Debt markets

Indian bond market rallied with Government 10yr benchmark bond closing 15bps lower at 6.88%. This rally was largely on account of improved liquidity, change in RBI stance and also on the possibility about government getting a sizeable amount from RBI post Jalan Committee report on optimum reserve level required for the central bank. This rally partially got reversed on account of profit booking post announcement that Jalan committee report will be submitted post budget. Benchmark bond traded in the range of 6.79% to 7.07% before closing the month at 6.88% vs 7.03% of last month.

Brent crude price rose by almost 7 pct and closed at 64.74 $ per barrel at end of the month.

Liquidity in the month of June turned positive at average 0.48 trillion from previous month's average of -0.36 trillion (Rev Repo-Repo-Marginal Standing Facility-Standing Liquidity Facility + term repo/re-repo) mainly due to higher Government spending.

INR traded in the range of 69.0275/$ to 69.9037/$ and finally closed the month at 69.02/$ in June vs 69.6987/$ in May. India's forex reserves rose to $426.4 bn as on 28th June from $421 bn in last week of May.

Domestic Macro Factors

Industrial Production

India's industrial production growth rose to 3.4% in April vs. 0.4% in March. This was much higher than market expectation of 0.6%. The recovery was broad based as all sectors other than infrastructure goods rose sharply. In terms of sectorial classification, growth in mining activity printed at 5.1% in April vs. 0.8% in March. The activity in manufacturing and electricity sectors printed respectively at 2.8% and 6.0% in April vs. 0.1% and 2.2% in March. In terms of used-based classification, activity in primary and capital goods rose to 5.2% and 2.5% in April vs. 2.6% and -8.4% in March. Consumer durables and non-durables both witnessed an uptick printing respectively at 2.4% and 5.2% in April vs. -3.1% and 1.0% in March. The activity in Infrastructure goods declined to 1.69% in April vs. 6.42% in March.

External Trade

India's external trade deficit slightly widened to $ 15.4 bn in May vs. $ 15.3 bn in April. This was lower than the market expectation of a deficit of $ 15.8 bn. Import growth moderated to 4.3% in May vs. 4.5% in April. Imports decreased to $ 45.3 bn in May vs $ 41.4 bn in April. Oil imports slowed to 8.2% in May vs. 9.3% in April. Gold imports increased to $ 4.8 bn in May vs. $ 4.0 bn in April. Non-oil, non-gold imports increased by $2 bn to $ 28.1 bn in May vs. $ 26.1 bn in April. Exports growth printed at 3.09% in May vs. 0.6% in April. Exports rose to $ 29.9 bn in May from $ 26.6 bn in April. The expansion was due to increases in sales of electronic goods, organic & inorganic chemicals.

CAD and BOP

India's current account deficit improved significantly to 0.7% of GDP (USD 4.6 bn) in Q4 FY19 from 2.7% of GDP (USD 17.8 bn) in Q3 FY19 and from 1.9% of GDP (USD 13.1 bn) in Q4 FY18. The improvement in CAD was led by narrowing of the merchandise trade deficit to 4.9% of GDP in Q4 from 7.4% in Q3. Balance of payments registered a surplus of 2.0% of GDP (USD 14.2 bn) which was the first surplus since Q4FY18, and the highest since Q4 FY15. However, notwithstanding this improvement in Q4, BOP registered a deficit of USD 3.3 bn in FY19 vs. a surplus of USD 43.6 bn in FY18.

Inflation

Headline CPI inflation remained stable at 3.05% in May vs 3.0% in April (revised upward from previously reported 2.9%). The slight uptick was mainly due to higher food price inflation. This was in line with the market expectation of 3.05%. Core inflation (CPI ex-food and fuel inflation) eased at 4.1% in May vs 4.7% in April. The core-core inflation (CPI ex-food & beverages, fuel, petrol, diesel and housing rent) reduced to 4.5% in May from 5.1% in April. Inflation for food and beverages combined rose to 2.03% in May vs. 1.38% in April. Housing inflation in May remained stable at 4.82% vs 4.76% in April. Fuels and lighting inflation remained nearly same at 2.48% in May vs. 2.56% in April. Other miscellaneous inflation combined moderated to 4.62% in May vs. 5.10% April.

WPI inflation moderated to 2.45% in May from 3.07% in April. This was much lower than market expectation of 3.03%. Inflation for primary article combined printed at 6.16% in May vs. 6.50% in April. Food and non-food articles inflation printed respectively at 7.0% and 6.2% in May vs. 7.4% and 5.2% in April. Inflation for Fuel and power sector combined 1.0% in May vs. 3.8% in April. Manufactured goods inflation moderated at 1.3% in May vs. 1.7% in April.

Outlook

The minutes of June meeting indicates that there is increased concern on growth slowdown though inflation is expected to remain under control. The unanimous adoption of accommodative stance after two rate cuts reinforces view that economic climate has become more conducive for continued easing. The sharp fall in core which is demand-driven inflation underlines growth concerns. There is concern over upside food inflation and fiscal risks though headline inflation is expected to be well with in targeted range of sub 4 %. This should open the possibility of further easing.

The subdued monsoon performance, currently tracking at 38% below normal on a cumulative basis may end up in pushing food inflation up. However, we see limited risk of Headline CPI crossing the 4% mark due to weakness in core inflation and adequate food buffers

Globally In the face of weakening growth impulses, central banks have realisation that there could be need for additional stimulus to support growth as well as inflation. The US Fed kept policy rates unchanged in its latest meeting and dropped its pledge to be "patient" before changing policy rates thereby it opening the door for possible rate cuts in 2019.Also it stopped referring to weakness in inflation as just "transient". Fed dot plots now indicate that 7 members expect 50bps cut in 2019 even as the median projection continued to indicate a hold.

ECB indicated the central bank's willingness to shore-up growth indicating that additional stimulus would be required if inflation target of 2% is under threat. This dovish turn from major central banks led to a steep drop in global bond yields. This also resulted in the expansion of universe of negative yielding bonds , with 10-year yields turning negative in more European countries The US 10-year yield dropped below 2% and JPY 10-year yield at 0.16%..

Crude prices may remain volatile as news flows on US led trade war and Geo political tension between US-Iran will remain in market focus. We see 25-50 bps rate cut in FY 2020 however any fiscal slippage or global risk may dent that expectations. However, if government sticks to fiscal deficit target and external account risk remain balanced ,RBI will have enough headroom to ease further. Hence, short duration funds like Money market fund, Banking and PSU Debt Fund, Short term debt fund and Corporate bond fund offer better risk adjusted opportunities, while we recommend mid duration and systematic deployments in long duration funds for investors with 36 months and greater investment horizon.