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### Macro-economic developments

- Non-farm payrolls in the United States rose by 201,000 in August 2018, higher than market expectations of around 190,000. The unemployment rate remained steady at 3.9%.
- As expected, the US Fed hiked rates in its September-end monetary policy review, and provided guidance for four more rate hikes through 2019 (1 more rate hike in 2018 and 3 rate hikes in 2019). It also dropped the "accommodative stance" sentence from the policy statement. The US GDP growth forecast for 2018 was revised upwards to 3.1% from June policy forecast of 2.8% earlier.
- Current account deficit (CAD) widened to 2.4% of GDP in Q1FY19 from 1.9% in previous quarter. Balance of payments, turned into a 7-year high deficit of $11.3 billion, due to widening CAD and sharp slowdown in capital flows (capital account came in at $5.3 billion in Q1FY19, compared to $25 billion in the previous quarter). Recent data showed that trade deficit in the month of August 2018 remained elevated at $17.4 billion versus $17.9 billion in the previous month.
- The Index of Industrial Production (IIP) growth remained healthy at 6.6%YoY in July 2018—led by Manufacturing sector (78% weight in index), where growth was 7.0%YoY in July 2018. The higher growth was aided by lower base effect, as GST was implemented from July 1, 2017. IIP growth for FYTD 19 (upto July) was 5.3%YoY, versus 2.3%YoY in the year ago period.
- The Nikkei India Manufacturing Purchasing Managers Index (PMI) rose to 52.2 in September from a 3-month low of 51.7 in August 2018, on the back of stronger gains in output and new orders.
- CPI headline inflation continued to moderate to 3.7%YoY in Aug 2018 from 4.2%YoY in the previous month, primarily due to fall in food inflation. Food inflation, which has the highest weight of around 40% in CPI inflation fell to a benign 0.3%YoY in Aug 2018, from 1.3%YoY in the previous month. Core inflation (ex food & fuel) also continued to fall to 5.9%YoY in Aug 2018, from 6.1% in July and 6.4% in June. However, fuel inflation rose to 8.5%YoY in Aug 2018 from 8.0%YoY in the previous month, on the back of rising crude oil prices.
- Crude prices continued to rise, with Brent crude price closing the month up almost 7%, and with a CYTD rise of around 24% in 2018 (up to September).
- Globally, the currency markets continued to be volatile, and the rupee fell more than 2% against the USD during the month moth of September, on the back of rising crude oil prices, widening trade deficit, and foreign outflows. CYTD in 2018 the rupee is down around 12% against the dollar, but has still managed to fare better than other EM currencies like Argentine Peso (-54%), Turkish Lira (-37%), Brazilian Real (-17%), South African Rand (-13%), and Russian Ruble (-12%). The rupee also stands better placed than during the Fed Taper tantrum of 2013, during which time it saw the currency plunge more than 20% against the USD intra-year.
- The government has announced various measures to help stem the fall rupee. These include measures to boost capital inflows and the recent hike in customs duty for non-essential imports--primarily consumption goods (avoided capital goods for now). However, these measures have not been able to curb the rupee weakness much, due to global weakness in EM currencies.

### Equity market developments and Outlook

- Indian markets registered a sharp correction in the month of September, on the back of rising crude oil prices, falling rupee, liquidity squeeze in markets, and some risk aversion in NBFCs--due to credit default by a major infrastructure lending company.
- The benchmark Nifty index closed the month down 6.4%, while the mid/small-cap segment registered a sharp fall, with the Nifty Midcap 50 index and Nifty Small-cap 100 index down 13.5% and 19.8% respectively in September. Besides this, sectors like realty, auto and financials also fell sharply during the month. Meanwhile, sectors like technology, metals and pharma outperformed—benefiting from a falling rupee.
- Global markets closed on a mixed note during the month. Developed markets continued to outperform, and the MSCI World index returned 0.4% in September, while the MSCI Emerging Market index closed with a loss of 0.8% during the month. India was among the bottom performing markets during the month.
- In the US, the S&P 500 index closed with a gain of 0.4%. Major European markets also closed the month on a flattish note, with France's CAC 40 index being one of the top performers within the region with a gain of 1.6%. Within Asia, India was one of the bottom performers (-6.4%). Meanwhile, some of the earlier beaten down emerging markets bounced back in September like Russia (+9%), China (+3.5%) and Brazil (+3.5%).
- Foreign portfolio investors (FPIs) net outflows increased to ₹ 9,623 crore in the month of September, from a net outflow of ₹ 2,029 crore in the previous month.
- Domestic Institutional Investors (DIIs) helped to counter the FPI outflows, with a net investment of ₹12,505 crore in the month of September, compared to ₹2,823 crore in previous month.
- We are seeing a consolidation in markets, due to macro-headwinds like rising crude prices (and its adverse impact on CAD), weakening rupee, and global factors like global risk aversion (leading to foreign outflows), trade war concerns, and global tightening of monetary policy. This correction, presents a buy on dips opportunity for the long term investor, as the structural growth story for India still remains intact and relatively better placed than its EM peers, and on the micro-side we are seeing a corporate earnings revival.
- The broader markets have seen deeper pain this year due to significant correction in the mid/small-cap space especially. With this correction, the valuation premium of Nifty Mid-cap index to the Nifty 50 index (on a forward P/E basis) has come down from above 60% in the early part of the year to around 13% at the end of September 2018. Therefore, we are starting to see some selective value in the mid-cap space. However, we continue to prefer large-caps from a risk-reward perspective, but some allocation to the mid-cap funds can also be considered for long term investors at this juncture--to take advantage of the deep correction.

### Fixed Income market developments and Outlook

- Bond yields hardened in the first half of September, on the back of rising crude oil prices, weakening rupee, credit default by a large infrastructure lending company—leading to a liquidity and credit squeeze. However, in the latter half of the month, bond yields softened on the back of various liquidity measures taken by the RBI, and a reduction in the government borrowing programme for H2 FY19. The benchmark 10 year bond yield finally closed the month at 8.02%--up 7 bps.
- With liquidity drying up within the system, the RBI announced liquidity infusion through OMO purchases to the tune of ₹20,000 crore in September and another ₹36,000 crore in the month of October. The government reduced the gross borrowing amount for H2 FY19, resulting in reduction of the gross borrowing amount for entire FY19 by ₹70,000 crore from the budgeted figure. The government also remained committed to sticking to fiscal deficit target of 3.3% of GDP for FY19, and said that the cut in borrowing will be matched by reduction in buy-back of government bonds and increased collection in small-savings schemes (where the govt. hiked rates in late September).
- Post the close of the month, in its 5th October monetary policy review, the RBI surprised markets by keeping rates unchanged and also changing the monetary policy stance from "neutral" earlier to "calibrated tightening". The central bank also cut the headline CPI inflation trajectory to 4% in Q2 FY19 (from 4.6% earlier), 3.9-4.5% in H2 FY19 (from 4.8% earlier), and 4.8% in Q1 FY20 (from 5% earlier). However, the RBI kept GDP forecast unchanged for FY19 at 7.4%, but cut the GDP forecast for Q1 FY20 marginally by 10 bps to 7.4%.
- India's fiscal deficit for FYTD 19 (upto August) reached 94.7% of the budgeted full year target, compared to 96.1% in the year ago period. The fiscal deficit was a bit elevated, primarily due to lower GST collections, lower than budgeted divestment proceeds and slight increase in capital expenditure.
- Foreign Portfolio Investors (FPIs) in debt markets registered a net outflow of ₹10,528 crore in September, compared to a net inflow of ₹ 2,367 crore in August.
- By changing the policy stance to "calibrated tightening", the RBI has indicated that future policy action will continue to be data dependent—and has left the avenue open for further rate hikes—if inflation trajectory doesn't pan out as per its forecast.
- The RBI also re-iterated that the central bank's mandate is flexible inflation targeting and not the exchange rate, which spooked the currency markets. We could see some further depreciation in the rupee in the short term, in case of rise in crude oil prices, and any further foreign outflows due to EM / global risk aversion.
- From an investment perspective, we continue to prefer the shorter end of the yield curve.