

Debt markets

Crude prices reversed their downtrend with OPEC supply cuts and truce in US-China trade war. Brent closed at \$60.84 /Barrel i.e 10.32% up in a month. The new 10yr benchmark was auctioned at 7.26% closed month at 7.28%. However later due to expansionary budget announcement and higher crude prices it touched 7.40%. The liquidity remained negative yet there was no effect on short term rates as there remained healthy demand for top rated securities.

Liquidity in the month of January remained negative but increased to average Rs -0.34 trillion from previous month's average of Rs -1 trillion (Rev Repo-Repo-Marginal Standing Facility-Standing Liquidity Facility + term repo/re-repo).

INR traded in the range of 69.4350/\$ to 71.44/\$ and finally closed the month at 71.2550/\$ in January vs 69.7675/\$ in December. India's forex reserves were at \$398.17 bn as on 25th January from \$393.40 bn in last week of December.

Domestic Macro Factors

Industrial Production

India's industrial production growth slowed sharply to 0.5% in November vs. 11 months high of 8.4% in October (upwardly revised from 8.1%). This was much lower than market expectation of 3.6%. In terms of sectorial classification, mining activity declined to 2.7% in November vs. 7.2% in October. The activity in manufacturing and electricity sector also slowed down to -0.4% and 5.1% in November vs. 8.2% and 10.8% in October respectively. In terms of use-based classification, Capital goods production decreased to -3.4% in November vs 6.1% in October. The consumer durables category decreased drastically at -3.4% in November from 17% in October. Consumer non-durables sector growth reduced to -0.6% in November vs. 8.8% in October. Infrastructure and Intermediate goods growth reduced to 5.03% and -4.5% in November vs 8.86% and 2.0% respectively in October.

External Trade

India's external trade deficit narrowed to \$ 13.1 bn in December vs. \$ 16.7 bn in November mainly due to decline in crude imports supported by higher exports. This was surprisingly lower than market expectation of a deficit of \$ 14.5 bn. Import growth decelerated to 2.4% in December vs. 4.3% in November. The moderation in Imports was also helped by drop in gold purchases. Exports growth rose to 0.4% y-o-y in December vs. 0.8% in November. Imports moderated to \$ 41.1 in December vs \$ 43.2 bn in November. Oil imports fell drastically to 3.1% in December from 41.3% in November. Gold imports growth printed at -24.3% in December vs \$ -15.6% in November. Non-oil, non-gold imports printed at -1.8% in December vs -5.8% in October. Exports rose to \$ 27.93 in December from \$ 26.3 bn in November. Oil exports reduced 3.1% in December vs. 42.7% in November. Non-oil exports declined by -1.6% in December vs -5.9% in November.

Fiscal

The GST collection for the month of January increased to Rs 1,02,503 crores, from previous months collection of Rs 94,726 crore. The Rs 1,02,503 crore collected includes Central GST of Rs 17,763 crore, State GST of Rs 24,826 crore, Integrated GST of Rs 51,225 crores and

Cess of Rs 8,690 crores.

Inflation

Headline CPI inflation printed at an 18-month low of 2.2% in December from 2.3% in November mainly due to lower food and oil prices. This was in line with market expectation of 2.2%. Core inflation remained a worry as it was flattish at 5.6% in December vs 5.8% in November. Food inflation further contracted to -2.5% in December vs -2.5 in November. Fuel moderated at 4.5% in December vs. 7.2% in November. The core inflation (CPI ex-food & beverages, fuel, petrol, diesel and housing rent) inched up to 5.9% in December from 5.7% in November.

WPI inflation eased to 3.8% in December from 4.64% in November. This was below market expectation of 4.42%. It was the lowest WPI since April. This was largely due to softer pace of rise in fuel prices and lower food prices. WPI food inflation printed at -0.1% in December vs. -3.3% in November. Fuel and power sector combined inflation printed at 8.4% in December from 16.3% in November. Inflation for manufactured goods printed 3.6% in December vs. 4.2% in November.

Outlook

In last FOMC meeting the policy statement indicated that it will be "patient" with future policy changes in light of the global economic developments and muted inflation pressure. This is a dovish change as for large part of last year markets have been in risk off mode in expectation of impending two rate hikes in 2019 after four hikes in 2018. This gave some respite to UST 10Y yields which closed at 2.68% (3.23% in Nov 2018). Easing crude prices and shrinking 2y-10y UST yields have been signaling softness in growth and employment numbers in line with recent data.

ECB did not bring any new action in its January policy but there is a downward shift in its growth assessment from its last meeting. It looks like Euro will need big positive change in incoming data before ECB could go on to rate hikes.

In domestic markets headline inflation continued to print low, 2.19% for Dec-19, as food prices remained checked and crude prices stable. This has raised hopes in market for change in policy stance by MPC from "Calibrated tightening" to "Neutral" if not rate cut. However, breach of Fiscal deficit target by 0.10% from budgeted estimate of 3.3% and the revision of FY20 target from 3.3% from targeted 3.1% is fiscally expansionary with implications on Government borrowing and inflation. In addition to that income support scheme to farmers and income tax relaxation will increase inflation risk. Further core CPI has been near 6% which should play in minds of policy makers as deterrent to ease policy. This has reduced possibility of rate cut in upcoming policy but it can't be totally ruled out as the RBI has been reiterating its mandate of targeting headline inflation.

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 outlook while we recommend mid duration and systematic deployments in long duration funds for investors with 36 months and more investment horizon.