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## Macro-economic developments

- RBI's Monetary Policy Committee (MPC) voted 5-1 in favor of keeping the policy repo rate unchanged at 6.25%. While the MPC revised its inflation projections downwards, the MPC was in favor of status-quo due to considerable uncertainty regarding the evolving inflation trajectory, lack of effective transmission due to stressed bank balance sheets and to avoid any risks due to disruptive policy reversals later. MPC took note of the potential inflationary pressures that may emerge from global political and financial risks, 7th Pay Commission recommendations, high general government deficit exacerbated by farm loan waivers.
- Currency in circulation reduced by ~ Rs 2.7 trillion from Rs 17.77 trillion in October , 2016 to ~Rs 15.1 trillion on June 23, 2017 on account of government's demonetization move, however the pace of remonetization seems to have stabilized with currency in circulation increasing by ~ Rs 0.3 trillion in June versus ~ Rs 1 trillion in May.
- System Liquidity continues in surplus mode by ~ Rs 4.1 trillion (including MSS issuances). With RBI announcing Open Market Operations (OMO) sale of Rs 10,000 crore on 6 July 2017, 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.
- May CPI inflation moderated to 2.18% YoY as against 2.99% in April; primarily on account of decrease in food inflation.
- IIP (New Series) grew by 3.1% in April as against growth by 2.7% in March, led by good infrastructure/construction (5.8% versus 0.9% in March 2017) and consumer non-durable output (8.3% versus 6.2% in March 2017) growth.
- US Fed in its June FOMC meeting decided to hike Fed rate by 0.25% to 1.00%-1.25% - citing strong labor market data and steady increase in inflation towards US Fed's 2% target. Moreover, it has maintained the projection of 3 hikes in CY 2017 in its guidance.
- Brent crude fell by 4.75% in June to close at USD 47.92/barrel; versus USD 50.31/barrel in May.
- INR depreciated by 0.1% in June to close at INR 64.58/USD; versus INR 64.51/USD in May.

## Equity market developments and Outlook

- The NIFTY rally hit a minor roadblock in June, the first half of the month saw muted price-action and a very range-bound NIFTY, and the second half saw a minor correction with the NIFTY reaching lows of ~9473.70 on 27 June. The broader markets were mixed – NIFTY Midcap 50 lost 34bps in June while the Smallcap index added 59bps.
- Sectoral price action was a reversal of previous months. The decline was led by PSU banks after news-flow around NPA resolution and provisioning increases mandated by the RBI, with the NIFTY PSU Bank Index down 6.55%. Weak oil throughout June also meant that the BSE Oil index was down 6.21%. Pharma was the surprise gainer, NIFTY Pharma up 5.22% while IT stocks continued their decline with a 4.13% fall in CNX IT. Nifty FMCG stayed positive, gaining 2.19% (led by a +2.92% gain in ITC).
- Both FII and DII flows were positive in June. FIIs poured in ~$325mn in the market taking their YTD total to $9.2bn while DIIs put in $825mn taking their YTD number to $3.1bn. This could be reflective of either some unwind by HNI/retail investors or a shift to midcaps/smallcaps away from largecaps.
- Global markets were mixed with the S&P down 27bps in June after a hawkish surprise by the FOMC - the Fed spoke about possible balance sheet reduction later this year. The FTSE lost 3.16% after Theresa May's band of conservatives fell short of a majority in the House of Commons, fuelling speculation about political instability. The under-performing SHCOMP had a good month, closing up +2.81% while the HIS stayed flat (-0.17%).

## Fixed Income market developments and Outlook

- 10 year G-Sec yields closed lower at 6.51% in June v/s 6.66% in May, due to RBI revising its inflation projection downward opening up room for accommodative policy, higher FII flows, lower crude prices and abating concerns in US regarding fiscal expansion.
- 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 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 –progress of monsoon, upcoming RBI and US Fed policy decisions, impact of demonetization on growth and inflation, 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.