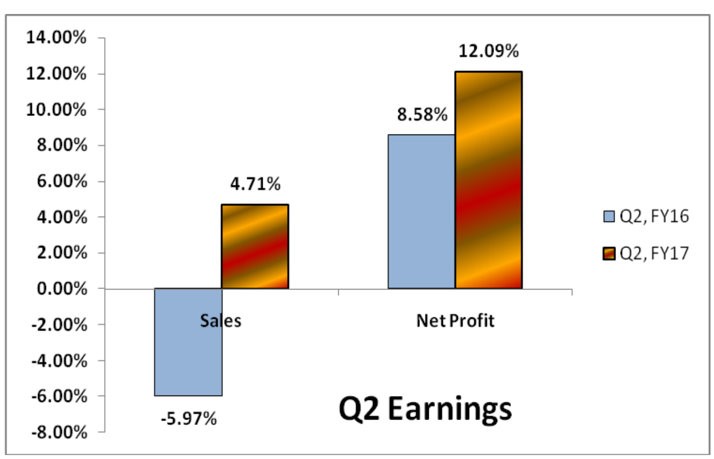
Capital League outlook

November 2016

Indian Economy

- The Indian government and central bank cancelled INR 500 and INR 1000 notes from being legal tender effective midnight of November 8 to nullify the black money hoarded in cash, tackle counterfeit currency in circulation in the economy and curb funding of terrorism with fake currency.
- In the short run, the move is disruptive for growth. Cash heavy sectors such as real estate, textiles and gems & jewellery are likely to be disrupted the most.
- In the long run, this will result in positive changes with fall in inflation and interest rates, increase in tax collection, fall in RBI's liability and shift from physical to financial assets.
- The government recently collected taxes to the tune of INR 30000 Cr in the VDIS (Voluntary declaration of Income scheme).
- The GST committee comprising of both the Centre and states is expected to meet on 2 -3 Dec'16 to finalise the draft legislations on tax structure, compensation to states, interstate movement of goods and services etc. The GST implementation from 1st Apr'17 coupled with the demonetization, Aadhar, Jan Dhan Yojana and Unified payment interface will rope in the parallel economy into the main-stream economy. It will lead to significant improvement in tax revenues in the long-term and accelerate financialisation of the economy thus transforming the financial markets.
- Indian bond (10 year G-Sec) yield has eased to its lowest level around 6.11% since May 2009 due to high liquidity with the banks and rising expectation of interest rate cut by the RBI in its Dec'16 policy.
- Retail inflation (CPI) eased to 4.2% in Oct'16 from 4.31% in Sep'16 with decline in price of food items. Demonetization is likely to result in deflationary forces due to lower aggregate demand.
- Exports grew by 9.59% in Sep'16 but imports also increased by 8.11% widening the trade deficit to USD 10.16 Bn. While the rise in exports is mainly in engineering products , gems & jewellery, the deficit is due to surge in gold imports.
- Corporate results for the Q2FY2017 have mainly been encouraging. The aggregate results for quarter ending 30 Sep'16 for 1105 companies are as shown in graph. Q3 & Q4 earnings are expected to fall on account of slowdown



in activity due to demonetization.

Global Economy

- The focus of US President elect, Mr Donald Trump is expected to be mainly on restoring the strength of US economy via revival of manufacturing and the services sector. This may bring improvement in the US current account balance and consequently possibility of appreciation in the Dollar index.
- OPEC has moved closer to an output cut to rein in oversupply that has put pressure on prices for last two years. Iran is expected to be given an exemption, if it agrees to at least cap its production rather than cutting it.
- Saudi Arabia has raised USD 17.5 Bn in the biggest-ever bond sale by an emerging-market nation as it seeks to shore up finances affected by the slide in oil prices.

Outlook

- Global market volatility is expected in case of some radical policy changes in US. Due to uncertain policy environment there is a rise in demand for US dollar due to move towards safe haven assets. This may result in further appreciation of dollar. US Fed is expected to hike interest rates in Dec'16 though that seems to be already priced in.
- In India, there will be likely an impact of the demonetization on businesses as discretionary spending and sectors thriving on demand from cash in parallel economy will bear the brunt from the present disruptions. Investments are likely to be shifted from physical assets as real estate & gold to financial assets.
- In the short term, over the next 2 quarters, there is expected to be a fall in corporate earnings which may keep stock markets subdued. However, with the positives clearly spelt out for the medium to long term, any dip in markets should be treated as a long term investment opportunity.
- Bonds are immediate beneficiaries with increased liquidity, lower inflation, lower interest rates, reduced government borrowing. Duration funds, dynamic funds as well as short term funds are expected to give good returns over the next 6-12 months.