MIRAE ASSET
Global Investments

INDIA MARKET
OUTLOOK - 2018

Indian Economy

2017 was a year where 2 major reforms, disrupted the Indian economy - Demonetization (which was enacted at end of CY'16) and implementation of GST. However the Indian economy remained resilient and showed positive growth in many parameters. The macro economic conditions of India have been the best in recent times and we see the same continuing in 2018, however there may be some challenges along the way. Global growth is showing signs of inching up, and should aid the growth in the Indian economy.

The table below highlights what we believe was the economic picture for the Indian economy in CY 2017.

The Good	The Not So Good	The Bad
Domestic Flows	Surge in Inflation in H2 of CY17	
Economic Reforms	GDP Growth	
Current Account Deficit	Fiscal Deficit	
Currency	FII Flows	

The table below highlights what we believe will be the economic picture for the Indian economy in CY 2018.

The Good	The Not So Good	The Bad
Domestic Flows	Inflation	Volatility due to state elections
Economic Reforms	Fiscal Deficit	Crude Oil
Current Account Deficit		
Currency		
GDP Growth		

GDP Growth

After declining to a three-year low of 5.7% in Q1 – the fifth straight quarterly decline – GDP nosed up to 6.3% in Q2 on improvement in industrial growth. The pick-up signals fading impact of demonetization and destocking that preluded the implementation of the Goods and Services Tax (GST).

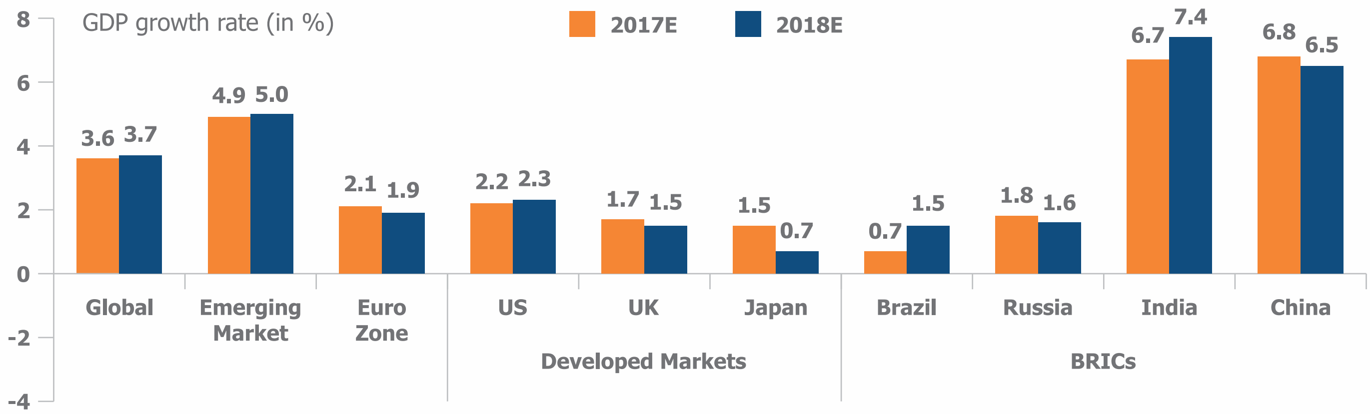
Nuances of GDP growth (at basic prices)

At basic prices	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18
Agriculture & allied	4.1	6.9	5.2	2.3	1.7
Industry	5.9	6.2	3.1	1.6	5.8
Manufacturing	7.7	8.2	5.3	1.2	4.0
Mining	-1.3	1.9	6.4	-0.7	5.5
Services	7.8	6.9	7.2	8.7	7.1
GVA	6.8	6.7	5.6	5.6	6.1

Source: CSO, CRISIL research.

The MPC forecasts for Gross Value Added (GVA) growth in fiscal 2018 at 6.7%. We expect the growth to pick up and average 7% this fiscal, helped by low-base effect of the second half of fiscal 2017.

Global Growth

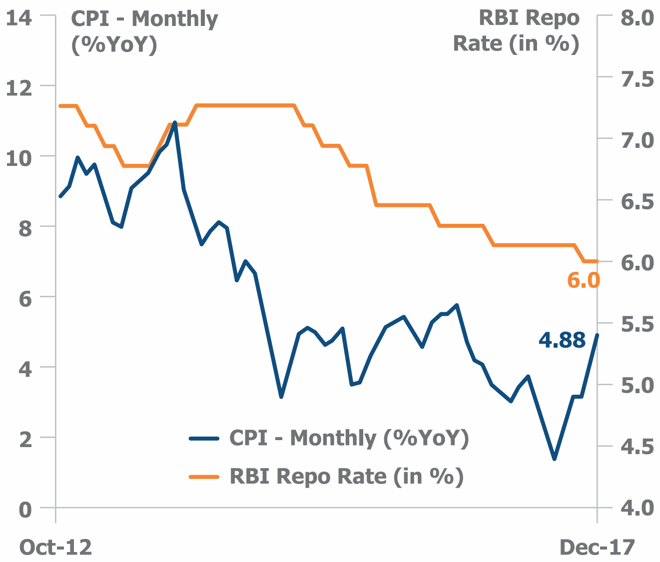


Source: IMF.

2017 is the first year of decent global growth after 5 years, which is a clear evidence of improving economic activity globally. Major Global economies (especially US) are poised for sustained recovery, as reflected in the various central banks' intentions to hike rates. Geopolitical risk remains a concern.

CPI Inflation

Consumer Price Index (CPI)-based inflation surged to a fifteen-month high of 4.9% in November 2017. CPI inflation is now nearly 340 basis points (bps) higher than the lowest point of 1.5% in June - reason why the Reserve Bank of India remains cautious. Inflationary pressures are again in the spotlight with the crude oil price seeing a sustained rise, impact of payment of higher house rent allowances to government employees, rising rural wages, some indication of return of pent up demand in the economy and a weak base.



Source: Bloomberg as on 31st December 2017.

The MPC forecasts CPI inflation to average ~3.6% (actual inflation at 2.6% in the first half and forecast at 4.3-4.7% in Q3 and Q4).

RBI Monetary Stance

The Reserve Bank of India's (RBI), Monetary Policy Committee (MPC) made no change in the policy rates in December – leaving the repo rate at 6%, the reverse repo at 5.75%, and the marginal standing facility rate at 6.25%. So far in the easing cycle, which began in January 2015, the repo rate has been reduced by 200 basis points (bps), with the last rate cut in August 2017.

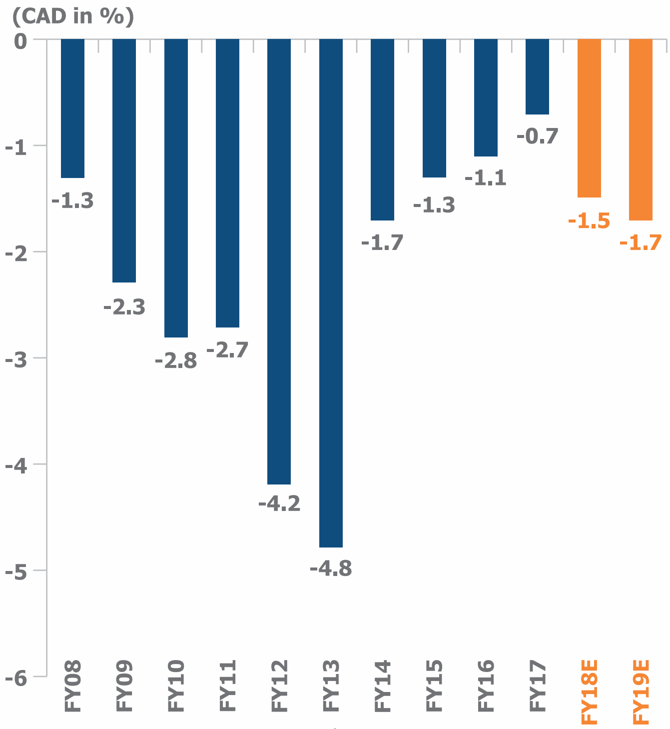
The MPC maintained its neutral monetary policy stance, but raised concern on the trajectory of inflation, which has risen of late. It reiterated focus on maintaining medium-term inflation at 4%, within a band of +/- 2%, while supporting growth.

With inflation having picked up sharply in recent months, oil prices trading at near 3 year high and possibility of fiscal slippage, there seems no headroom for RBI to cut rates in the foreseeable period. However, with growth momentum yet to pick up strongly, RBI may refrain from hiking rates preemptively in a rush. Thus RBI is likely to remain on hold for better part of 2018. Any rate action, in either direction, may materialize only in later part of 2018.

Current Account Deficit

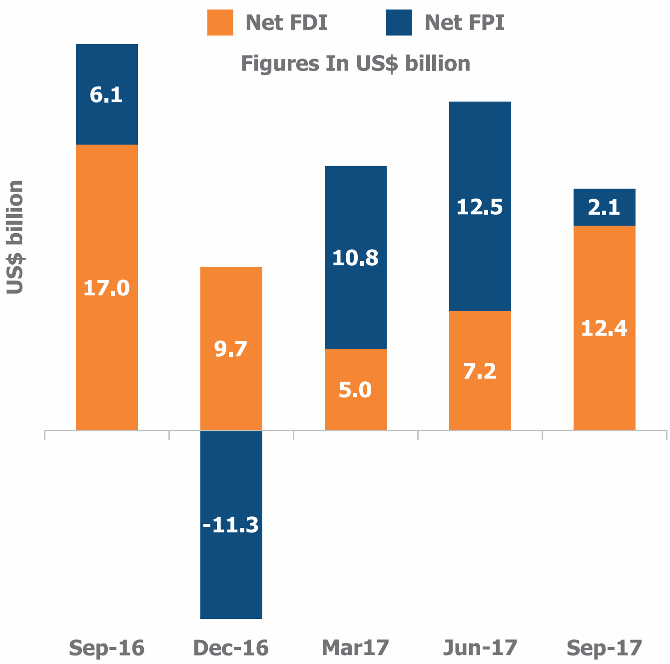
India's Current Account Deficit (CAD) was $7.2 billion (1.2% of GDP) in the second quarter this fiscal (Q2 FY18), or half of the $15 billion (2.5% of GDP) in Q1, but twice the $3.5 billion (0.6% of GDP) in Q2 FY17.

Foreign direct investment (FDI) contributed more to foreign capital inflows than foreign portfolio investments (FPI) & helps in lowering CAD. **We estimate CAD will remain at manageable levels, which can be financed by FDI/FPI inflows.**



Source: Bloomberg consensus as on 31st December 2017.

FDI - FPI contribution in capital inflows

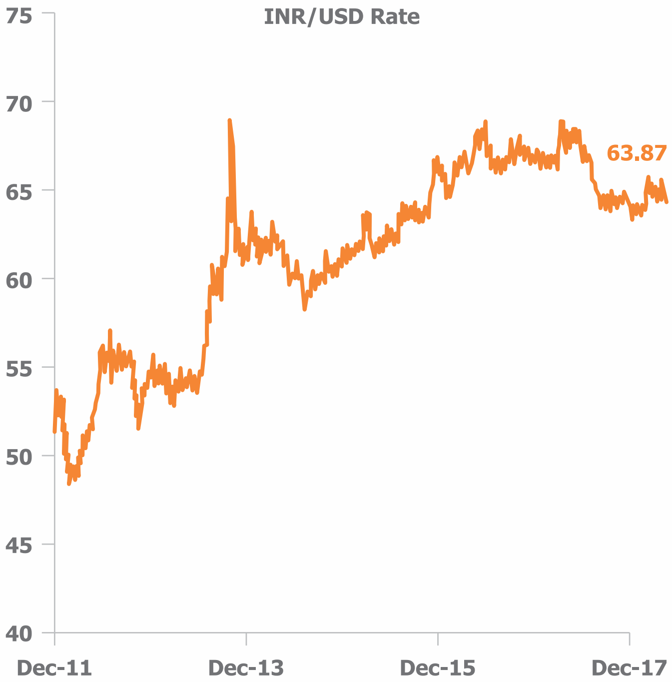


Source: RBI, CEIC, CRISIL Research.

Currency

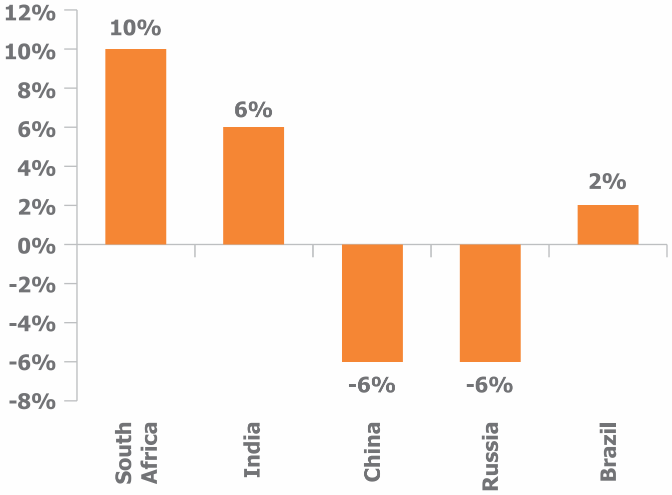
2017 has been a year of two halves for INR. In H1 CY17, INR appreciated ~6% against USD but in H2 it has remained flat. H1 appreciation driven by overall lower current deficit, strong capital inflows and relatively lower ability with RBI to intervene given a surge in INR liquidity in the banking system post demonetization. While H2 remained flat, led by widening of the current account deficit and relatively lower capital inflows compared to H1.

With no demonetization like event, RBI's constraint is likely to be relaxed in FY19 as the system liquidity inches towards neutral. On the other hand if for some reason INR depreciates, the more than US$400bn reserves can cushion the fall too. Flexibility on two-way intervention can pave the way for INR currency to remain range-bound.



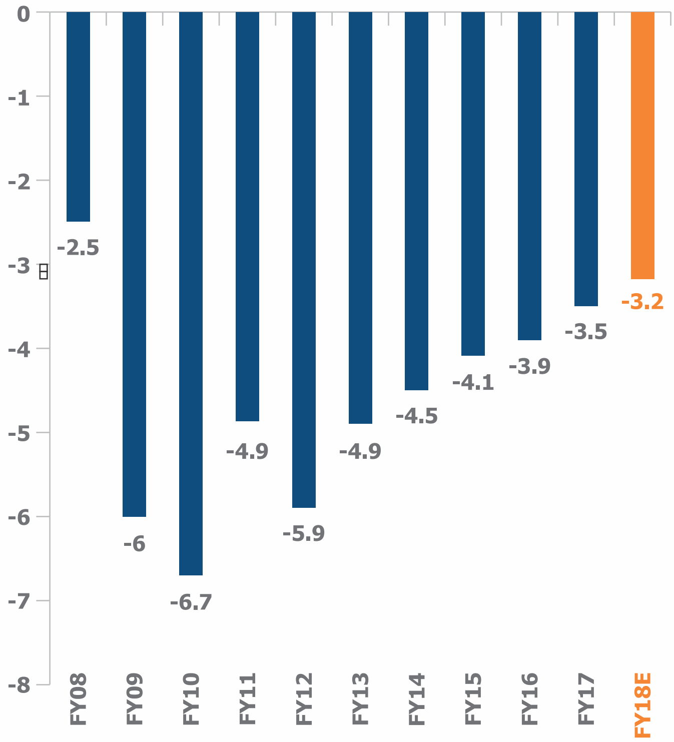
Source: Bloomberg as on 31st December 2017.

Emerging Market Currency Return in CY17*



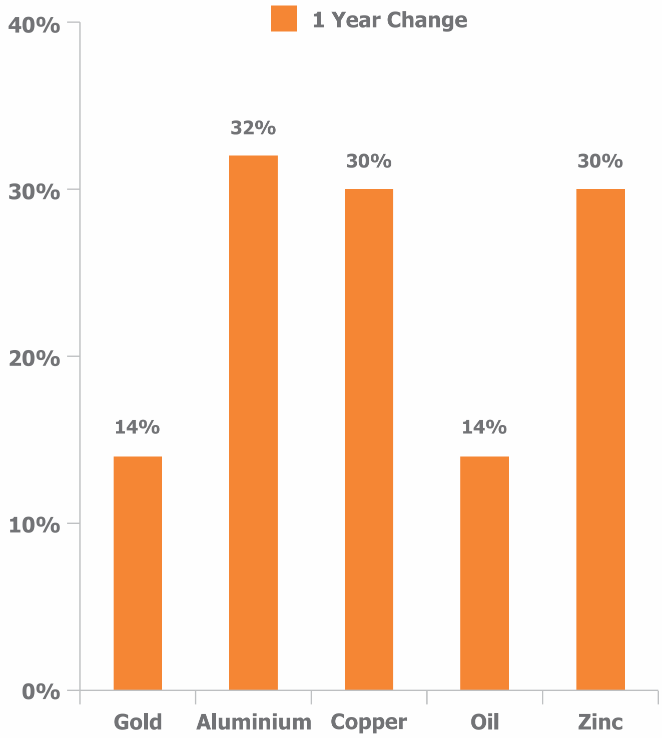
Source: Bloomberg as on 31st December 2017. *Rounded off

Fiscal Deficit



Source: Bloomberg as on 31st December 2017.

- Inspite of the extra government borrowing announced in last week of December, central government has shown significant fiscal prudence by limiting its fiscal deficit within guidance / FRBM targets.
- Increase in oil & commodity prices will lead to increase in CAD & impact fiscal deficit and will remain a key risk.



Source: Bloomberg as on 31st December 2017. Metal prices are LME prices.

Debt Market

Review 2017

Calendar year 2017 commenced on a promising note with huge liquidity flows into banking system due to demonetization, low oil prices and strong fiscal position. However, in later part of the year, a strong rise in global crude oil prices, a spike in inflation domestically due to rising food, fuel and housing prices, disruption in revenues due to GST implementation and a hawkish Fed turned the market sentiments into negative zone. India 10Y govt bond yields rose nearly 80bps from 6.52% to 7.33%, mostly in last quarter. Headline CPI inflation rose nearly 150bps from 3.4% in December'16 to 4.9% in November'17. Fed raised rates 3 times from 0.50-0.75% to 1.25-1.50% during the year in view of a strong economy and rising employment. INR appreciated nearly 6% for the year from 67.93/$ to below 64/$ driven by strong FPI flows. Liquidity remained in surplus for most part of the year but inched towards neutral by year end due to strong sterilization by RBI including by way of OMO sales.

Monthly FPI/FII Net Investments (Calendar Year - 2017)

	INR crores		
Calendar Year	**Equity**	**Debt**	**Total**
January	-1,177	-2,319	-3,496
February	9,902	5,960	15,862
March	30,906	25,355	56,261
April	2,394	20,364	22,758
May	7,711	19,155	26,866
June	3,617	25,685	29,302
July	5,161	18,867	24,028
August	-12,770	15,447	2,677
September	-11,392	1,349	-10,043
October	3,055	16,064	19,119
November	19,728	531	20,258
December	-5,883	2,350	-3,544
Total - 2017	**51,252**	**1,48,808**	**2,00,048**

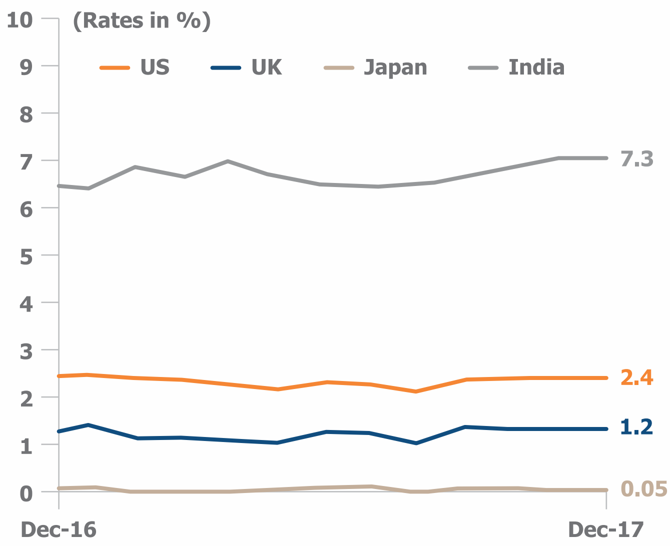
Source: NSDL, 31st December 2017.

Fixed Income Rates (in %)

Fixed Income - Rates	29th Dec' 2017	31st Dec' 2016
Call Money	6.10	6.20
CBLO	5.82	6.23
3 month CD	6.38	6.20
3 month CP	7.06	6.71
1 year CD	6.75	6.63
1 year CP	7.53	7.34
G-Sec (10 yrs)	7.33	6.52

Source: Bloomberg as on 31st December 2017.

Global Interest Rates



Source: Bloomberg as on 31st December 2017.

- Post global crisis, Interest rates have been trending down and now, rates seem to have bottomed out.
- Fed and European Central Banks' indications of rate hike and QE withdrawal points towards their increasing confidence in global economic growth.

Debt Outlook 2018

Its time again for crystal ball gazing, to make assessment for what holds in store for fixed income investors in 2018. Macro economic environment appears pretty challenging for debt markets as we prepare to welcome the new calendar year. Headline CPI inflation at 4.88% for November'17, already above the higher end of RBI assessment of 4.70%, is expected to print near 6% in Q1CY18. Pushing higher the inflation trajectory are three crucial variables. First the Brent crude oil prices which are now trading at near $67/bl, almost a 3 year high. To complicate matters further, even as oil remains on boil, Govt needed to cut excise duty on petroleum products in response to public outrage putting pressure on fiscal balance (Analyst estimates at ₹ 13000 crs on this count). Secondly, increased allowances under 10th pay commission recommendations have resulted in housing component of inflation to shoot up. Finally, the vegetable prices witnessed a sharp surge in Q4CY17 pushing headline inflation higher. To the extent that the current surge is partly attributed to normalization of vegetable prices, which had collapsed in November last year immediately after demonetization, a quick easing of the same is unlikely. Core inflation that has remained rather sticky throughout the year has also risen in recent months and crossed 5% mark in November. Along side, revenue collections have not shown the expected improvement post implementation of GST and fiscal deficit for April-Oct period has already reached nearly 97% for the budget. Even assuming, govt is able to retain the current year's fiscal deficit target of 3.2%, it would be an uphill task to retain 3% fiscal deficit target for FY19 as dictated by FRBM. In recent months, export growth has been erratic and imports have shown sharp uptick necessitating a recast of CAD projection by most analysts. Thus, on macro front, headwinds to lower rates remain pretty strong in the form of accelerating inflation, possible fiscal slippage and widening CAD.

On the global front, Fed firmly remains on gradual rate hike path. The balance sheet shrinking exercise by Fed will step up to $20bn/pm from Q1CY18 and will peak at $50bn/pm by end of year sucking out over $300bn of liquidity from global markets in current year. US economy is on a firm footing having grown at 3.3% in last quarter, its' fastest pace in over 3 years. Unemployment rate at 4.1% is lowest in over a decade. The likely passing of a tax cut bill will further provide a strong stimulus. Similarly, Euro zone economy is also growing strongly and its not long before that ECB will need to tone down the ongoing QE exercise. Thus, global markets are also hinting at higher rates in coming year.

The silver lining though amongst this gloomy scenario is that interest rates in India have already risen sharply in recent months and are benchmark 10Y govt bonds have been trading at near 7.35%, the yearly high of 2017. A large section of market believes that all these negatives are already factored in and any further spike in market rates in unlikely. On the other hand, any improvement in macro environment may allow rates to ease.

Given RBI's cautious stance, in the current environment, it may remain on prolonged pause, holding key policy rates at current levels. A slowing growth may also hold RBI back from hiking rates even if the next few months turn into a more challenging macro environment.

In conclusion, H12018 may witness a mild increase in benchmark rates given deteriorating macros. However, if revenue collections show improvement, as they are expected to, as initial glitches of GST stabilizes and if India has another normal monsoon allowing food prices to soften, market rates may start easing in H2CY18.

Equity Market

2017 - Recap

2017 will be remembered for its strong comeback (Sensex up 27% v/s almost flat in 2016) after one of its kind of reforms in terms of demonetization and GST which disrupted the economy. However, India was also joined by similar performance in other key indices (US +25%, MSCI EM +29%, Japan +19%). On the sectoral performance front, all other domestic sectoral indices were positive with consumer durables being the best performer & Health care being the worst performer.

Equity remained the best performing asset class in 2017.

Reforms on Track (2015-2017)

Fiscal Prudence

- J-A-M* architecture
  *J-A-M: Jandhan-Aadhar-Mobile
- Inflation control

Tax Reforms

- GST
- Committed to reduce corporate tax rate

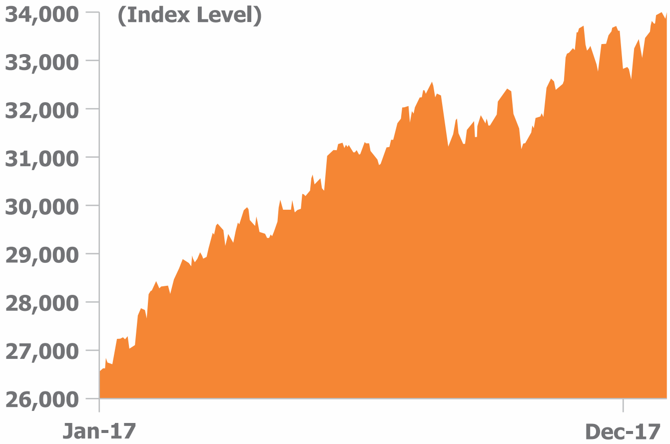
Ease of Doing Business

- RERA, IBC, UDAY, FDI, etc.
- Transparency in auctioning

Aspirational Targets

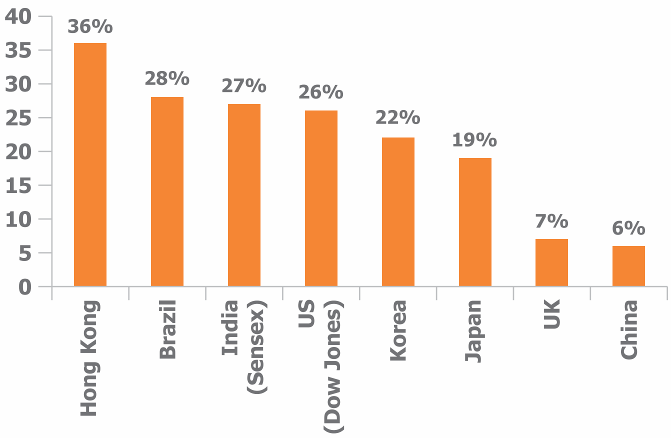
- Housing for All
- Doubling of farm income

Sensex performance for CY17



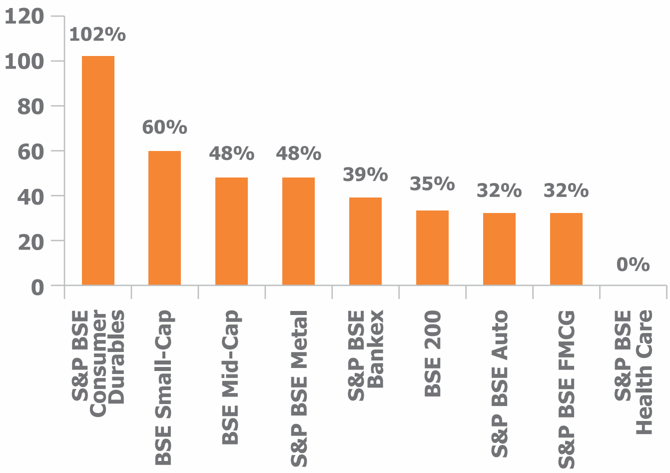
Source: Bloomberg as on 31st December 2017.

Performance of global indices in CY17



Source: Bloomberg as on 31st December 2017.

Performance of key sectoral indices in CY17



Source: Bloomberg as on 31st December 2017.

2018 Outlook

Corporate earnings recovery visibility has improved for 2018 with the building blocks for domestic economic recovery seem to be falling in place - led by both structural and cyclical factors. Global economic recovery is expected to continue and could revive India exports. In terms of chronology, key events to watchout for 2018 would be India Annual budget, rate hikes by global central banks', monsoon trends, followed by newsflow on run up to state and general elections. Key risks for 2018 include

(a) Higher-than-expected crude oil prices and weaker-than-expected GST revenues,

(b) Twin balance sheet stress,

(c) Pace of rate hikes by global central banks,

(d) Upcoming election outcomes and

(e) Geopolitical situation.

The valuation of key Indices (Nifty/Sensex) might appear stretched as against the historical averages. However, we believe the valuations are optically high as India corporate earnings are at cyclical lows. Corporate profit to GDP is at a decade low at 2.9%, while RoE's are almost 10% lower than the peak of 2008. At a broader level, recovery in the earnings and signs of return in investment cycle will be keenly watched in 2018. India remains one of the few regions with structural long term growth drivers, and expects market returns to track earnings growth which is expected to revive. These coupled with concerted efforts by government to revive the investment cycle, benefits of decent monsoons and pay hike, will help revive the growth in corporate earnings, which has been muted for few years.

At a portfolio level we continue to use bottoms-up approach and invest in companies that have shown good profitability across the cycles and run by competent management. We would advise to follow a well-crafted balanced allocation towards equites, with a large portion allocated to multi-cap funds. We would advice investors to invest through SIP route (with a well-defined goal in mind) or in a staggered manner (through STP) to participate in the Indian equity markets.

Key themes likely to shape up in 2018 could be...

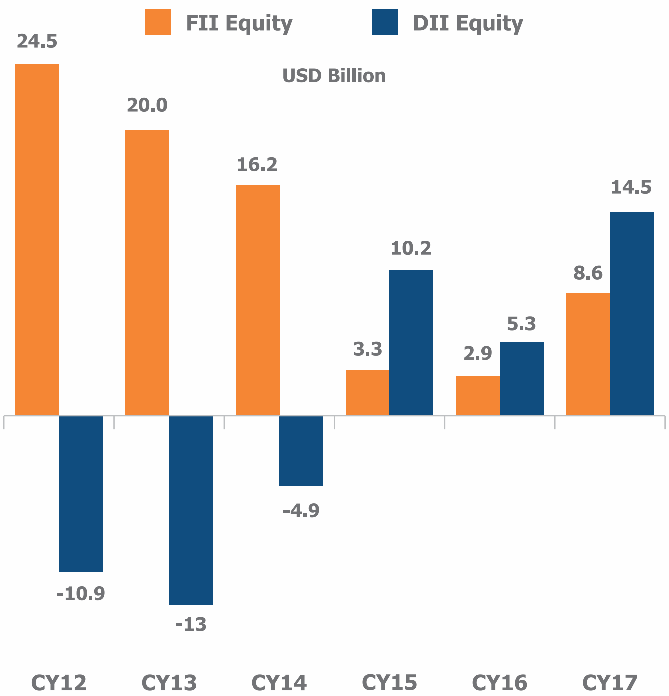
- **Balancing forces on the economic front**
  Macro scenario (inflation, fiscal, interest rates) was favourable in 2017, while 2018 could be a more balanced year. We expect economic growth to pick up as demonetization and GST disruption wanes, government spends continues and investment cycle picks up in 2H. However, balancing factors could be (1) rising inflation, (2) hardening global interest rate cycle and (3) lower domestic fiscal space. Recent state election results and upcoming 2018/19 elections could have some bearing on the upcoming budget. Government till now has maintained fiscal discipline (also led to rating upgrade by Moody's), however we will not be surprised if it allows itself some slack in the deficit targets to increase spending..

- **Corporate earnings recovery**
  Corporate earnings is expected to make a comeback in 2018 after subdued trend in the last few years. India corporate earnings have started normalizing after the demonetization / GST led disruptions and would see a good growth with improving operating conditions and helped by base effect. Two consecutive good monsoons, improved farm insurance penetration and farm loan waivers in some states should have a positive impact on the rural economy.

- **Visibility of benefits from recent Reforms**
  Indian government has pushed various reforms/ schemes over the last few years which include GST (Goods and service tax), Housing for All and IBC (Insolvency and Bankruptcy Code) among others. While it would take some time to realize the full benefits of these reforms, we expect some early visibility on benefits in 2018. We expect near term benefits from "Housing for All" scheme (has a multiplies effect across value chain) and PSU bank recapitalization (will support credit growth) along with NPA resolutions.

- **Trend towards financial savings and digitization**
  We expect continued trend towards financial savings led by (a) Formalization of the economy (GST, Demonetization, Aadhar, RERA), (b) widening social security net (PM Mudra Yojana, Pension Yojana, NPS) and (c) strengthening financial network (Jan Dhan, UPI, DBT). Linking of Aadhar can throw up positive surprises and help in accelerating the pace of formalization of the economy. Government has already saved billions by targeting subsidy schemes under DBT.

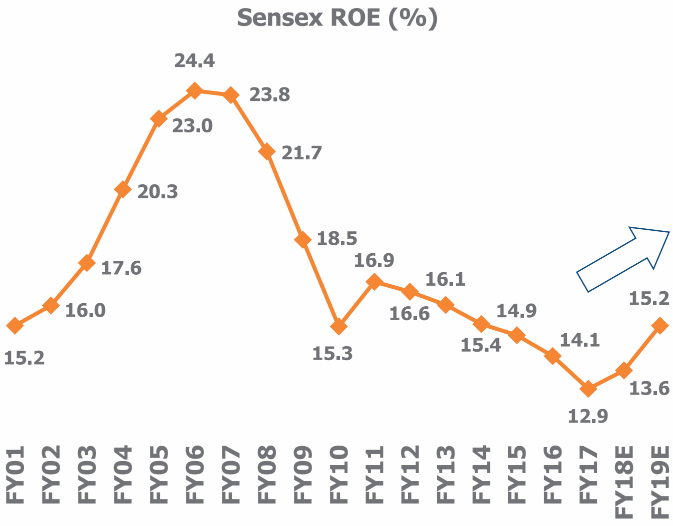
DII flows providing strength to markets



Source: RBI, CEIC, CRISIL Research

Source: Bloomberg as on 31st December 2017.

1. Sensex ROE



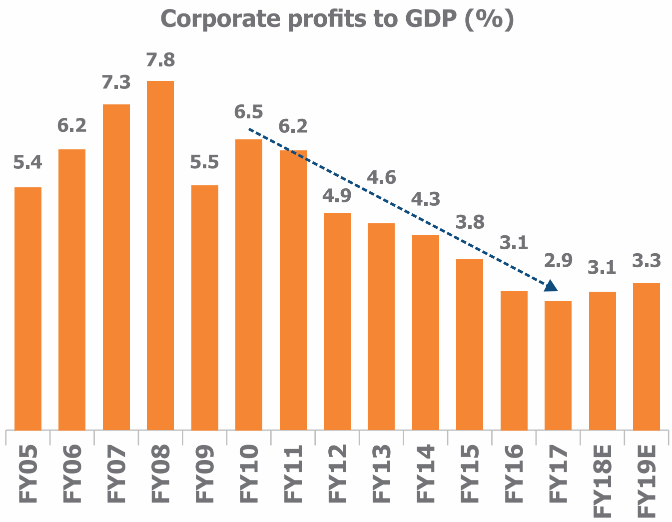
Source: Ace, Bloomberg.

4. India well placed in FII Flows

FII flows ($bn)	2013	2014	2015	2016	2017
India	19.6	16.2	3.3	2.9	8.0
Taiwan	9.2	13.2	3.4	11.0	6.0
South Korea	4.9	5.7	-3.6	10.5	8.1
Indonesia	-1.8	3.8	-1.6	1.3	-2.9
South Africa	0.1	1.5	0.7	-8.6	-3.9
Brazil	4.9	9.0	5.7	3.9	3.0
Total	**36.8**	**49.3**	**7.9**	**20.9**	**18.4**
India's share (%)	**53.2**	**32.8**	**41.4**	**13.9**	**44.5**

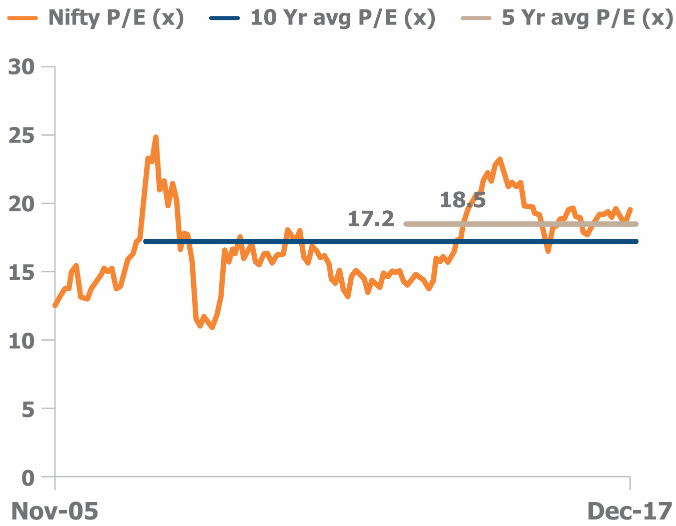
Source: Business Standard.

2. Corporate profits to GDP



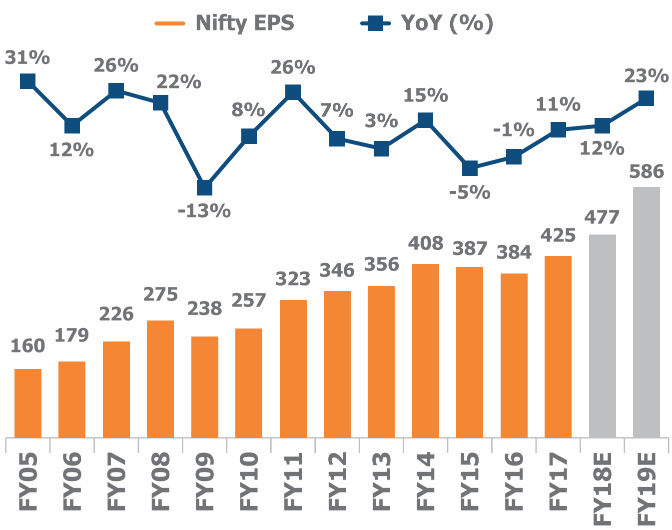
Source: Ace, Bloomberg; Data for top 500 companies.

5. Nifty P/E



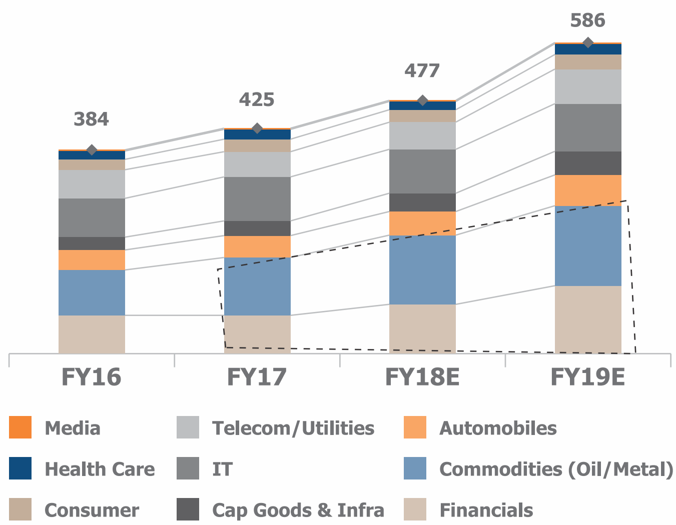
Source: Bloomberg as on 31st December 2017.

3. Nifty EPS Growth



Source: Bloomberg as on 31st December 2017.

6. Sectoral break-up of Nifty EPS (INR)



Source: Bloomberg as on 31st December 2017.

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