Capital League outlook

October, 2018

Indian Economy

- RBI maintained status quo on the interest rates in its monetary policy review but changed its stance from "neutral" to "calibrated tightening". This indicates rates will either increase or will be unchanged going forward based on the inflation data and uncertainty stemming from global headwinds including rising oil prices.
- Retail inflation (CPI) rose to 3.77% in Sep'18 as compared to 3.69% in Aug'18 but still remained under the RBI's targeted level of 4% inspite of high petrol and diesel prices.
- Index of Industrial Production (IIP) slipped to 4.3% in Aug'18 as compared to 6.6% in Jul'18 due to decline in the mining sector output and poor offtake of capital goods.
- India received 9.4% lower rainfall than normal in the current monsoon season. However, the total Kharif crop sowing has declined marginally with only 2% less sowing than last year.
- The INR depreciation vis-a-vis USD continues to be a cause for concern. Though it will boost the earnings of the export oriented businesses like IT services, pharmaceuticals etc.
- The fall in INR as compared to its various peers is among lowest in last 5 years:

Currency	**Depreciation in last 5 years vis-à-vis USD (% fall as on 01-Oct-18)**
Chinese Yuan Renminbi	-10
Indian Rupee	**-14**
Australian Dollar	-23
South African Rand	-29
Brazilian Real	-45
Russian Ruble	-50

- To support the INR the RBI has eased cash requirements for banks and allowed companies in the manufacturing sector to raise overseas funds. It has sold USD 34 Bn in the currency market since Apr'18.
- The Union government has announced a cut in its borrowing target for 2H of FY19, to support the liquidity in the economy.
- The government has exempted tax on interest payment on debt raised through offshore Rupee denominated bonds. This will improve capital inflow and help the domestic currency strengthen against the US dollar.
- The government also announced hike in customs duty on various items, including jet fuel, communication items and air conditioners, to curb 'non-essential imports' and check the widening current account deficit.

- FIIs flows continue to be negative for MTD Oct’18 also with outflows from Indian equity markets of approx. INR 1,780 Cr. Domestic Institutional Investors (DIIs) continue to support the markets with a net inflow of approx. INR 27,278 Cr.
- Corporate earnings may come under pressure for quarters ahead if rupee slide continues, raw material costs escalate and competitive pressures in some of the sectors (such as telecom, aviation, staples and auto) prevents the companies to hike prices.

Global Economy

- US Fed has raised interest rates by 25 bps in Sep’18. It signaled another hike in Dec’18 as the economy continues to improve, unemployment remains low and inflation touches 2%.
- The ongoing US-China trade war continues to be an area of concern for global trade.
- US and EU have reached an agreement to de-escalate tensions by increasing US imports to the EU.
- Crude Oil price had crossed USD 85 per barrel, highest in last 4 years. U.S. sanctions on Iran have squeezed Iranian crude exports, tightening supply.

Outlook

- The borrowing plan by the central government has been reduced signaling its commitment to the fiscal target. RBI’s OMO purchase announcement has provided a temporary relief to the G-sec yields. While the steps taken by the government and RBI are expected to provide some comfort to the bond market, elevated crude oil prices, weakening rupee, tight domestic and global liquidity and expectations of tighter monetary policy are expected to limit the gains of debt market.
- On the fixed income side we continue to focus on Accrual funds, Fixed Maturity Plans (FMPs) and tax free bonds to lock-in better yields.
- Consensus estimates suggests that earnings of NIFTY companies are expected to grow by 20% in FY19 and FY20. This shows a sharp turnaround by the corporate sector after an average EPS growth of 3.54% p.a. for last 5 years.
- NIFTY has corrected by 13% from its peak; however stocks have corrected by 30% - 80% in the broad market.
- Headwinds from global issues like increasing oil prices, trade wars and rising interest rates and consequently a falling Rupee are a concern. It is also likely that US economy could slowdown going forward and Fed rate hikes could lead to further risk off in the global markets. Combined with National elections in India in May’19, next one year can be very volatile for Indian markets.
- **Our Long term view on the India Growth Story continues to be positive. However, given the current risks in the domestic and global environment, we advise caution in the near term.**