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Macro-economic developments

- US Q3 GDP growth came in at 2.1% (annualized rate) as per the final estimate (compared to 1.9% in the first estimate). Growth in consumer spending, which accounts for more than two-thirds of U.S. economic activity, was raised to 3.2% in the third quarter from the previously reported 2.9%. US GDP growth for Q1 CY2019 came in at healthy 3.1%, but slowed to 2.0% in Q2 CY2019. The US Fed projects GDP growth at 2.2% for CY2019, and at 2.0% for CY2020.
- The US Fed kept rates unchanged at 1.5% - 1.75% in its December 2019 meeting, and signaled that rates could remain unchanged through 2020. The European Central Bank (ECB) also kept rates unchanged in its December 2019 meeting, after cutting its benchmark deposit rate by 10 bps to a record low of -0.5% in its September 2019 meeting. Global bond yields hardened on some improved economic data, pause in monetary easing, and some resolution to the US-China trade war.
- The US-China trade war saw some resolution with the countries agreeing to a phase-one deal recently. As per the deal, the US will be halving its tariff from 15% to 7.5% on $120 bln of Chinese imports, but maintaining its tariff of 25% on $250 bln of Chinese imports. The US & China will be suspending any fresh tariffs that were to come into effect. US said that China has agreed to increase its total purchases of U.S. goods and services by at least $200 bln over next 2 years (incl. US agricultural products).
- India's current account deficit (CAD) narrowed to 0.9% of GDP in Q2 FY20 vs 2.0% of GDP in the previous quarter, primarily due to moderation in trade deficit. CAD expected at ~1.3% in FY20 vs 2.1% in FY19
- However, capital account flows decreased sharply to $12.1 bln in Q2 FY20, from $27.9 bln in Q1 FY20—primarily led by slowdown in foreign investment (FDI & FPI). Therefore, the balance of payment (BOP) surplus reduced to $5.1 bln in Q2 FY20, compared to a surplus of $14.0 bln in the previous quarter.
- Consumer Price Index (CPI) headline inflation rose to 5.5%YoY in Nov 2019 from 4.6%YoY in the previous month. This was primarily due to rise in food inflation (weight of 39% in CPI) to 10.0%YoY in Nov 2019, from 7.9%YoY in the previous month. Meanwhile, core inflation (ex food & fuel) rose marginally to 3.7%YoY in Oct 2019 from 3.4%YoY in previous month.
- Index of Industrial Production (IIP) growth came in at -3.8%YoY in Oct 2019 vs -4.3%YoY in the previous month. The heavy-weight manufacturing sector (78% weight in IIP) growth recovered to -2.1%YoY, from -4.0%YoY in the previous month. Other sectors like mining and electricity also registered a sharp contraction during the month. For FYTD20 (upto October), IIP growth was significantly lower at 0.5%YoY, compared to 5.7%YoY in the corresponding period, a year ago.
- During the month of December, crude prices rose on the back of OPEC cuts (OPEC & allies announced production cuts of 500,000 barrels per day) and on US-China phase one trade deal. Recently in the new year, there have been some geo-political tension between US-Iran, which is putting upward pressure on crude prices.
- The rupee closed the month on a flattish note at INR 71.38 / USD, although it was a relative underperformer within the pack of peer Asian currencies. Higher oil prices, economic slowdown weighed on the currency.

Equity market developments and Outlook

- Indian markets delivered flattish returns during the month, although the headline Nifty index hit record highs. However, India relatively underperformed most peer Asian and emerging markets during the month. The benchmark Nifty 50 index returned +0.9%, while the broader markets slightly underperformed, with the Nifty Midcap 50 index and Nifty Smallcap 100 index returning -0.5% and +0.3% respectively.
- Sectors that outperformed during the month included metal, realty, IT and auto. The sectors that underperformed during the month were capital goods, consumer durables, auto, FMCG and IT.
- Globally, emerging markets and Asian markets relatively outperformed in December, with global risk appetite returning and some resolution to the US-China trade war. The MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +7.2% and +6.4% respectively, while the MSCI World index rose +2.9% during the month.
- In the US, the S&P 500 index rose by 2.9% during the month. European markets delivered subdued returns, with UK being an outperformer. Within Asia—Hong Kong, China, Taiwan and Indonesia were the out-performers, while the under-performers within the region were Thailand, South Korea, Singapore and India. Emerging markets like Russia and Brazil also closed the year on a strong note.
- Foreign portfolio investors (FPIs) registered a net equity inflow of ₹6,118 crore in the month of December, compared to a robust net inflow of ₹22,489 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a net outflow of ₹741 crore in December, compared to a net outflow of ₹7,971 crore in the previous month.
- The year 2020 is going to be marked by gradual recovery in corporate earnings growth, as GDP growth should bottom out. Nifty earnings growth is expected to pick-up from 12% in FY20 to 19% in FY21, and this will help to drive the markets going forward.
- Eye needs to be kept on the upcoming union budget, progress on US-China trade resolution, global monetary policy stance, global growth trajectory, geo-political events, and global risk appetite.
- From an investment perspective, we continue to prefer large-caps, but also see some attractive bottom-up opportunities in the mid-cap segment—from a valuation standpoint. Investors should continue to invest systematically in equities.

Fixed Income market developments and Outlook

- Bond yields rose sharply post the surprise move by RBI to keep rates unchanged in its December policy review, compared to market consensus expectations of a rate cut. Rise in crude oil prices and global bond yields, fiscal concerns and FPI debt outflows also put pressure on bond yields. The 10 year yield spiked from 6.46% (pre policy) to 6.80% in mid-December, reflecting the unwinding of rate-cut expectations.
- However, in the second half of December, the RBI announced an "Operation Twist" (similar to what the US Federal Reserve had done in 2011), in which it would simultaneously purchase long term securities and sell short term securities. This would help to reduce the steepness in the yield curve, and be beneficial especially for the longer end of the curve, which had steepened post the policy. Long term bond yields have softened considerably post the Operation Twist announcement, with the 10 year yield falling from 6.80% in mid-December, to finally close the month at 6.56%.
- In the December 2019 policy review, the RBI Monetary Policy Committee (MPC) unanimously voted to keep the key policy rate unchanged at 5.15%. RBI raised its headline CPI inflation projection to 4.7-5.1% in H2 FY20 (from 3.5-3.7% earlier) and to 3.8-4.0% in H1 FY21 (from 3.6% in Q1 FY21), with risks broadly balanced.
- Fiscal deficit for FYTD 20 (upto November) was 114.8% of the budgeted estimate for entire FY20, same as in the corresponding period in the previous fiscal year. Tax revenue collections (both direct and indirect) have been tepid and below budgeted estimates so far. Non-tax revenues have been strong – led by RBI dividends. The government has trimmed expenditure over the past couple of months and this has been led by capex expenditure, although revenue expenditure has also slowed.
- Recent government data showed that GST collections for the month of December 2019 (reflecting activity for the month of November) breached the ₹1 lakh crore mark again, as in the month of November—after declining in past months.
- Foreign Portfolio Investors (FPIs) registered a net outflow of ₹5,350 crore in the month of November, compared to a net outflow of ₹3,224 crore in the previous month.
- On the monetary policy front, the RBI wants to pause and see the impact of past rate cuts, and their transmission. RBI MPC recognized that there is monetary policy space for future action, but it will be data–dependent. Also, the recent "Operation Twist" announced by the RBI is intended to reduce the steepness in the yield curve, and therefore has been positive for long term bond yields.
- Factors to watch out for include the upcoming budget (esp. the fiscal deficit and govt. borrowing figures), and crude oil prices –as a result of geo-political tensions between US-Iran.
- From an investment perspective, we presently prefer the shorter to medium term end of the yield curve.

Ver: Dec 2019