Debt markets

Indian bond yield ended 13bps higher as geopolitical pressures mounted. Crude continued to make recovery amid OPEC supply cuts and Venezuelan sanctions. In this volatile environment 10yr Govt. benchmark traded in the range of 7.29% to 7.47% before closing month at 7.41%.

Liquidity for the month of February remained negative at an average Rs-0.7 trillion from previous month's average of Rs-0.34 trillion (Rev Repo-Repo-Marginal Standing Facility-Standing Liquidity Facility + term repo/re-repo).

INR traded in the range of 70.7150/$ to 71.8075/$ and finally closed the month at 70.7462/$ in February vs 71.0850/$ in January. India's forex reserves were at $399.21 bn as on 22nd February from $398.17 bn in last week of January.

Domestic Macro Factors

Industrial Production

India's industrial production growth picked up to 2.4% in December vs. 0.3% in November (revised from 0.5%). This was slightly above market expectation of 1.6%. The recovery was mainly led by the growth in manufacturing segment which rose to 2.7% in December vs. -0.6% in November. In other sectors, mining activity declined further to -1.0% in December vs. 2.7% in November and electricity sector slowed down to 4.4% in December vs. 5.1% in November. In terms of use-based classification, capital goods production increased to 5.9% in December vs -3.1% in November. The consumer durables category recovered to 2.9% in November from -2.1% in November. Consumer non-durables sector growth rose to 5.3% in December vs. -0.6% in November. Infrastructure and intermediate goods growth printed at 10.07% and -1.5% in December vs 5.03% and -4.9% respectively in November.

Gross Domestic Product

GDP growth for Q4 moderated to 6.6% YOY from 7% in Q3 (downwardly revised from 7.10%). This was slightly below market expectations of 6.7%. The moderation in growth was mainly due to base effect. Private consumption growth demand slowed to 8.4% YOY in Q4 vs. 9.8% in Q3 (revised from 7% earlier reported). Government consumption growth moderated to 6.5% in Q4 from 10.8% in Q3, while fixed investment growth surprisingly inched up to 10.6% in Q4 from 10.2 in Q3. GVA growth moderated to 6.3% in Q4 vs. 6.8% in Q3. This was below market expectation of 6.5%. Agriculture GVA growth moderated in Q4 at 2.7% vs. 4.2% in Q3. Industry GVA growth and services SVA growth remained flat in Q4 at 6.1% and 7.6%.

External Trade

India's external trade deficit widened to $ 14.7 bn in January vs. $ 13.1 bn in December mainly due to decline in exports. This was above market expectation of a deficit of $ 13.5 bn. Import growth printed flat YOY after declining to -2.4% in December. Imports remained steady at $ 41.1 in January vs $ 41.0 bn in December. Oil imports growth reduced to -3.6% in January from 3.2% in December. Gold imports growth increased to 38.2% in January vs -24.3% in December. Non-oil, non-gold imports printed at -0.8% in January vs. -1.9% in December. Exports growth printed at 3.7% y-o-y in January vs. 0.3% in December. Exports moderated slightly at $ 26.4 bn in January from $ 27.9 bn in December. Oil exports reduced by -19% in January vs. 13.2% in December. Non-oil exports printed at 8.00% in January vs. -1.6% in December.

Fiscal

The GST collection for the month of February declined to Rs97,247 crores, from previous months collection of Rs1,02,503 crores mainly due to reduction in tax rates of 23 goods and services. The Rs97,247 crore collected includes Central GST of Rs17,626 crores, State GST of Rs24,192 crores, Integrated GST of Rs46,953 crores and Cess of Rs8,476 crores.

Inflation

Headline CPI moderated slightly to 2.05% in January from 2.1% in December (revised from 2.2% earlier reported) mainly due to lower food and core inflation. This was below market expectation of 2.5%. Core inflation eased to 5.3% in January vs 5.6% in December. Food inflation printed at -2.2% in January vs -2.6 in December (revised from -2.5% reported earlier). Fuel moderated to 2.2% in January vs. 4.5% in December. The core inflation (CPI ex-food & beverages, fuel, petrol, diesel and housing rent) reduced marginally to 5.8% in January from 5.9% in December.

WPI eased to 2.76% in January from 3.80% in December. This was below market expectations of 3.70%. It was the lowest WPI since March 2018. This was largely due to slowdown in cost of fuel and manufactured products. WPI food articles printed at 2.3% in January vs. -0.1% in December. Fuel and power sector combined inflation printed at 1.8% in January from 8.4% in December. Inflation for manufactured goods printed 2.6% in January vs. 3.6% in December.

Outlook

In US FOMC meeting minutes released during the month, policymakers expressed their willingness to end Balance Sheet unwinding program later this year and keep rate steady amid expectations for a slower pace of US economic growth and that the rate hike would be necessary only if inflation rises unexpectedly. However, its worthy to note that FOMC members are still estimating two rate hikes this year (reduced from three hikes previously). However the base case that markets are pricing in currently is of no rate hike during the year.

In domestic markets headline inflation continued to print low, 2.05 % for Jan-19, as food prices remained checked and moderating core inflation. Food prices are likely to remain subdued on seasonal downside in winter months and oil prices stabilizing around USD 65 pb level, the near-term headline inflation trajectory appears benign. Further the favorable base until Jun-19 likely to support Q1 FY20 inflation trajectory. Upside risks to this view emanate from expansionary fiscal policy, poor monsoon and rise in global commodity prices.

This has raised hopes in market for a rate cut in the next policy meeting by RBI. Post this anticipated cut, we believe that any further rate action would be dependent upon data and contingent upon the balance of caution stemming from the recent sharp acceleration in wage inflation, monsoon performance in 2019, unfolding of consumption led fiscal stimulus, outcome of elections, actions by major Central Banks on rates and balance sheet unwinding and uncertainty on the geopolitics led oil price outlook.

In addition to that liquidity in domestic market due to huge Government borrowing program (Central +State+PSU) can crowd out the private borrowing and impact bond prices. We continue to recommend Liquid, Money Market and Low Duration funds for shorter holding periods. Short duration funds with accrual focus for investors with 9 to 12 months holding period while we recommend mid duration and systematic deployments in long duration funds for investors with 36 months and greater investment horizon.