from 7.28% levels at the end of January.

- The IIP for December came inhigher at 2.40%, compared to 0.3% in November, due to the high base effect. The manufacturing index for December recovered sharply and came in positive at 2.7% vs -0.6% in December. The electricity index showed a lower growth and came in at 4.4% vs 5.1% in December.The mining index, came in lower in negative zone at -1.0% in December as compared to 2.7% in the month of November.On the use based index, basic goodscame in lowerat -1.2%, while intermediate goodscontinued to be in negative at -1.5% from -4.4% in December.Consumer durable goods recovered and came in positive from negative at 4.4%in December, from -1.2% in November. Consumer non-durables sub-index, also, slipped and showed a negative printof -0.6% from 7.9% inNovember.

- Headline CPI inflation, for January,easedconsiderably and came inat 2.05% from 2.19% in December.The low print in the number was mainly due to favorable base and easing effect of food and beverages inflation as well as in fuel inflation.The food index continued to stay in negative zoneat -1.29% in January versus -1.49% in December.Underlying the food inflation, vegetable inflation continued to stay in the negative zone at -13.32% from -16.14%. Pulses deflation eased, but continued to stay in the negative zone at -5.50% as compared to -7.13% in the previous month. The fuel and light index fell to 2.20% from 4.54% and housing index showed a marginally lower print of 5.20% from 5.32%. The miscellaneous index, alsocame in slightly lower at 6.04% from 6.45% in the month of January. On a sequential basis, the core inflation came in lower at 5.38% from5.73% in the month of January.

- Headline WPI inflation came in lower, at 2.76% in Januaryfrom 3.80% in December mainly due to the softening in the fuel index and manufactured prices. Primary articles inflation rose sharply from 2.28% in Decemberto 3.54% in January. Food inflation inched up and came in positive zone at 2.34%from -0.07% in January.The manufactured products category was lower in January at 2.61% vs 3.59% in the previous month. The fuel and power index, too, came in sharplylower at1.85% as compared to 8.38%. Vegetable index continued to show a negative print for the month of January at -4.21% vs -17.55% in the month of December. Core WPI inflation, also came in sharply lower at 2.91% in January vs 4.22% in December.

- In January, Exportsat $27.93bn were up 0.4% as compared to $26.5bn last month, while imports at $41bn were down by 2.40% as compared to $43.2bn last month. Consequently trade deficit came in at $13.10bn as compared to $16.67bn in the previous month.

Market Outlook –

- At the current juncture, there are contrasting narratives playing out in the bond markets.
- The inflation trajectory is forecast to be benign, with the peak inflation for the year staying well within the mandated range for RBI. Domestic growth is slowing down, which helps reduce the potential for demand-pull inflation pressures. Global growth, too, is slowing down, which is expected to keep commodity prices soft and head off supply-push price pressures. Oil, though, remains an exception, where the producers' cartel has had reasonable success in restricting supply to support crude oil prices.
- Monetary policies of the large developed economy monetary authorities are turning increasingly soft in response to faltering growth and low inflation. The inflation-targeting RBI MPC is expected to cut interest rates by another 50 bps in the coming months. These factors are positive for the bond markets.
- However, the key concern for the markets over the coming quarters, is the sharp rise in bond supply. Government borrowing is expected to be large in the coming quarters, as the Government is expected to front-load its borrowing in the first half of the coming year. The large OMO purchases from RBI, which supported the markets this year, is likely to be lower in the coming year, adding to the supply concerns.The large borrowing, with limited OMO support, is likely to push yields higher.
- The contrasting factors have led to a steepening of the yield curve. We expect that this steepness will persist till the concerns over supply are mitigated, either through RBI stepping up its purchases through OMO auctions, or an increased FPI inflow in the bond markets.