India Equity & Fixed Income Markets

Market Commentary: December 2022

Global Economy

The US GDP expanded at a revised 3.2% in Q3 2022 on an annualized basis, compared with a contraction of 0.6% in Q2. The US Fed, in its December policy meeting raised its target interest rate by 50 bps, taking its benchmark lending rate to 4.25% - 4.50%, its highest level in 15 years. The US Fed also indicated in its policy minutes that interest rates will remain higher for longer and that it would need to see substantial more evidence of inflation been on a sustained downward path before any easing to take place.

The Eurozone economy expanded by a revised 2.3% y-o-y in Q3 2022, moderating from an upwardly revised 4.3% in Q2 2022. The European Central Bank raised its main refinancing operations rate by 50 bps to 2.50%.

The UK's economy contracted by 0.2% on a sequential basis in Q3 2022. The Bank of England in its November meeting raised interest rates by 50 basis points to 3.5% in its December meet.

China's GDP expanded at a faster than expected rate of 3.9% on a y-o-y basis in Q3 2022 owing to Government support measures and easing Covid restrictions. The People's Bank of China (PBoC) kept its interest rates unchanged as policymakers remained wary of stoking further weakness in the yuan by easing monetary conditions.

Japan's economy contracted by a revised 0.8% on an annualized basis in Q3 2022, from an upwardly revised 4.6% expansion in Q2 2022. The Bank of Japan maintained its key short-term interest rate at -0.1%, but it decided to allow the 10-year bond yield to move up/down 50 bps around the 0% target, wider than the previous 25-point band. This marked a potential pivot by one of the last leading central banks sticking to an ultra-loose monetary policy. (Source: CRISIL Research)

Indian Economy

India's real GDP (at market prices) slowed from 13.5% YoY in the Jun-22 quarter to 6.3%YoY in the Sept-22 quarter due to the waning of favourable base effect. Growth was led by private household consumption and fixed capex expenditure while net exports remained a drag to GDP growth.

A variety of high frequency data, suggest robust economic momentum underpinned by pent-up demand for high contact services that had been lagging thus far. India's factory output growth as measured by the Purchasing Manager's Index rose to a two year high of 57.8 in December from 55.7 in November, maintaining robust growth despite global headwinds. Output in the services sector expanded at the quickest pace in six months, with the Services PMI index coming in at 58.5 in December as compared to 56.4 in November. (Source: CRISIL Research)

Equity Market Performance and Key Updates

Indian equity indices snapped a two-month gain in Dec-22, with benchmarks S&P BSE Sensex and Nifty 50 declining 3.6% and 3.5% respectively amid concerns of global slowdown, high interest rates globally and surging Covid-19 cases in China.

With respect to the broader EM peers, MSCI India underperformed in the month (-5.5%), while MSCI EM declined by 1.4%. (Currency: USD; Source: Morningstar Direct)

Mid-cap and small-cap indices did better than large-cap indices and were down 2.5% and 2%, respectively. All S&P BSE sectoral indices declined in Dec-22, except metals which was up 3% on the news of China further easing the three-year border controls aimed at curbing Covid-19. IT and Energy underperformed the most.

In CY22, in USD terms, MSCI India was down 8.7% while MSCI EM index was down 22.4%. (Source: Morningstar Direct; Currency: USD)

Foreign portfolio investors (FPI's) turned net sellers of USD 0.2bn of Indian equities in the month of December while Domestic Institutional Investors (DII's) bought USD 2.9bn of equities. On a calendar year basis, in 2022, FPIs were net sellers of US$17 bn of equities while DIIs bought US$35.8bn worth of equities. (Source: JP Morgan research)

Bond Markets

G-secs ended lower in Dec-22, with the yield on the 10-year benchmark 7.26% 2032 settling at 7.33% on Dec 30, 2022, compared with 7.28% on Nov 30, 2022. Prices fell on tracking a rally in the US Treasury yield and after the Bank of Japan (BOJ) decided to modify its yield curve control strategy. The BoJ stated it will allow the 10-year bond yield to move 50 bps on either side of its 0% target, wider than the previous 25-bps band.

Domestic yields rose further after the RBI's MPC hiked key rates and raised concerns over inflation. The MPC raised the repo rate by 35 bps, its fifth consecutive increase, to 6.25%. A further dip in gilts was, however, restricted by a pullback in oil prices and US inflation, which triggered investors' expectations that the Fed may slow down the pace of rate hikes in the future.

Interbank call money rates remained below the RBI's repo rate in Dec-22 amid adequate liquidity in the system. The RBI intermittently conducted variable-rate reverse repo auctions during the month to absorb excess liquidity. (Source: CCIL, CRISIL Research)

Monetary Policy

The Reserve Bank of India (RBI) has raised its benchmark repo rate for the fifth consecutive time, albeit by 35bps instead of the previous 50bps hikes, to 6.25%. The monetary policy stance remains maintained at 'withdrawal of excess accommodation'. The RBI also lowered its growth forecast for FY23 to 6.8% from its earlier projection of 7%. Inflation is projected to remain above its 4% target for the next 12 months with the inflation forecast for FY23 maintained at 6.7%. (Source: RBI)

Currency

INR depreciated by 1.6% in the month and ended the month at 82.73 per USD as compared to 81.43 per USD in November. (Source: Bloomberg, JP Morgan research)

Inflation

Retail inflation eased to 5.72% in December on an annual basis as against 5.88% in November. Inflation has remained within the Central bank's tolerance band of 2-6% for the second consecutive month. (Source: MOSPI, CRISIL)

Bank Credit/ Deposit Growth

Bank deposits grew 10.4% y-o-y and credit 15.8% y-o-y in December as compared to a growth of 8.2% and 15.8% in November respectively. (Source: RBI)

Liquidity

Liquidity in the month has decreased, with the average daily absorption under the liquidity adjustment facility now at INR 602bn as of 31st December as compared to INR 1.2tn as of 30th November. (Source: RBI)

GST Collections

The gross GST revenue collection for the month of December 2022 accounted for INR 1.49trn. The revenue collection has witnessed a surge of 15% on an annualized basis. (Source: Ministry of Finance)

Government Deficits

Federal fiscal deficit for the first eight months of the financial year (Apr-Nov) rose to USD 118bn billion (59% of annual budget), though rising tax collections helped offset a higher subsidy bill.

Trade deficit in November decreases to a six month low of USD 23.8bn, as exports recovered a little to USD 31.9bn in the month from USD 29.8bn last month. (Source: MOSPI, RBI)

Equity Outlook

Equity markets were impacted by the US Fed's increasing hawkishness and BOJ's pivot towards higher interest rates. However, valuations of Indian equities remain high. A sideways moving equity market would mean a shift in investment approach toward multiple asset classes.

Indian equities valuations continue to remain high as compared to other global markets. However, 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/Auto Ancillaries and Telecom.

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.

Fixed Income Outlook

- Bond yields rose in December 2022 after the RBI hiked repo rate to 6.25%. Global cues such as the Bank of Japan allowing the 10-year JGB yield to trade higher up to 0.5% and the US Fed signaling more rate hikes, pushed up domestic yields.
- We have entered 2023 with high inflation, high interest rates and low liquidity, which makes fixed income relatively attractive to other asset classes.
- The yield curve shape has also flattened, bringing down term premiums and the extra carry from long-dated securities and hence the higher maturity segment does not offer any sort of carry compensation at the present time.
- With the economic cycle advancing from slowdown to growth, we expect credit spreads to expand further.
- Further, credit growth outpacing deposit growth could result in deposit rate moving higher, which in-turn may drive yields higher. In such a phase, accrual strategy is preferred over duration.
- We continue to hold floating-rate bonds as a defensive, high carry instrument and believe it is still attractive in the current rising interest rate scenario.
- Overall, we believe we are in the mature phase of the interest rate hiking cycle wherein yields are above the inflation rate, delivering a positive real rate of return, making it a good year for debt investment.

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