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Macro-economic developments

- RBI's Monetary Policy Committee (MPC) voted 5-1 in favor of keeping the key policy rates unchanged (repo rate at 6.00%). MPC observed that CPI inflation rose by 2% since its August bimonthly policy meeting, which along with heightened financial market volatility, higher oil prices and potential inflationary pressures from fiscal slippage

led to RBI increasing its inflation projection to 4.2-4.6% from 3.5-4.5% for H2FY2018. RBI believes that the teething problems linked to GST may get resolved soon, allowing growth to accelerate in H2FY2018. RBI has also revised downwards its growth projections for FY18 from 7.3% to 6.7%.

- System Liquidity continues in surplus mode by ~₹2.0 trillion (including MSS issuances). With RBI announcing Open Market Operations (OMO) sale of ₹90,000 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.
- Currency in circulation reduced by ~₹1.6 trillion from ₹17.7 trillion in October, 2016 to ~₹16.1 trillion on October 27, 2017 on account of government's demonetization move.
- September CPI inflation was flat at 3.28% YoY as against 3.28% in August; as lower food inflation offset higher fuel prices and a pick-up in core inflation led by the house rent allowance (HRA) increase and GST impact.
- IIP growth accelerated sharply to 4.3% in August from 0.9% in July. Manufacturing sector grew at 3.1% owing to strong rebound in capital goods (5.4%) and consumer non-durables (6.9%), while Mining growth was at 9.4% on the back of 15.3% coal production growth.
- Fiscal deficit for April - September 2017 was 4.99 lakh crore viz. 91.3% of 5.46 lakh crore of the budgeted fiscal deficit for FY18 (against 83.9% 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.
- The government announced ₹2.11 trillion PSU bank recapitalization program with the expectation of kick starting credit cycle in India.
- Brent crude price rose by 6.7% in October to close at USD 61.37/barrel; versus USD 57.54/barrel in September.
- INR appreciated by 0.8% in October to close at INR 64.75/USD; versus INR 65.28/USD in September.

Equity market developments and Outlook

- A big move up for the Indian markets this month, with a reversal in investor sentiment – as growth worries (GST linked disruption) ebbed on the back of govt. reform action (PSU Bank recapitalization of \$32bn) and the early festive season translating in to better consumption trends. The ensuing earnings season thus far has reflected better than expected growth across sectors (albeit expectations were muted) and

management commentary too has been more upbeat. Ahead, focus will be on govt. spending as the fiscal deficit has already crossed 90%, though tax collections are also starting to climb.

- Latest macro data has been improving. Sep CPI benign on softer food prices to 3.3% while Aug IP growth beat expectations, up 4.3% YoY vs 0.9% in July 12. Importantly, it was broad-based with consumer durables, infra & construction goods leading the pack. The recovery in industrial production after the impact of GST has been sharper than we had anticipated, boding well for Q3 GDP
- FIIs turned net buyers for the month (+\$227mn) even as the DIIs continued to support markets on the back of continued inflows (bought equities worth \$1.5bn). YTD, FIIs & DIIs have bought US\$5.6bn and US\$11.2bn in equities, respectively. Though note that since Aug'17, India has seen the sharpest FII equity outflow (\$3.3bn of the total \$5.8bn FII equity outflow in Asia EM).
- Reversing the trend of last two months, the equity indices bounced back during Oct'17. The appreciation of the index has been the best since Mar'16. Both mid and small-cap indices continued to outperform the large cap indices during Oct'17 as also during the first 10 months of 2017 and last 12 months.
- Sectors which consistently outperformed Sensex and Nifty in Oct'17 so far as well as in the last 12 months are capital goods, metals, oil & gas and realty. In contrast, sectors which consistently underperformed the indices in Oct'17 as well as in the last 12 months are auto, healthcare and IT.

Fixed Income market developments and Outlook

- 10 year G-Sec yields closed higher at 6.86% in October v/s 6.66% in September, due to concerns regarding fiscal slippage, hawkish MPC minutes, uptick in CPI inflation and excess supply concerns due to higher state government borrowings, OMO sales and 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; however the evolving growth and inflation trajectory over the coming months needs to be closely tracked. We think the yield curve will continue to 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, fiscal expansionary measures taken by the government to boost growth, 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. Ver: Oct 2017