Bajaj Allianz Life Insurance Company Ltd

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Macro-economic developments

- Currency in circulation reduced by ~₹ 2.4 trillion from ₹17.77 trillion in October, 2016 to ~₹15.4 trillion on August 25, 2017 on account of government's demonetization move. As per RBI's estimates, 99% of demonetized notes have come back into the banking system.
- System Liquidity continues in surplus mode by ~ ₹4.4 trillion (including MSS issuances). With RBI announcing Open Market Operations (OMO) sale of ₹50,000 crore till date, RBI is expected to take further measures such as issuances of securities under Market Stabilization Scheme (MSS), Open Market Operations (OMO) sale etc. to revert the system liquidity to a position closer to neutrality.
- July CPI inflation rose to 2.36% YoY as against 1.54% in June; primarily on account of higher food, fuel and housing (due to the impact of 7th Pay Commission recommendations) inflation.
- IIP contracted by 0.1% in June vs. 1.7% growth in May. Manufacturing output contracted by 0.4% in June (1.2% in May) as firms scaled back production ahead of the GST. Mining picked up to 0.4% in June (0.9% in May) and electricity generation was at 2.1% (8.7% in May).
- Q1FY18 growth was disappointing with GDP growth slowing to 5.7% (6.1% in Q4FY17) while GVA growth came at 5.6% (5.6% in Q4FY17), primarily due to slowdown in manufacturing growth due to production cuts ahead of the GST. Agricultural, industry and services sectors grew at 2.3%, 1.5% and 7.8% respectively in Q1FY18 on y-o-y basis.
- Fiscal deficit for April - July 2017 was 5.05 lakh crore viz. 92.4% of 5.46 lakh crore of the budgeted fiscal deficit for FY17 (against 73.7% during the same period last year) due to front loaded expenditure by government on account of advancement of budget and reduction in RBI's surplus transferred to government.
- July trade deficit narrowed to USD 11.45bn vs USD 12.9bn in June due to moderation in imports.
- Brent crude price reduced by 0.51% in August to close at USD 52.38/barrel; versus USD 52.65/barrel in July.
- INR appreciated by 0.44% in August to close at INR 63.91/USD; versus INR 64.19/USD in July.

Equity market developments and Outlook

- NIFTY fell 1.98% in August – led by a combination of escalating geopolitical stress (in North Korea) and weak corporate earnings domestically. MSCI India 1Q profits fell 5% yoy (-8% qoq) with an average EPS surprise of -4%, the worst in the past 6 quarters. The broader markets were in line with NIFTY Midcap and Smallcap falling 1.29%/0.30% respectively.
- Among sectors, the decline was led by Pharma stocks (NSE Pharma: -7.42%) owing to a spate of particularly weak results – price erosion headwinds in the US continued in addition with a decline in the domestic business due to GST related destocking. PSU Banks underperformed as 1Q results showed no evidence of a turnaround in the asset cycle yet. Among the gainers, metal stocks outperformed in line with constructive price action on industrial metals globally. Oil stocks also rallied (BSEOIL: +6.17%) led higher by OMCs on earnings beat.
- In the past month, FIIs turned net sellers in Indian equities, with outflows of US$1.8bn in August, the highest since de-monetization in early Nov'16. Comparing foreign flows across the region, India saw the largest amount of FII outflows in Aug vs. other Asian markets. This was compensated for by domestic Mutual Funds – that bought ~$2.8bn of equities in the same period.
- Global markets also remained tepid in August – the S&P closed 0.19% lower while UKX was 0.09% higher. SHCOMP/HSI rallied +2.03%/+1.54% on better corporate earnings while the KOSPI closed 2.53% lower through August on escalating geopolitical risks in the Korean peninsula.

Fixed Income market developments and Outlook

- 10 year G-Sec yields closed higher at 6.53% in August v/s 6.47% in July, due to higher CPI inflation in July and excess supply concerns due to higher state government borrowings, OMO sales etc.
- With the surge in inflow into the banking system, RBI is expected to continue with measures to absorb the surplus liquidity through MSS issuances, OMO sales etc.
- We believe that CPI inflation readings would start edging up in H2FY18 due to waning favorable base effect impact & increasing rural wages and rise in inflation globally.
- Our view is that the interest rate easing cycle has broadly come to an end, possibly with some room for accommodation left, depending on the evolving growth and inflation trajectory over the coming months. We think the yield curve will steepen. The excess liquidity in the banking system and the upward movement in yields present a good investment opportunity in the shorter end of the yield curve.
- Key factors to watch out for will be – trajectory of growth and inflation, US Fed policy decisions, impact of farm loan waivers on fiscal situation of states, implementation of GST framework and 7th Pay Commission recommendations.
- In view of the improving macro-economic dynamics, policyholders would be well placed to benefit from the economic revival, if they continue to remain invested in the India growth story.