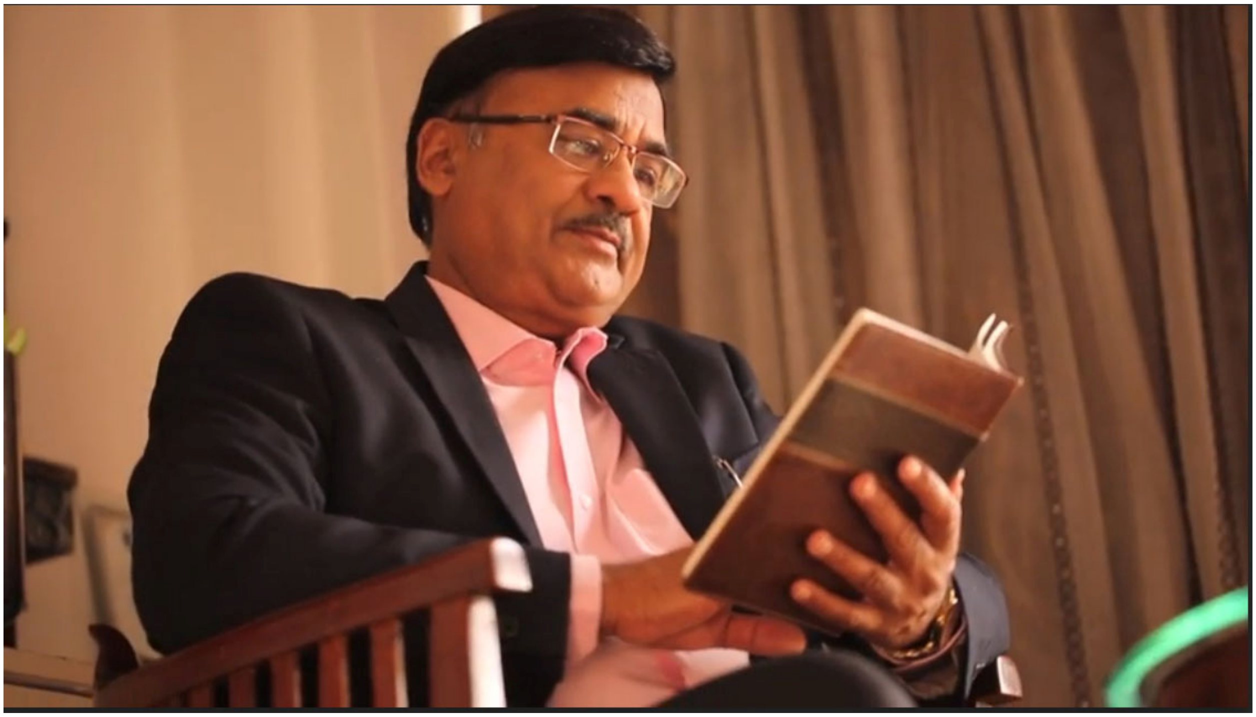

Dr. Ashok Ajmera (FCA), CMD & CEO

Dr. Ajmera's column as on Oct. 07, 2017

RBI keeps repo rate unchanged; all eyes on upcoming Q2FY18 earnings season..

The benchmark Nifty gained 0.92 per cent on Friday, ahead of the outcome of the Goods and Services Tax (GST) Council meet. This rally helped markets register their first weekly gain in the past three weeks. The benchmarks gained 1.2 per cent during the week. Previous week, they were down two per cent.

However, in our view caution should be exercised as situation could still be precarious, as foreign portfolio investors (FPIs) are continuing to take money off the table. FPIs have sold shares worth ~2,668 crore during the week. However, the EM fund outflow picture changed marginally for markets such as Brazil that saw an inflow of almost US$200 million. Fund flow in many Asian markets was tepid as they were closed for holidays. South Korea, however, saw an outflow of over US$480 million. While FIIs broadly remain cautious on EMs, the MSCI EM has inched higher again to its three year high (up over 2%) and currently above 1100.

The six-member Monetary Policy Committee (MPC) of Reserve Bank of India, headed by Governor Urjit Patel, on Wednesday left the short-term lending rate, also known as repo rate, unchanged at 6 per cent. The committee also did not tweak the cash reserve ratio

(CRR), which remained unchanged at 4 per cent, but cut statutory liquidity ratio (SLR) requirement by 50 basis points to 19.5 per cent. The projection of real GVA growth for 2017-18 has been revised downward to 6.7 per cent from an August 2017 projection of 7.3 per cent, with risks evenly balanced.

On the domestic front, real gross value added (GVA) growth slowed significantly in Q1 of 2017-18, cushioned partly by extensive frontloading of expenditure by the central government. GVA growth in agriculture and allied activities slackened quarter-on-quarter in the usual first quarter moderation, partly reflecting deceleration in the growth of livestock products, forestry and fisheries. Post the RBI monetary policy outcome in which key interest rates were kept unchanged, the index witnessed a round of profit booking.

There are factors that continue to impart upside risks to this baseline inflation trajectory, RBI said. Advance estimates of kharif foodgrains production are early setbacks that impart a downside to the outlook. The implementation of the GST so far appears to have had an adverse impact, rendering prospects for the manufacturing sector uncertain in the short term.

Friday's gain was led by metal stocks. The benchmark BSE Sensex rose 0.7 per cent and the National Stock Exchange's Nifty 50 gained 0.9 per cent at the close in Mumbai. All 19 sector gauges compiled by BSE advanced, paced by the S&P BSE Metal Index's 3.1 per cent rally. Tata Steel climbed 4.6 per cent to its highest closing since January 2011, after posting a quarterly surge in domestic sales.

Mutual funds (MFs) garnered investor flows in excess of Rs 20,000 crore for the second straight month in September, taking the year-to-date inflow tally beyond Rs 1 lakh crore.

Last month, the equity schemes saw net inflows of Rs 22,233 crore, including Rs 2,404 crore pocketed by tax-saving MF schemes, according to data released by the Association of Mutual Funds in India on Friday.

Rupee depreciation

The rupee has reversed its depreciation momentum and is likely to remain in consolidation in the range of 64.5-65.7. A move beyond 65.7 could again trigger some sell-off in the debt segment (may be a key trigger for the weakness in equity segment as well). However, a close tab should be kept on GoI 10 year yield, which is shooting towards 6.8%. A move beyond this level could trigger weakness in the rupee while equity and FII may sell equity and debt.

Ajcon's view

In Q1FY18, Nifty companies reported high single-digit aggregate sales growth in the June quarter, but margins have contracted sharply leading to a decline in profitability. There has to be a dramatic improvement in the coming quarters if the double-digit profit growth estimates for FY18 have to be achieved.

The investment cycle also has shown no signs of upturn as evident from the fall in capex to GDP ratio. While government spending has gathered pace in pockets like roads, railways etc., private sector is not investing enough. With a million Indians reaching the employment age every month, flagship projects like "Skill India", "Make in India" etc. need to start showing results. The only remaining engine of growth, namely consumption, can only power the economy so much. The services sector will not be able to create enough jobs, since tectonic shifts are taking place in sectors like information technology, an important contributor to India's consumption engine so far.

September has been good for markets as the Nifty moved aboved the psychological 10,000-mark despite sluggish economic growth in Q1FY18, driven by domestic liquidity. Additionally, expectations from the GST Council meet to get reduction in rates and faster refund gave thrust to small-cap and mid-cap stocks to outperform. Global market remains positive due to better outlook on the US employment data and tax reforms.

With the US Fed starting its balance sheet unwinding in the coming week, the reaction from the market will be the key. Additionally, progress on tax reform coupled with data like change in nonfarm payrolls, etc., will determine the direction not only for US markets but also for global markets

We recommend investors to be stock specific and consider companies with good earnings visibility at a decent valuation.

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CIN: L74140MH1986PLC041941

SEBI registration Number: INH000001170 as per SEBI (Research Analysts) Regulations, 2014.

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