India Equity & Fixed Income Markets

Market Commentary: September 2022

Global Economy

The US Gross Domestic Product (GDP) shrank at a 0.6% annualized rate last quarter, contracting at a more moderate pace than initially thought in the second quarter as consumer spending blunted some of the drag from a sharp slowdown in inventory accumulation. The US Fed, in its September policy meeting, raised its target interest rate by 75 bps for the third consecutive time. The central bank also reiterated its commitment to tackle persistent high inflation.

Eurozone's annualized GDP expanded at a slower pace at 4.1% in Q2CY22, than the 5.4% growth in Q1CY22. The European Central Bank raised its main refinancing operations rate by 75 bps to 1.25%, the highest level since 2011.

The UK's economy expanded 2.9% y-o-y in Q2 2022, compared to 8.7% growth in Q1 2022. The Bank of England raised its key interest rate by 50 bps to 2.25%, its 7th consecutive rate hike.

Japan's economy grew at a revised annualized 3.5% in Q2CY22, better than the initial estimate of a 2.2% expansion, as robust private consumption provided a boost to the country's long-delayed recovery from the COVID-19 pandemic. Japan's central bank intervened in the foreign exchange market in the month to prop up the Yen for the first time in 24 years as the Bank of Japan kept its ultra-low rates unchanged at a policy meeting, a decision that added further pressure on the currency.

The People's Bank of China kept its benchmark lending rates unchanged at last month's policy meet, as expected, as authorities appeared to hold off immediate monetary easing following rapid declines in the local currency and as central banks elsewhere tightened policy. (Source: CRISIL Research)

Indian Economy

Q1FY23 real GDP growth came in at 13.5% y-o-y, below consensus expectations of 15.2%, aided by private consumption growth of 25.9% y-o-y and investment growth of 20.1% y-o-y. Nominal GDP was quite strong, expanding 26.7%YoY. While the growth in the June quarter was largely supported by a rebound in contact-intensive services consumption on economic reopening, Government's capex push and improving capacity utilisation levels, a drag came from lower net exports.

A variety of high frequency data, suggest robust sequential gains underpinned by pent-up demand for high contact services that had been lagging thus far. This is reflected in the continuing recovery of trade, hotels, transport and communication services. The Index of Industrial Production (IIP) grew 2.36% on-year in July-22, slower than 12.7% growth in June-22, albeit off a much favorable base. The Output of eight core sectors grew 3.3% on-year in August-22, compared to 4.5% rise in July-22, which could signify a margin squeeze due to energy price inflation. (Source: CRISIL Research)

Monetary Policy

The Reserve Bank of India (RBI) in its fifth meeting for FY2022-23 on 30th September, raised the repo rate by 50bps to 5.9%, in line with our expectations, maintaining its focus on tackling inflation. All but one member voted for a 50bps rate hike, while one member voted for a 35bps rate hike, the first such divergence in views in the current hiking cycle. Furthermore, the RBI maintained its FY23 inflation projection at 6.7%, while trimming its GDP growth forecast to 7% from 7.2% earlier for FY23. (Source: RBI)

Inflation

August CPI printed close to consensus expectations, coming in at 7.0% y-o-y, as food prices re-accelerated discernibly after declining in July. Importantly, the momentum of underlying core-core inflation continues to soften, slowing to 0.4% m-o-m growth – an annualized rate of less than 5% for the first time in seven months. (Source: MOSPI, CRISIL)

Brent Crude

Brent crude price plunged nearly 11.8% to close at USD 85.14 per barrel on Sept 30 as against USD 96.5 per barrel a month ago (Source: CRISIL Research)

GST Collections

Goods and services tax (GST) collections in August came in at INR 1.47tn in September this year, 26% higher than the same month in last year. (Source: Ministry of Finance)

Currency

INR depreciated sharply over the month (down 2.3% m-o-m) and ended the month at 81.35 per USD in September, while the DXY gained (+3.1%) in September (following a +2.6% rise observed in August) and ended the month at 112.12 (+19.0% in the last 12 months). (Source: Bloomberg, JP Morgan research)

Government Deficit

Fiscal deficit for the five months through August touched INR 5.42 trillion (USD 66.56 billion) or 32.6% of annual estimates, the result of a sharp offtake in capital expenditure, moderate increase in revenue and higher transfers to states. The same was 31.3% in the same period a year ago.

Exports shrink by 3.52% to USD 32.62bn in September as against USD 33.81bn in the same month in 2021, while the trade deficit widened to USD 26.72bn (Source: MOSPI, RBI)

Equity Market Performance and Key Updates

Indian equities declined 6.3% (USD terms), reversing the upward trajectory of August while outperforming the region and its peers (MSCI APxJ/EM: -12.9%/-11.9%). Markets were under pressure in the month on the back of weaker-than-expected domestic GDP growth data for Q1FY23 and weak core sector output data for August. Markets were also under pressure after FPIs resumed selling Indian equities (USD -1.4bn in the month) after buying for two consecutive months, while Domestic investors continued buying Indian equities in the month (+USD 1.8bn).

Performance of Midcaps -4.1% MoM) and Smallcaps (-0.5% MoM) were mixed against the Largecaps (-4.1% MoM). All sectors barring Healthcare, Communication Services and Consumer Staples declined during the month, with Energy, Utilities and IT declining the most. (Source: Morningstar Direct; Currency: USD)

On a YTD basis, India has been a significant outperformer (-10.3%) as compared to the broader MSCI EM (-28.9%), MSCI World (-26.7%) and MSCI EU (-30.5%) markets. (Source: Morningstar Direct; Currency: USD)

So far, India has seen YTD FPI outflows of USD 22.4bn, while Domestic investors have bought net USD 32.6bn of Indian equities this year. (Source: Bloomberg, JP Morgan Research)

Equity Outlook

Globally, correction in equity markets continued in September as increasing hawkishness of the US Fed and higher than expected inflation data dampened equity outlook. A global risk-off sentiment and demand slowdown impacted Indian equities as well.

The war in Europe too continues to elongate with supply chain bottlenecks persisting globally. Going ahead, equity markets are likely to remain volatile as the extraordinary monetary and fiscal stimulus conditions recede around the world which might lead to a risk-off sentiments from EM equities.

Indian equities valuations continue to remain high as compared to other global markets. We would continue to accumulate companies with strong balance sheets, agile managements, low leverage and sustainable business models. We are positive on sectors which are closely linked to the economic recovery like Banks, Auto and also Healthcare where valuations are reasonable.

Over the long term, we remain constructive on Indian equities owing to a conducive domestic environment, supportive Government policies focused on capex led economic growth, favorable external indicators - high forex reserves, increased share of Foreign Direct Investment (FDI) flows and increasing participation of domestic investors in equity markets which is a more structural trend. As major developed & emerging economies grapple with multiple problems like rising inflation and rising rates, slowing growth and contracting economic activity, India is relatively doing better on these parameters and remains of the favored destination to play the China +1 theme.

Going forward, the pace of US Fed rate hikes in their further meetings and its normalization of balance sheets, trajectory of crude oil prices, geopolitical developments in Europe, inflation trajectory in India and finally retail investor sentiments may provide cues for market performance. Market performance ahead could also be determined by earnings growth in coming quarters as the current high inflationary environment could lead to downgrades in the earnings estimates for some sectors.

Bond Markets

G-Sec yields climbed higher due to 50bps repo rate hikes on 30th September. Elevated domestic and US inflation also fueled concerns about aggressive rate hikes by the respective central banks. The Fed also hiked its key interest rates by 75 bps in the month while maintaining its hawkish stance.

The benchmark 10-year G-Sec yield rose 21 bps to 7.40% on Sep 30, 2022 from 7.19% as on August 31, 2022. Overnight yields moved up ~77 bps to 6.0% during the month. The 91-day T-bill yield rose ~55 bps to 6.2%; 182-day T-bill yield rose 58 bps to 6.6%. (Source: CCIL; RBI)

Similar trend was visible in corporate bonds as yields on the 10-year AAA-rated and AA-rated bonds rose ~15 bps in a month to 7.71% and 8.41%, respectively. Credit spreads over G-Secs compressed slightly due to greater rise in G-Sec yields. (Source: CRISIL research)

Fixed Income Outlook

- The recent 50bps rate hike was on expected lines as the RBI continued its emphasis on containing inflation.
- We expect liquidity conditions to tighten further on the back of RBI's forex interventions and accelerating credit growth in the banking system.
- Expect inflation to remain more entrenched due to US Dollar strengthening, elevated food prices and robust aggregate demand.
- Expect rate hikes to continue due to elevated inflation and hawkish global central bank's policy stance.
- Fixed income as an asset class is becoming attractive due to higher yields across duration and credit.
- The curve has flattened out meaningfully, and hence incremental deploying opportunities in the longer end of the curve looks less attractive. On the other hand, carry on the 1-2 yr corporate bonds are quite attractive, as we are cautious on duration in our fixed income portfolios.
- We continue to be positioned in floating-rate bonds as a defensive stance due to rising-rate environment and expect them to outperform all other fixed-income instruments in the current rising interest rate scenario.

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