Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- US non-farm payrolls rose by a healthy 164,000 in the month of July, mostly in line with expectations. The unemployment rate remained steady at 3.7%.
- The US-China trade war continued to escalate. After the US announced imposing a fresh tariff on $300 bln of imports from China effective from 1st September 2019, China retaliated by imposing fresh tariff on $75 bln of US imports into China, in two batches from 1st Sep 2019 and 15th Dec 2019. China also added that an extra 5% tariff will be put on American soybeans starting September, and a 25% duty on US cars will resume from 15th Dec 2019. China also put a 5% levy on US crude oil import, making it the first time that crude oil has been targeted in this trade war. President Trump later said that fresh tariff on $300 bln of China imports announced earlier, would happen in two phases – effective 1st Sep 2019 and 15th Dec 2019; and the tariff rate would go up to 15% from 10% earlier. He also threatened that the tariff rate on $250 billion of US imports would go up from 25% to 30% effective from 1st October 2019. To sum up, the US has till now put tariffs on $550 bln of China imports, and China has till now retaliated by putting tariffs on $185 bln of US imports.
- US 10 year treasury bond yield fell by 50 bps to close the month at ~1.5%, on expectations of further US Fed rate cuts.
- In India, the government and finance minister (FM) announced a slew of measures to deal with the ongoing slowdown and improve market sentiments. On August 23, the FM announced that the higher surcharge on capital gains tax (announced in the Union Budget) would be rolled back for FPIs and domestic high net worth individuals. Also, PSU bank recapitalization of ₹ 70,000 crore would be released upfront—helping to improve liquidity and credit growth. Besides this, additional liquidity support of Rs. 20,000 crore to be provided by NHB to housing financial companies. For the auto sector, an additional 15% depreciation to be allowed on all vehicles purchased by March 2020 (which will especially help the ailing commercial vehicle sector), and the govt. also postponed increase in registration fee charges for vehicles to June 2020.
- On August 30, the FM announced the mega merger of 10 PSU banks into 4 large banks, and also announced steps to improve the governance of PSU banks. The government announced capital infusion of around ₹ 55,000 crore into these PSU banks. Since 2017, when the PSU bank consolidation started, the total number of PSU banks will reduce from 27 banks to 12 banks, after this consolidation move.
- On the domestic macro front, India's GDP growth slowed down to more than a 6-year low of 5.0%YoY in Q1 FY20, compared to 5.8%YoY in the previous quarter. The slowdown in GDP growth was primarily caused by private consumption (the largest component of GDP), which slowed down to 3.1%YoY in Q1 FY20, compared to 7.2%YoY in the previous quarter. Gross fixed capital formation (investment) growth also came in at a subdued 4.0%YoY in Q1 FY20, versus 3.6% in the previous quarter. However, government expenditure managed to grow at a healthy 8.8%YoY in Q1 FY20, albeit it slowed down from 13.1%YoY growth in the previous quarter. GVA growth also slowed down to 4.9%YoY from 5.7%YoY in the previous quarter. Manufacturing sector growth slumped to a meagre 0.6%YoY in Q1 FY20, from 3.1%YoY in the previous quarter, while services sector growth also slowed down to 6.7%YoY from 8.2%YoY in the previous quarter.
- The Index of Industrial Production (IIP) growth slowed down to 2.0%YoY in June 2019, compared 4.6%YoY in the previous month. Growth was helped by Electricity sector (+8.2%YoY), while Manufacturing sector (having highest weightage of ~78% in index) recorded only 1.2%YoY growth during the month.
- Consumer Price Index (CPI) headline inflation fell marginally to 3.1%YoY in July 2019 (still well below the RBI target), from 3.2%YoY in the previous month. Food inflation (biggest component of CPI, with 39% weight) rose a bit, as expected, to 2.4%YoY in July, from 2.2%YoY in the previous month. Core inflation (ex food & fuel) also rose to 4.5%YoY in July, from 4.1%YoY in the previous month.
- Crude prices fell during the month on concerns of global growth slowdown and trade tensions. Brent crude closed the month of August down 7.3%, at $60.4/bbl.
- FPI equity outflows and weakness in macro-economic parameters caused the rupee to fall 3.65% in the month of August, to close at 71.41/US dollar.

Equity market developments and Outlook

- Indian markets closed on a flattish note during the month—faring relatively better, amidst the correction in global markets. The markets recovered in late August, as the govt. announced roll-back of higher surcharge (announced in the budget) on capital gains tax applicable to FPIs and domestic HNIs, and also announced a slew of measures to deal with the economic slowdown and improve market sentiments. The benchmark Nifty 50 index closed the month down 0.9%, while the broader markets underperformed a bit, with the Nifty Midcap 50 index and Nifty Smallcap 100 index returning -2.2% and -1.4% respectively. Sectors that outperformed during the month included consumer durables, IT auto, and FMCG. The sectors that underperformed during the month were metals, banking, power and capital goods.
- Global markets witnessed a correction during the month. The MSCI Asia ex-Japan index and MSCI Emerging Markets index underperformed, returning -4.6% and -5.1% respectively in August. Meanwhile, developed markets fared better, with the MSCI World Index returning -2.2%.
- In the US, the S&P 500 index fell by 1.8% in August. Among European markets, UK's FTSE 100 index was among the bottom performers during the month—delivering a return of -5.0%, while France's CAC 40 was among the top performers—returning -0.7%. Within Asia—Hong Kong, Singapore and Thailand were the under-performers, while the out-performers within the region were India, Indonesia and Malaysia.
- Foreign portfolio investors (FPIs) registered a net outflow of ₹ 15,552 crore in the month of August, compared to a net outflow of ₹ 13,316 crore in the previous month.
- However, Domestic Institutional Investors (DIIs) countered FPI outflows, and registered a strong net investment in equities of ₹ 20,934 crore in August, compared to a net investment of ₹ 20,395 crore in the previous month.
- The government has announced a slew of measures to help revive economic growth and improve investor sentiment, and more such announcements are expected for other sectors—by the markets.
- With rate cuts and bond yields coming down significantly, the cost of capital has come down (which is beneficial for companies), and the market correction over the past couple of months has also made valuations more reasonable.
- Eye needs to be kept on the extent of global and domestic growth slowdown, US-China trade war developments, and overall global investor risk appetite—as it will determine the trajectory of foreign portfolio flows into India.
- 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 rose during the month on the back of profit booking (after the sharp rally last month), rupee depreciation, and expectations of fiscal stimulus from the government (which eventually didn't materialize). The 10 year benchmark yield closed the month at 6.56%--up 19 bps.
- The RBI Monetary Policy Committee (MPC) voted to cut the policy repo rate by 35 bps in its August policy review, with all MPC members unanimously voting for a rate cut (4 members for 35 bps cut and 2 members for 25 bps cut). The central bank revised down the GDP growth forecast for FY20 marginally to 6.9%YoY (from 7.0% earlier)--with risks somewhat tilted to the 'downside'. RBI's inflation projection remained broadly unchanged from the previous policy, at 3.1%YoY for Q2 FY20, and 3.5-3.7% in H2 FY20--with risks 'evenly balanced'.
- In line with recommendations of Bimal Jalan Committee, the RBI said that it will transfer Rs. 1.76 lakh crore to the government. The transfer includes Rs. 1.23 lakh crore of surplus for FY19 and Rs. 52,637 crore of excess provisions identified as per the revised Economic Capital Framework (ECF) adopted at the meeting.
- Latest data showed that fiscal deficit for FYTD 20 (upto July) was 77.8% of the budgeted estimate for entire FY20, compared to 86.5% in the corresponding period in the previous fiscal year. This was primarily on the back of lower expenditure (esp. capital expenditure), despite tax collections falling short of budgeted estimate.
- GST collections for the month of August (reflecting activity in July) dipped below the ₹ 1 lakh crore mark to ₹ 98,202 crore.
- Foreign Portfolio Investor (FPI) net inflow in debt markets was ₹ 11,415 crore in the month of August, compared to ₹ 8,418 crore in the previous month.
- With fiscal discipline being maintained by government, 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 to medium term end of the yield curve.