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Macro-economic developments

- US Q2 GDP growth slowed to 2.1%YoY from 3.1%YoY in the previous quarter, along expected lines. Personal consumption expenditure (the biggest component of GDP) grew by a strong 4.3%YoY—making it the strongest performance since Q4 2017; but fall in domestic private investment and inventories were a drag on GDP growth.
- The US Fed cut rates by 25 bps in its July-end meeting (as expected), making it the first rate cut in over a decade. However, the Fed chairman said that this cut was a "mid-cycle adjustment to policy"—hinting that future policy action will be data dependent, which was a less dovish commentary than market expectations.
- At the start of August, US President Donald Trump announced the imposing of fresh tariff of 10% on the remaining $300 bln of imports from China, effective from the month of September, thereby further escalating the trade tensions. Already another $250 bln of imports from China are subject to 25% tariff.
- The Union Budget FY20, announced on 5th July 2019, was a balanced and forward-looking one—promoting ease of living. It focused on segments like digital economy, infrastructure, and provided various benefits to electric vehicles--to increase penetration. Tax to GDP ratio fell to 10.9% in FY19 (due to lower than projected income tax and indirect tax collections); but is budgeted to rise to 11.7% in FY20—with direct taxes contribution rising. Also, on the revenue side, capital receipts & non-tax revenue growth was budgeted to pick-up in FY20.
- For infrastructure sector, the government intends to provide ₹ 100 lakh crore over the next 5 years, which may help to revive the investment cycle. For financial sector, PSU bank recapitalization of ₹ 70,000 crore has been provided (which was above expectations).
- From a taxation perspective, the government has extended lower corporate tax rate of 25% for companies having annual turnover upto ₹ 400 crore (compared to ₹ 250 crore before). However, there was a surprise increase in surcharge on ultra high net worth individuals (UHNIs) earnings more than ₹ 2 crores--thereby increasing the effective tax rate. Additional deduction of ₹ 1.5 lakhs was announced for interest on affordable housing loans taken in this fiscal year. Customs and excise duties were increased on various commodities. Also, tax of 20% was imposed on buy-back shares of listed companies, thus plugging the tax arbitrage.
- On the domestic macro front, India's trade deficit remained steady at $15.3 billion in the month of June 2019, compared to $15.4 billion in the previous month. Both export and import growth registered a contraction during the month.
- The Index of Industrial Production (IIP) growth came in at 3.1%YoY in May 2019, compared 4.3%YoY in the previous month. This was primarily helped by Electricity sector (+7.4%YoY), while Manufacturing sector (having highest weightage) growth was subdued at 2.5%YoY during the month.
- Consumer Price Index (CPI) headline inflation rose marginally to 3.2%YoY in June 2019 (still well below the RBI target), versus 3.0%YoY in the previous month. Food inflation (biggest component of CPI, with 39% weight) rose a bit, as expected, to 2.2%YoY in June, from 1.8%YoY in the previous month. However, core inflation (ex food & fuel) remained steady at 4.1%YoY.
- Crude prices fell a bit during the month on concerns of global growth slowdown and trade tensions. Brent crude finally closed the month of July down ~2%, at $65.2/bbl.
- Despite FPI equity outflows during the month, the rupee managed to close the month on a flattish note-- up 0.3%, at 68.80/US dollar.

Equity market developments and Outlook

- Indian markets saw a sell-off during the month of July, and underperformed its global peers. The benchmark Nifty 50 index closed the month down 5.7%, while the broader markets underperformed, with the Nifty Midcap 50 index and Nifty Smallcap 100 index returning -10.6% and -10.9% respectively. Sectors that underperformed during the month included consumer durables, auto, metals and capital goods. The sectors that outperformed during the month were defensives like IT, pharma, and FMCG.
- Concerns of some domestic slowdown, and some budget announcements weighed on investor sentiments. The sharp increase in surcharge is also expected to impact certain sections of foreign portfolio investors (FPIs), besides the domestic super-rich and ultra-high net worth individuals, and resulted in FPI equity outflows during the month. The government's proposal to increase the minimum free float (public shareholding) limit from 25% to 35%, could lead to an increase in supply of equity paper in the markets. However, we feel that that this will happen in a phased manner (allowing time for the markets to absorb the supply), and in the long term is a positive move--as it will increase weight of India / Indian stocks in global indices and the liquidity in the markets.
- Also, the govt. announced in the budget that it is examining the opening-up of FDI in aviation, media (animation) and insurance sectors, and hiked the FDI limit to 100% for insurance intermediaries. The disinvestment target for FY20 was also increased to ₹ 1.05 lakh crore (from ₹ 90,000 crore in interim budget).
- Global markets fared better during the month, with the MSCI World index, MSCI Asia ex-Japan index and MSCI Emerging Markets index returning +0.4%, -2.2% and -1.7% respectively.
- In the US, the S&P 500 index rose by 1.3% in July. Among European markets UK's FTSE 100 index was among the top performers during the month—delivering a return of +2.2%. Within Asia—Japan and Taiwan were the outperformers, while the bottom performers within the region were India and South Korea.
- Foreign portfolio investors (FPIs) registered a net outflow of ₹ 13,316 crore in the month of July, compared to a net inflow of ₹ 1,033 crore in the previous month.
- However, Domestic Institutional Investors (DIIs) countered FPI outflows, and registered a strong net investment in equities of ₹ 20,395 crore in July, compared to a net investment of ₹ 3,643 crore in the previous month.
- With rate cuts and bond yields coming down significantly, the cost of capital has come down (which is beneficial for companies), and the recent market correction has also made valuations more reasonable.
- Q1 FY20 corporate earnings till now have been muted, but we are hopeful of a more meaningful recovery in H2 FY20, and that should be the driver for market trajectory—going ahead.
- Presently, we recommend investors to systematically invest in equities. Investors can consider making lumpsum investment on any large market dips/corrections, but should have a sufficient long-term investment horizon. .

Fixed Income market developments and Outlook

- Bond yields fell sharply during the month on the back of some positive budget announcements for debt markets, RBI rate cuts, FPI debt inflows, improving liquidity scenario, softening of global bond yields and benign inflation. The 10 year benchmark yield closed the month at 6.37%--down 50 bps.
- In the budget, the government maintained fiscal discipline (announced fiscal deficit target of 3.3% for FY20 vs 3.4% earlier, and plans to reduce it to 3.0% by FY22). Gross market borrowing for FY20 was maintained at ₹ 7.1 lakh crore and net market borrowing at ₹ 4.7 lakh crore (in line with interim budget estimate).
- Another positive announcement in the budget for the debt markets, was that the govt. plans to raise foreign money via foreign currency-denominated sovereign bonds, thus putting less pressure on local market borrowings.
- To address the stress in NBFC sector, the govt. announced in the budget that it will provide one-time six-month partial credit guarantee to PSU banks for first loss up to 10%, for the purchase of pooled assets of NBFCs amounting to a total of ₹ 1 lakh crore. Subsequent to this, the RBI provided additional liquidity support of ₹1.34 lakh crore to banks for purchase of assets from NBFC /HFCs. Also, the regulator for housing finance companies (HFCs) is to be changed to RBI from National Housing Bank (NHB), so that one regulator can oversee entire lending activities.
- Latest data showed that fiscal deficit for FYTD 20 (upto June) was 61.4% of the budgeted estimate for entire FY20, compared to 68.7% in the corresponding period in the previous fiscal year. This was primarily on the back of lower expenditure (esp. capital expenditure) and stable tax collection.
- GST collections for the month of July (reflecting activity in June) showed a 5.8%YoY growth to ₹ 1.02 lakh crore, after dipping to Rs. 99,939 crore in the month of June.
- Foreign Portfolio Investor (FPI) net inflow in debt markets was ₹8,418 crore in the month of July, compared to ₹ 8,265 in the previous month.
- With fiscal discipline being maintained by govt. in the budget, and the RBI's focus shifting to growth concerns, we may see further rate cut/cuts from the central bank, provided inflation remains within the trajectory. However, we feel that the market may have largely priced this in, and therefore from an investment perspective, we presently prefer the shorter end of the yield curve.