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Macro-economic developments

- On the global front, non-farm payrolls in the United States increased by a robust 200,000 in January 2018, higher than market expectations of 180,000. More importantly, average hourly earnings were up by 2.9% (annualized), which was the best since mid-2009.
- US GDP growth for Q4 2017 got revised to 2.5%YoY from 2.6%YoY in the first advance estimate. This was considerably lower than a 3.2%YoY growth in the previous quarter, and the slowdown was primarily due to higher imports and modest inventory accumulation.
- GDP growth for Q3 FY18 came in above expectations at 7.2%YoY versus 6.5%YoY growth registered in the previous quarter. The pick-up in GDP growth (highest in five quarters), was helped especially by investment spending, with gross fixed capital formation (GFCF) growing by 15.3%YoY in Q3 FY18—the fastest pace in four years.
- GVA (Gross Value Added) growth for Q3 FY18 also came in at 6.7%YoY versus 6.2%YoY in the previous quarter. The uptick in growth was helped by pick-up in growth in agriculture sector (4.1%YoY in Q3 vs 2.7%YoY in Q2), manufacturing sector (8.1%YoY in Q3 vs 6.9%YoY in Q2), construction sector (6.8%YoY in Q3 vs only 2.8%YoY in Q2) and the overall services sector (7.7%YoY in Q3 vs 7.1% in Q2).
- The Central Statistics Office (CSO) also revised upwards the GVA and GDP forecast for FY18 to 6.4% and 6.6% respectively, compared to 6.1% and 6.5% earlier. With this, India remains on track to grow at above 7% in FY19, and emerge as the fastest growing major economy in the world.
- Index of Industrial Production (IIP) growth came in at 7.1%YoY in Dec 2017 from 8.8%YoY in the previous month—led by Manufacturing sector (78% weight in index), where growth was 8.4%YoY in Dec 2017. IIP for FYTD 18 (April – Dec 2017) was still a bit sluggish at 3.7%, compared to 5.1% in the year ago period.
- CPI headline inflation fell marginally to 5.1% in Jan 2018 from to 5.2%YoY in Dec 2017. It had hit a record low of 1.5%YoY in Jun 2017. Core inflation (ex food & fuel) rose to ~5%YoY in Jan 2018 from a low of 3.8%YoY in Jun 2017
- Brent crude price fell 4.7% in February to close at US 65.78/barrel; versus USD 69.05/barrel at the end of January 2018.
- INR depreciated by 2.5% in February to close at INR 65.18/USD.

Equity market developments and Outlook

- Equity markets witnessed a correction during the month, in line with correction in global markets as well. The benchmark Nifty 50 index fell 4.8%, while NSE Smallcap 100 index and Nifty Midcap 50 index fell 5.2% and 3.0% respectively during the month.
- On the sectoral front, banking and capital goods stocks were the most hurt during the month, with the BSE Bankex and BSE Capital Goods indices falling by 8.6% and 6.3% respectively. PSU bank stocks were especially under pressure due to emergence of scams in some of these banks. Meanwhile, IT, metals and FMCG stocks fell relatively less with the BSE IT, BSE Metal and BSE FMCG indices returning -0.4%, -1.6% and -1.9% respectively.
- Foreign portfolio investors (FPIs) registered a significant net outflow of ₹ 12,492 in the month of February, after seeing a net inflow of a similar amount in the previous month.
- Domestic Institutional Investors (DIIs) supported the markets and registered a net inflow of ₹ 17,813 crore in the month of February 2018, with mutual funds being the biggest contributors within the segment.
- Most global markets also witnessed a correction during the month. In the US, the S&P 500 index closed with a loss of 3.9%. Within Europe, Dax index (Germany) was an underperformer, returning -5.7%. Within Asia, the China, Hong Kong, and South Korean markets were among the bottom performers during the month. Meanwhile, emerging markets like Russia, Thailand and Brazil managed to close in the green in February.
- Corporate earnings for Q3 FY18 seems to indicate a recovery. Earnings growth were broadly in-line with expectation in Q3 FY18, although PSU banks were a drag. IT and Metals were the bright spots. Nifty Sales, EBITDA & PAT growth for Q3FY18 was 13.4%, 8.8% and 16.6% (excl. SBI for PAT) respectively. Nifty EBITDA margin (ex financials & OMCs) grew 40 bps to 22.2%. ~70% of Nifty universe posted in-line or higher than expected PAT in Q3
- There has been some volatility in global markets and in India due to sharp rise in US bond yields. US 10 year bond yield has hardened sharply by 40-50 bps since the start of 2018—breaching the 2.9% mark. This has been contributed by inflationary concerns, strong jobs data, recent landmark cut in corporate taxes (which is expected to boost US corporate earnings and spur the economy), and higher probability of rate hikes by the US Fed. The US Fed's median forecast is of 3 rate hikes in 2018, but market has started to price in the possibility of 4 rate hikes—as indicated by Fed Fund futures. The announcement of US import tariffs on steel and aluminum has also raised concerns of protectionism & disruption to world trade.
- An eye needs to be kept on monetary policy stance of major central banks. Any pick-up in pace in monetary tightening by the central banks may pose risk to flows into emerging markets (including India).
- We expect earnings growth to pick up from FY19, and that will drive markets, rather than PE expansion. Sectors like private banks, metals, IT & Pharma to contribute to earnings growth in the upcoming years.

Fixed Income market developments and Outlook

- Bond yields hardened during the month on back of hawkish comments by RBI on inflation, rise in global bond yields and also due to some contraction in liquidity. The new 10 year G-Sec benchmark yield closed the month at 7.73% - up 30 bps.
- The RBI Monetary Policy Committee (MPC) kept key policy rates unchanged (in a 5-1 vote) in its February policy meet, and maintained its 'neutral' stance, as broadly anticipated by the markets.
- The RBI highlighted various upside risk to inflation and said that it would need to be vigilant on inflation as it expects CPI headline inflation at 5.1% in Q4 FY18. It further added that CPI headline inflation is projected at 5.1%-5.6% in H1 FY19 and it could moderate to 4.5%-4.6% in H2 FY19.
- On the growth front, the RBI revised the GVA growth for FY18 to 6.6% from 6.7% earlier, and for FY19 to 7.2% from 7.4% earlier.
- The RBI also provided some relief to MSME borrowers registered under GST, by easing NPA recognition norm to some extent, and by removal of credit caps on MSMEs under priority sector. The MPC highlighted that a large proportion of bank loans continue to be linked to the Base Rate despite introduction of the Marginal Cost of Funds based Lending Rates (MCLR) system. Therefore, the RBI has decided to link the Base Rate to the MCLR with effect from April 1, 2018.
- Foreign Portfolio Investors (FPIs) registered a net outflow of ₹ 2,771 crore in the debt segment during the month of February.
- Data released by the government showed that fiscal deficit for the first 10 months of FY18 (April to December) touched 113.7% of the new revised estimate, compared to 105.7% in the year ago period.
- However, with the significant rise in bond yields, we feel that most of the negatives have been priced in by the market, and therefore bond yields could remain range-bound in the near term. We prefer the shorter to medium term end of the yield curve presently.