MONTHLY UPDATE
JANUARY 2019

HDFC Life

Sar utha ke jiyo!

January 2019

"The best preparation for tomorrow is doing your best today"

- *H Jackson Brown Jr*

Equity markets

Indices	31st Dec 2018	31st Jan 2019	1 Month Return (%)	1 Year Return (%)
BSE Sensex	36,068.33	36,256.69	0.52	0.81
S&P CNX Nifty	10,862.55	10,830.95	-0.29	-1.78
BSE 100	11,161.02	11,054.82	-0.95	-3.19
BSE Mid Cap	15,438.45	14,560.09	-5.69	-16.15
BSE Small Cap	14,706.69	13,926.22	-5.31	-25.59

Source: Bloomberg

Broader Indian equity markets were almost flat during Jan'19; Sensex was up 0.52% m-o-m in Jan'19 whereas Nifty was down 0.29%. Mid and small cap indices underperformed the large cap indices; BSE mid cap index was down 5.69% while BSE small cap index was down 5.31% during the month.

The Sensex is up 0.81% on a y-o-y basis whereas Nifty is down 1.78% y-o-y as at the end of Jan'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 16.15% y-o-y and BSE small cap index is down 25.59% y-o-y.

All the major global equity indices posted positive returns during the month of Jan'19 with indices gaining in the range of 3.49% to 10.59%. Nasdaq gained the most followed by HangSeng index.

For the month of Jan'19, IT sector gained the most at 8.34% followed by Consumer durable and banking sector. All the other sectoral indices declined during the month; with Auto sector declining the most by 11.23%.

After two months of net buyers, FIIs turned net sellers to the tune of Rs505cr of equities while quantum of DII's investment increased to Rs2,147cr. Among DIIs, Mutual funds bought Rs6,537cr. In debt market too FIIs were net sellers of Rs2,601cr during the month. For YTD till Jan'19, FIIs have sold equities worth Rs50,741cr while DIIs have bought equities worth Rs86,980cr.

Macro Economic Data

Industrial output growth slipped to a 17-month low of 0.5% in Nov'18, from 8.4% in Oct'18. The deceleration was led by the manufacturing sector which contracted by 0.4% in Nov'18, following 8.2% growth in Oct'18 and capital goods sector which declined by 3.4% in Nov'18 vs. 17% growth in Oct'18. Also, Infra and construction goods output growth slowed down to 5% in Nov'18 from 8.9% in Oct'18.

Core sector output growth slowed down to 2.6% in Dec'18, from 3.4% in Nov'18. The fall was majorly led by sharp drop in coal output growth (3.7% in Nov'18 vs. 11.3% in Oct'18), petroleum products output growth (-4.8 % in Dec'18 vs 2.3 % in Nov'18) and further decline in crude oil output (4.3% in Dec'18 vs. 3.5% in Oct'18). The electricity output growth slowed down to 4.0% in Dec’18, following 5.1% growth in Nov’18. However, cement output growth (11.6% in Dec’18 vs 8.8 % in Nov’18) and steel output growth (13.2 % in Dec’18 vs 5.8 % in Nov’18) accelerated.

CPI inflation further eased to 2.2% in Dec’18 from 2.3% in Nov’18 from. The easing in CPI inflation is majorly led by food category deflation (-1.5 % in Dec’18 vs -1.7 % in Nov’18). Within food, three key categories - Pulses, Sugar and Vegetables (~10% wt. in CPI) - are in sharp deflation at ~-11%. Core inflation moderated marginally to 5.6 % in Dec’18, from 5.7% in Nov’18 led by fall in transportation inflation to 4.3% in Dec’18 from 6.1% in Nov’18.

Trade deficit narrowed to a 10-month low of US$13.1bn in Dec’18 from US$16.7bn in Nov’18. Imports declined by 2.4% in Dec’18to US$41.1bn while exports grew marginally by 0.4% in Dec’18 to US$13.1bn. Gold imports declined by 24.3% to US$2.6bn in Dec’18, from US$3.4bn in Dec'17. Core imports i.e. non-oil & non-gold imports dropped by 1.9% yoy to US$27.8bn in Dec’18, following 5.8% decline in Nov’18. Non-oil & non-gold trade deficit narrowed to US$6.7bn in Dec’18 from to US$8.4bn in Oct’18.

The old 10-year benchmark yield increased to 7.48% as at the end of Jan’19 vs 7.37% as at end Dec’18. During the month of Jan’19 new 10 year instrument was issued; the coupon for which was set at 7.26%.

Indian Rupee depreciated by 2% during Jan’19, as it closed at 71.1 from 69.7 at the end of Jan’19 per dollar as of end-Dec’18.

Commodities (USD)	1 Month Return (%)	One Year Return (%)
Gold	3.02	-1.58
Silver	3.67	-8.53
Crude Oil	14.56	-20.43
Copper	3.42	-17.69
Primary Aluminum	3.47	-18.61
Lead	4.50	-18.75
Nickel	16.74	-16.22
Tin	7.06	-2.75
Zinc	10.21	-25.67

All the major commodities were up in Jan’19; Nickel followed by Crude Oil posted the maximum gains. On a y-o-y basis, all the major commodities continue to post decline. Zinc has declined the most by 25.67% followed by Crude Oil at 20.43%. Gold and Tin has posted the minimum decline of 1.58% and 2.75% respectively.

Source: Bloomberg

Observations

Interim Budget FY20: Govt. presented an expansionary budget as total expenditure has been budgeted to go up by 13.3% in FY20. The major focus has been laid upon putting more money in the pockets of poor/middle-class population. Revenue expenditure is expected to increase by 14.4% yoy – the highest since FY10 while Capex has taken a back seat (up only 6.2% yoy).

The Budget focused on three key segments - agri, real estate and middle-class. For the agri sector, Govt. launched a direct cash transfer scheme of Rs.6000 per year to small and marginal farmers (<5acres of land holding) which would cost Rs.750bn (0.36% of GDP). For the real estate sector, Govt. proposed many steps to provide some relief to the ailing sector. For the middle-class, Govt. announced a full tax rebate for the salaried people (only for people earning <Rs 0.5mn/year) which would result in Rs.185bn loss in tax revenue in FY20BE. Fiscal deficit target was revised upwards to 3.4% in FY19 from 3.3% earlier and it was kept at 3.4% for FY20BE. Gross market borrowings have been budgeted to zoom to Rs.7.1bn, a sharp jump of 24%yoy.

34 Nifty companies have released their December-quarter results until 3rd Feb'19. Encouragingly, the trend in earnings revision has improved significantly this quarter. Broader headline numbers of Nifty cos have been in line with consensus estimates, with Consumption leading from the front and Corporate Banks exhibiting a smart recovery in asset quality.

Outlook

Global equity markets fared well over the month as trade tensions appeared to be abating. Locally sentiment was impacted by a mixed 3QFY19 reporting season and investor concerns in companies a) with perceived lapses in corporate governance, and b) where promoters had pledged significant shares. Sentiment was boosted on the last day of the month after a dovish Fed meeting, which resulted in a rally in risky assets. In US Fed policy meeting on 30th Jan, the Fed took a dramatically dovish turn by dropping any bias in the FOMC statement toward hiking rates and noted that they are prepared to alter the balance sheet normalization process if needed.

Macro variables deteriorated a tad over the month as crude oil prices rallied 23% from their December lows to $61/bbl., although this is still 30% below the highs seen in October 18 ($85+/bbl.). USDINR has reacted to the upward oil prices in the last one month, depreciating 1.9%. Headline inflation is consistently undershooting expectations and is meaningfully below RBI’s target of 4% for 5 consecutive months now.

We expect volatile year for equity markets as on one hand macro and corporate indicators suggest things could improve in 2019, on the other investors have to deal with two major uncertainties – global growth outlook and domestic general election outcome. Global financial indicators and commodity prices in 2HCY18 have begun to reflect risks of a global growth slowdown in 2019 (and contributed at least in part to oil prices decline). An uncertain global environment could feed through to EM / India through impact on exporters and FII flows. Opinion polls suggest 2019 could be a tougher battle than 2014. This could lead to uncertainty, increase in volatility and impact both global and domestic flows.

Despite the uncertainty in the short term, we believe that the medium term outlook of the Indian economy and consequently the equity markets remain solid. Earnings disappointment has been a norm in the past 5years and FY19E is no exception. However, we believe earnings are likely to grow at 19% CAGR over next 2 years driven by turnaround in financials, auto and pharma sectors. Turnaround in corporate bank balance sheet is already visible and hence scope for disappointment should be minimal. Indian market valuations at 17x FY20 earnings are at historical mean levels. However, given 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 – February, 2019

JanuaryHighlights

- Bond yields rose steadily in the month of Januaryafter witnessing a sharp fall in December.Global Crude oil prices rose from $53.80 per barrel, in December, to close the month at $61.89 per barrel, in January. Moreover, hopes of positive developments in the US-China trade war improved risk sentiments globally and led to a rise in bond yields.Data releases, though, came in positive with CPI inflation and trade deficit coming below the market expectations.Liquidity conditions continued to remain negative in the month of January too. To address the liquidity situation, the RBI conducted longer tenure term repos and OMO purchases of government securities. The RBI purchased Rs 500bn of GSecs in the OMO auctions in January.The RBI also issued a new 10Yr G-Sec bond in January at a coupon of 7.26%. The old G-Sec 10Yr benchmark bond yield rose from 7.37% to close at 7.48% in the month of January, while the new 10-year paper closed at 7.28%.
- The IIP for November came in sharply lower at 0.5%, compared to 8.4% in October, most likely due to festivals related seasonality. The mining index, came in lower at 2.7% in November as compared to 7.0% in the month of October. The manufacturing index for November slipped sharply to a negative print of-0.4% vs 7.9% in October. The electricity index also showed a lower growth and came in at 5.1% vs 10.8% in November. On the use based index, basic goodscame in lower as compared to the previous month at 3.2%, while intermediate goodswent in negative to show a print of -4.5% from 1.8% in November.Consumer durable goods also came in negative at-0.7%in November, from 12.1% in October. Consumer non-durables sub-index, also, slipped and showed a negative printof -0.6% from 7.9% inNovember.
- Headline CPI inflation, for December,easedconsiderably and came inat 2.19% from 2.33% in November.The low print in the number was mainly due to favorable base effect and easing of almost all the inflation components. The food index continued to stay in negative zoneat -1.49% in December versus -1.69% in November.Underlying the food inflation, vegetable inflation came in lower at -16.14% from -15.59%. Pulses deflation eased, but continued to stay in the negative zone at -7.13% as compared to -9.22% in the previous month. The fuel and light index fell to 4.54% from 7.39% and housing index showed a marginally lower print of 5.32% from 5.99%. The miscellaneous index, came in slightly higher at 6.45% from 6.15% in the month of December. On a MoM basis the core inflation was unchanged at 5.73% from the previous month.
- Headline WPI inflation came in lower, at 3.80% in December from4.64% in November mainly due to the softening in the fuel index and manufactured prices. Primary articles inflation rose sharply from 0.88% in November to 2.28% in

December. Food inflation, however inched up butcontinued to be in negative zone at -0.07%from -3.31% in December.The manufactured products category was lower in December at 3.59% vs 4.21% in the previous month. The fuel and power index, too, was lower, and showed a print of 8.38% as compared to 16.28%. Vegetable index continued to show a negative print for the month of December at -17.55% vs -26.98% in the month of November. Core inflation, also came in lower at 4.22% in December vs 4.88% in November.

- InDecember, 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 –

- The confluence of positive developments of falling oil prices, lower inflation and large OMO purchases by RBI helped bond yields soften significantly from the peak levels seen in September. The markets have already factored in these developments. We need to see a further meaningful correction in oil prices or a further sharp downturn in global growth outlook and an easing in the developed market monetary policy stance to see further softening in domestic bond yields.
- However, the key concern for the markets over the remainder of the fiscal year is the sharp rise in bond supply. The additional borrowing by the Central Government, the increase in borrowing by State Governments in the last quarter, and the increase in supply by large corporates, rushing to complete their targeted borrowing for the year, has led to a spike in the quantum of potential bond issuances for February and March. The large borrowing is likely to push yields higher. The OMO purchases from RBI is the only factor that is likely to temper any rise in yields. The leads and lags in these factors will keep markets volatile in the remaining months of the current financial year.
- Banks are facing strong credit growth, which is out-stripping deposit growth by a fair margin. The increasing pressure to raise more deposits will limit any rate reductions by banks, on the deposit side or the lending side. Banks’ participation in the bond markets can also reduce and lead to a steeper yield curve as bond supply increases.