India Equity & Fixed Income Markets

Market Commentary: March 2023

Global Economy

The US GDP grew at an annualized rate of 2.7% in Q4CY22, slowing down from a 3.2% growth in Q3CY22. The Federal Reserve raised the target range for the Fed funds rate by 25 basis points (bps) to 4.75 – 5% in its March-23 meeting.

The Eurozone economy expanded by 1.9% y-o-y in Q4CY22, compared to a 2.3% growth in the previous quarter. The European Central Bank (ECB) raised its key rates by 50 bps in its meeting in March. Accordingly, the main refinancing operation rate stood at 3.50%.

UK's economy expanded 0.6% y-o-y in Q4CY22, lower than an upwardly revised 2% growth in the previous quarter. The Bank of England (BOE) raised its key bank rate by 25 bps to 4.25% at its March-23 policy decision meet, lower than the 50bps hikes in previous meets. It also expects inflation to moderate faster than before.

Japan's economy staged a recovery in Q4CY22, expanding by 2.3% on an annualized basis compared to a 0.8% contraction in the previous quarter. The Bank of Japan maintained its key short-term interest rate at -0.1% in its March meet. It also maintained its yield curve cap on 10-year government bonds at 0.5% levels. (Source: CRISIL Research)

Indian Economy

Real GDP growth for the quarter ending December 2022 slowed down to 4.4% y-o-y, lower than consensus expectations. The slowdown can be mainly attributed to loss in momentum of private consumption, which grew by 2.1% y-o-y as compared to 8.8% y-o-y growth previous quarter. On the positive side, fixed capital formation and exports have continued to hold up, driven by Government's infrastructure spending and services exports respectively. (Source: CRISIL Research)

Equity Market Performance and Key Updates

Indian equities snapped their three-month declining streak in March, with MSCI India gaining 1.2% in USD terms, on the back of easing global banking crisis. Sentiments were supported with a US –based asset management firm buying a substantial stake in the Adani group of companies. Indian markets underperformed the broader EM index though, as MSCI EM rallied by 3.0% in the month.

Utilities was the top outperforming sector in the month, followed by Industrials and Staples while IT lagged broader markets. Midcaps (+0.1%) and Smallcaps (-0.8%) underperformed the broader MSCI India index. (Source: Morningstar Direct, Currency: USD)

FIIs turned net buyers of Indian equities in March (+USD 967 mn, following USD 647 mn outflows in February). Domestic Institutional Investors continued their buying trend from the previous month, recording positive flows (+USD 3.7 bn). (Source: NSDL, BSE)

Bond Markets

Government securities ended higher in March, with the yield on the 10-year benchmark 7.26% IGB 2032 security settling at 7.31% on March 31, 2023, compared with 7.43% on February 28, 2023. Bond prices rallied in the month owing to expectations of a pause in rate hike cycle going ahead by the US Fed post its latest policy meet in March. Prices were also supported by the increased buying from mutual funds owing to the recent taxation changes on debt-oriented mutual funds from 1st April, 2023 onwards. (Source: CCIL; RBI)

Interbank call money rates remained below the RBI's repo rate of 6.50% in March, even though the liquidity in the system was largely in deficit. The RBI intermittently conducted variable-rate repo auctions during the month to infuse liquidity.

FPIs sold net USD 307mn of Indian debt in the month, following net purchase of USD 302mn in February. (Source: CDSL, Morgan Stanley research)

Central government borrowing calendar for FY24 (April 01, 2023 to March 31, 2024):

The RBI announced the borrowing calendar for dated IGB securities for H1 FY2024 (April – September), and for Treasury bills for Q1 FY24 (April – June):

1. IGB securities gross supply for H1 FY24 stands at INR 8.88 tn (USD 108 bn), which comprises of 57.6% of the total gross supply for FY24 (i.e. INR 15.43 tn, or USD 188 bn). Net borrowing, accounting for redemptions for H1 FY24 stands at INR 7.3 tn (USD 88 bn), is at an all-time high.
2. The supply is concentrated on the longer end part of the curve, ~72% of the borrowing is concentrated in above 10 yr maturity, vs 63% in the corresponding period last year (H1 FY23):

Tenor	Amount (INR Bn)	Amount (USD Bn)	Percentage
3 Yr	560	6.8	6.3%
5 Yr	1,040	12.7	11.7%
7 Yr	910	11.1	10.2%
10 Yr	1,820	22.1	20.5%
14 Yr	1,560	19.0	17.6%
30 Yr	1,430	17.4	16.1%
40 Yr	1,560	19.0	17.6%
Total	**8,880**	**108.1**	**100%**

3. **There are no floating rate bonds supply in FY24, compared to 6% of gross supply in FY23**
4. No green bond supply in H1 FY24
5. Treasury Bills**:** For Q1 FY24, the gross Treasury Bill issuance stands at INR 4.16 tn (USD 50.6 bn). On a net basis, the supply is INR 1.42 tn (USD 17bn) for the quarter, as against INR 2.4 tn (USD 29 bn) in corresponding period of last year.
6. The supply in the shorter end part of the curve is much lower as compared to the longer end. This increase was requested by all sections of the market given the demand from insurance and pension funds was extremely strong in FY23.

Monetary Policy

The Reserve Bank of India in its first monetary policy meeting for the FY23-24 on 6th April, kept the policy repo rate unchanged at 6.50%, against market consensus. It also emphasized that the decision was a 'pause not a pivot', and kept the option open for 'further actions' in its future meetings if the situation should so warrant. (Source: RBI)

Currency

INR appreciated over the month (up +0.6% MoM) and ended the month at 82.18 per USD in March. (Source: Bloomberg)

Inflation

India's retail inflation moderated to a fifteen-month low of 5.66% in March compared to 6.44% in February as food prices moderated on account of lower vegetable prices. The crucial core inflation too fell to a ten-month low of 6% in March 2023. (Source: MOSPI, CRISIL)

Bank Credit/ Deposit Growth

Bank deposits grew 10.3% and credit 15.6% on-year in March vs 10.2% and 16.2% in February. (Source: RBI)

Liquidity

Liquidity in the month increased with the daily absorption under the liquidity adjustment facility now at INR 1,041bn as compared to INR 182bn as of 28th February. (Source: RBI)

GST Collections

Bank deposits grew 10.3% and credit 15.6% on-year in March-23 vs 10.2% and 16.2% respectively in February. (Source: Ministry of Finance)

Government Deficits

Fiscal deficit for the first eleven months of the financial year (Apr-Feb) rose to INR 14.53tn (82.8% of annual budget), comparable to the 82.7% deficit in same period last year.

The trade deficit narrowed to USD 17.43 bn in February 2023, from USD 17.75 bn in January, benefiting from a dip in non-oil and non-gold imports.

India's current account deficit (CAD) has narrowed to USD 18.2bn or 2.2% of GDP in the October to December quarter (Q3FY23) from 4.4% of the GDP in the quarter ending September. The reduction can be mainly attributed to the decline in trade deficit due to robust exports in services sector and private transfer receipts. (Source: MOSPI, RBI)

Equity Outlook

Indian market performance has remained subdued over the past few months as compared to other Asian markets on account of elevated valuations and also local bank deposit rates going up notably which may have prompted discretionary retail outflows from markets. On a YTD basis, in USD terms, MSCI India (-6.4%) has underperformed the MSCI EM index (+4.0%), thereby resulting in moderation of its valuation premium to EM peers. While Indian equities valuations are now closer to its own long term average levels.

We do not expect markets to correct significantly from these levels. The reason for the same is that fundamentally the economy continues to be on firm footing with consumer spending, Government expenditure towards capex and new projects and private capex revival holding up.

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/interest rates and slow growth, India is doing relatively better and remains a favored destination to play the China +1 theme.

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, Retail and some Internet stocks. In terms of market capitalization, on a valuation basis, large caps are better placed than mid cap and midcaps are better placed than small-caps.

Going forward, market would take cues from global central policies trajectory of crude oil prices, any signs of resolution of conflict in Europe, inflation trajectory in India and sentiment of foreign and retail investor flows.

Fixed Income Outlook

- The 10-year G-Sec Bond yield moderated to 7.20% (previous day closing: 7.28%) and the 5-year bond yield fell to 7.04% (previous day close: 7.15%) following the rate hike announcement on 6th April. The RBI's overnight weighted average call rate hovered close to policy rate after the policy announcement, and was higher than the previous rate of 6.26%.
- The latest monetary policy decision was unexpected, with RBI breaking its streak of rate hikes in the past six consecutive meets. One of the key difference observed in this meeting was that the members unanimously voted to keep rates unchanged (as against a 4/6 majority in the previous meet supporting a rate hike).
- We believe that the Central Bank will continue to take a calibrated approach, given the heightened volatility in global financial markets and a resilient domestic economy. A shift in global Central Banks consensus may reflect in further actions by the RBI.
- We think we are at the end of the rate hike cycle, with an elongated pause expected post peak in interest rates.
- We expect inflation to moderate in the near future, mainly due to the base effects of last year. However, core inflation may remain sticky due to the lagged pass-through of input costs and potential upside risks from increased imports. Hence is no room for any monetary policy easing from the Central Bank at this point of time.
- We recommend an accrual strategy and active duration management in the fixed income space.
- Continue with our positive stance on floating rate instruments due to their high carry and remain positive on the shorter end of the curve due to low duration risk.

Market Snapshot

Yields (As on March 31, 2022)

Yields (%)	G-secs*	AAA	AA+	AA	AA-	A+
6 Months	7.13	7.47	8.27	9.25	10.2	11.09
1 Year	7.14	7.7	8.5	9.48	10.43	11.32
3 Years	7.16	7.7	8.5	9.48	10.43	11.32
5 Years	7.19	7.7	9.2	10.18	11.13	12.02
10 Years	7.31	7.87	9.37	10.35	11.3	12.19

**Weighted average yields for G-sec data 6-month G-sec: 182-day T-Bill rate; 1-year G-Sec: 6.69% IGB 2024; 3-year G-Sec: 5.63% IGB 2026; 5-year G-Sec: 7.17% IGB 2028; 10-year G-Sec: 7.26% IGB 2032*

Money Market Update (As on March 31, 2022)

	Certificate of Deposits			Commercial Paper		
Tenure	31 Mar'23 (%)	28 Feb'23 (%)	Change (in bps)	31 Mar'23 (%)	28 Feb'23 (%)	Change (in bps)
1 Months	7.20	6.90	30	7.63	7.25	38
3 Months	7.00	7.58	-58	7.35	7.86	-51
6 Months	7.37	7.70	-33	7.71	7.95	-24
12 Months	7.60	7.86	-26	7.90	8.10	-20

Bond Market Update (As on March 31, 2022)

	G-Secs*			AAA Corporate Bonds		
Tenure	31 Mar'23 (%)	28 Feb'23 (%)	Change (in bps)	31 Mar'23 (%)	28 Feb'23 (%)	Change (in bps)
1 Year	7.14	7.33	-19	7.70	7.78	-8
3 Years	7.16	7.38	-22	7.70	7.78	-8
5 Years	7.19	7.43	-23	7.70	7.77	-7
10 Years	7.31	7.46	-14	7.87	7.95	-8

**Weighted average yields for G-sec data*

Corporate Bond Credit Spreads (As on March 31, 2022)

Tenure	6 Months	1 Year	2 Years	3 Years	5 Years	7 Years	10 Years
AAA	0.48	0.54	0.53	0.42	0.41	0.33	0.42
AA+	1.29	1.34	1.33	1.22	1.91	1.83	1.92
AA	2.27	2.32	2.31	2.20	2.89	2.81	2.90
AA-	3.21	3.27	3.26	3.15	3.83	3.76	3.85
A+	4.10	4.15	4.15	4.03	4.72	4.64	4.74
A	5.14	5.20	5.19	5.08	5.77	5.69	5.78
A-	5.31	5.36	5.36	5.25	5.93	5.86	5.95

Economic Indicators Update

Indicator	Latest	Previous
USD/INR	82.18 (Mar'23)	82.67 (Feb'23)
GDP	+4.4% (Oct – Dec'22)	+6.3% (Jul – Sep'22)
Retail Inflation (CPI)	5.66% (Mar'23)	6.44% (Feb'23)
Wholesale Inflation (WPI)	3.85% (Feb'23)	4.73% (Jan'23)
IIP	+5.6% (Feb'23)	+5.2% (Jan'23)

Data Source – RBI, Mospi.Nic.in, CRISIL Fixed Income database, Morningstar Direct

Disclaimers