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Macro-economic developments

- Non-farm payrolls in the United States rose by 157,000 in July 2018, lower than market expectations of around 190,000. However, the unemployment rate fell to 3.9% in July 2018, from 4.0% in the previous month.
- US GDP growth for Q2 CY18 clocked in at nearly a 4-year high of 4.2%YoY (revised up from 4.1% earlier). The pick-up in economic growth was helped by strong consumer and business spending as well as a surge in exports ahead of retaliatory tariffs from China.
- India GDP and GVA growth for Q1 FY19 came in above expectations, despite a favourable lower base in the year ago period due to GST implementation. GDP growth rose to 8.2%YoY in Q1 FY19 compared to 5.2%YoY in Q1 FY18 and 7.7%YoY in Q4 FY18 (previous quarter). The strong GDP print was helped primarily by private consumption expenditure, which grew at 8.6%YoY during the quarter, compared to growth of 6.9%YoY in the corresponding year-ago period. On the investments side, Gross Fixed Capital Formation growth also came in at a healthy 10%YoY during Q1 FY19, compared to a subdued growth of just 0.8%YoY in the corresponding year-ago quarter, due to GST implementation.
- GVA growth rose to 8.0%YoY in Q1 FY19 compared to 5.6%YoY in Q1 FY18 and 7.6%YoY in Q4 FY18 (previous quarter). On the sectoral front, growth was spurred by manufacturing sector, which saw a strong growth of 13.5%YoY, compared to -1.8%YoY in the corresponding year-ago quarter (amidst the GST implementation). Services sector growth was relatively lower at 7.5%YoY in Q1 FY19, compared to 8.5%YoY in the corresponding year-ago quarter.
- Trade deficit widened to near a 5-year high of $18 billion in July 2018, compared to a revised $17.1 billion in the previous month. Export growth moderated to 14.3%YoY in July, while import growth accelerated to 28.8%YoY. The rise in imports was primarily led by strong growth in oil imports, which rose by 57.5%YoY in July, on the back of elevated crude oil prices.
- The Index of Industrial Production (IIP) growth rose to 7.0%YoY in June 2018—led by Manufacturing sector (78% weight in index), where growth was 6.9%YoY in June 2018. The higher growth was aided by lower base effect, due to GST implementation. For Q1FY19, IIP growth was 5.2%YoY, compared to 1.9%YoY growth in year ago period.
- However, the Nikkei India Manufacturing Purchasing Managers Index (PMI) fell for the second consecutive month to 51.7 in August 2018, from 52.3 in the previous month, on the back of softer gains in output and new orders.
- CPI headline inflation came in below expectations at 4.2%YoY in July 2018 compared to 4.9%YoY in the previous month. This was primarily due to fall in food inflation (which has a 47% weight in the index) to 1.4%YoY in July 2018 from 2.9%YoY in the previous month. Core inflation reduced to 6.1%YoY in July 2018 from 6.4%YoY in the previous month
- After correcting in the month of July, crude oil prices once again gained momentum in August, with Brent crude price closing the month at USD 77.42/barrel – up 4.3%.
- Globally, currency markets witnessed volatility during the month, on the back of sharp depreciation in Turkish Lira (-26%) and Argentine Peso (-28%). INR fell 3.5% against the USD in August, and is down around 10% CYTD in 2018. However, despite the fall in the rupee, it is relatively better placed than during the Fed Taper Tantrum of 2013, with other fragile emerging market currencies like Brazilian Real, Russian Ruble and South African Rand falling more, YTD in 2018.

Equity market developments and Outlook

- Indian markets were buoyant in August, helped primarily by healthy corporate earnings season for Q1 FY19. The benchmark Nifty index closed the month up around 3%. Mid-cap stocks outperformed, with the Nifty Midcap 50 index closing the month up 6.7%. With the rupee under pressure, export oriented sectors like Pharma and IT did well during the month, and the BSE Healthcare index and BSE IT index returned 12.2% and 7% respectively. The BSE Metal index (+9.2%) was also among the top performers with some metal majors posting good corporate results. Oil & Gas and auto sectors relatively underperformed during the month.
- Global markets closed on a mixed note during the month. Developed markets continued to outperform, and the MSCI World index returned around 1% in August, while the MSCI Emerging Market index closed with a loss of 3% during the month. India was among the top performing markets during the month, after the US.
- In the US, the S&P 500 index closed with a gain of 3%. Major European markets closed the month with losses, with UK's FTSE 100 index being one of the bottom performers within the region with a 4% loss. Within Asia, India was one of the top performers, followed by Malaysia. Meanwhile, the Chinese market continued to be under pressure with the benchmark Shanghai Composite index closing with loss of 5.3%--bringing its CYTD 2018 loss to almost 18%.
- Foreign portfolio investors (FPIs) once again registered net outflows to the tune ₹ 2,029 crore in the month of August, after seeing a net inflow of ₹ 1,429 crore in the previous month.
- Domestic Institutional Investors (DIIs) continued to see a slowdown in flows, with a net investment of only around ₹ 2,800 crore in the month of August, compared to ₹ 4,200 crore in previous month.
- Q1 FY19 corporate earnings have broadly been good, despite a lower and favourable base. At an aggregate level, the benchmark Nifty index sales rose to a multi-year high of around 24%YoY during the quarter. Nifty index Profit after Tax (PAT) growth excluding corporate banks (which dragged down earnings due to higher provisioning during the quarter) was also at a healthy 25%YoY.
- We expect earnings growth to accelerate to mid-teens in FY19 and FY20. The sectors that we expect to drive earnings growth going forward are private financials and consumption related themes. The recovery in earnings growth is also expected to be aided by earlier underperforming sectors, which we feel may have bottomed out—like Corporate banks and Pharma.
- On the macro-economic front, recent data like GDP growth and high frequency indicators have been good. However, some macro headwinds remain--like elevated and rising crude oil prices and its impact on the twin deficits, rising interest rates and a weakening rupee. Global uncertainty on escalating trade war, tightening of monetary policy by major central banks, and global risk aversion in EM markets/currencies, also remain. This could lead to some volatility in markets in the short term. But in the long term we are still positive on the markets, as the India growth story remains intact, and we expect equity market returns to broadly track earnings growth.

Fixed Income market developments and Outlook

- After easing in the previous month, bond yields hardened in the month of August, on the back of weakening rupee and rising crude oil prices. The benchmark 10 year bond yield closed the month at 7.95%--up 18 bps.
- The RBI has gone in for two front-loaded rate hikes in June and August, as the central bank endeavours to keep inflation within the prescribed target, amidst various upside pressures and uncertainties. With the RBI retaining a neutral stance, we feel that future monetary policy action will continue to be data dependent.
- India's fiscal deficit for FYTD 19 (upto July) reached 86.5% of the budgeted full year target, compared to 92.4% in the year ago period. The fiscal deficit was a bit elevated, primarily due to lower GST collections. Recent data showed that July GST collections fell 3% (month-on-month) to around ₹ 94,000 crore, and for FYTD19 the central government GST collection stands 26% below budgeted estimate. The government has budgeted to trim fiscal deficit to 3.3% of GDP in FY19, after meeting its upwardly revised 3.5% target in FY18.
- Foreign Portfolio Investors (FPIs) in debt markets saw a net inflow of ₹ 2,367 crore in August, compared to a net inflow of ₹ 718 crore in July.
- In the current interest rate environment, we continue to prefer the shorter end of the yield curve.