India Equity & Fixed Income Markets

Market Commentary: April 2022

Global Economy

The US Federal Reserve on 4th May raised its benchmark interest rate by half a percentage point, the most aggressive step yet to contain the 40-year high inflation print in March 2022. The federal funds rate now lies in the range of 0.75%-1%, with the Fed hinting at further 50bps rate hikes in subsequent meetings with a more aggressive 75bps rate hike ruled out. Also, The Fed has started on its quantitative tightening journey with a balance sheet roll of worth USD 30bn in Treasuries and USD 17.5bn in mortgage-backed securities (MBS) to commence from 1st June 2022. After three months, the roll off for Treasuries will increase to USD 60bn and USD 35bn for MBS per month.

The US Gross Domestic Product (GDP) growth unexpectedly declined at an annualized pace of 1.4% in Q1 2022, marking an abrupt reversal for the economy coming off its best performance since 1984 in Q4 2021.

Euro area GDP expanded by 5% y-o-y in the Q1 2022, higher than an upward revised estimates of 4.7% in Q4 2021 while the European Central Bank (ECB) maintained status quo on interest rates, although hinting at a faster than expected normalization of policy this year.

The Bank of England hiked its main interest rate for a fourth consecutive meeting, to its highest level in 13 years at 1% as UK's inflation rose to its highest level of in 30 years (7% in March 2022).

Japan's GDP growth rebounded to 1.3% q-o-q in Q4 2021, an annualized rate of 5.4%. The Bank of Japan left its key short-term interest rate unchanged at -0.1% and that for 10-year bond yields around 0% during its January March meeting, and has also maintained its easy monetary policy stance.

China's GDP grew by 4.8% y-o-y in Q1 2022, faster than the 4% increase in the previous quarter. Earlier, the Chinese government had cut its GDP growth target in CY2022 to 5.5% in order to focus on sustainable growth and stabilise its economic fundamentals. The People's Bank of China (PBoC) has maintained the one-year loan prime rate (LPR) at 3.7%, while the five-year rate was pegged at 4.6%. (Source: CRISIL Research)

Indian Economy

The IMF has slashed its forecast for India's FY23 GDP growth to 8.2% from 9% earlier, observing that higher commodity prices is likely to weigh on private consumption and investment. High frequency growth data has been encouraging with recovery gaining strength and becoming more broad based. Output of eight core sectors grew 4.3% on-year in March following an upwardly revised 6.0% growth in February. Manufacturing PMI rises to 54.7 in April on the back of robust growth of exports. The services PMI stood at 57.9 in April 2022, up from 53.6 in March 2022, highlighting a sharp rate of expansion that was the fastest since November 2021. (Source: MOSPI, CRISIL)

Equity Market Performance and Key Updates

The headline Nifty 50 index declined by 2.1% in April amid weak global cues, rising bond yields, sticky inflation, surging Covid cases in China, prolonged conflict in Europe and the increasing probability of an aggressive rate hike path by the US Fed. Both Midcaps (+1.3%) and Smallcaps (+1.4%) outperformed Largecaps during the month. (Source: Morningstar; Currency: INR). Among sector indices, IT, Financials and Communications underperformed broader markets while Utilities sector outperformed.

FPIs continued to remain net sellers of Indian equities in April with USD 3.4bn of outflows, following USD 3.7bn outflows in March). This marked the 7th consecutive month of net equity outflows for FPIs, with total YTD outflows of USD 16.9bn. FPIs continued their selling in debt markets too, recording outflows of USD 555mn, following USD 672mn outflows in March. Domestic Institutional Investors recorded inflows of USD 4.1bn in April, maintaining their net inflows trend since March 2021. (Source: Bloomberg, JP Morgan research)

MSCI India too declined by 1.7% in the month, however it outperformed MSCI EM Index which closed down 5.6% in USD terms during the month (Source: Morningstar; Currency: USD).

On the COVID vaccination front, The Drug Controller General of India (DCGI) has granted emergency use authorization to two Covid-19 vaccines — Biological E's 'Corbevax' and Bharat Biotech's Covaxin — for children under the age of 12 years.

Bond Markets

G-Sec yields surged in April after the Reserve Bank of India increased the floor of interest rates in the economy by 40 basis points, by launching the Standing Deposit Facility (SDF) in its monetary policy meet in the month. The benchmark 10-year G-sec yield jumped 30 bps in a month to 7.14%, reaching a high of 7.22%.

Corporate bond yields also saw an uptick. However, the rise in yields was lower compared to the rise in G-secs'. The 10-year AAA-rated bond's yield rose by 13bps to 7.31% at the end of April. Similar trend was visible in the yields of spread assets.

On the auction front, the RBI reduced liquidity of ~INR 1.3tn via sale of G-Secs; and another INR 1.61tn via sale of Treasury Bills. State Governments' (SDLs) borrowings were low in April at ~INR 95bn.

Monetary Policy

The Reserve Bank of India (RBI), in an unscheduled meeting on 4th May, raised the repo rate by 40bps to 4.4%. It also raised the cash reserve ratio (CRR) from 4% to 4.5% in an effort to withdraw excessive liquidity from the system. The RBI reiterated that it remains "accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth", while also clearly outlining the persistent high food and core inflation and guiding to elevated levels of inflation in April.

Yields on the 10-year 6.54% G-Sec maturing in 2032 jumped close to 7.4% in the aftermath of the announcement, from ~7.10% on the previous day. (Source: Bloomberg)

Currency

INR depreciated over the month (down 0.8% m-o-m) and ended the month at INR 76.43 per USD on 30th April. In the last 12 months, INR (-3.1%) though weaker, has performed better than the broader EM FX (-8.4%). (Source: CRISIL Research)

Inflation

India's retail inflation rises to 8-year high of 7.79% in April as compared to 6.95% in March, with inflation now coming in higher than RBI's upper limit of 6% for the fourth straight month. The increase was primarily on account of higher food inflation led by the edible oils category, with inflation in the food basket coming in at 8.38% in April as compared to 7.68% in March. (Source: MOSPI, CRISIL Research)

Bank Credit/ Deposit Growth

Bank deposit grew 10% and credit 10.1% on-year in April, compared with 8.8% and credit 8.5% in March. (Source: RBI, CRISIL Research)

Liquidity

Net liquidity in the banking system moderated to INR 5.4tn as of April 30, 2021 from INR 7.64tn as of 31st March. (Source: RBI)

GST Collections

India's Goods and Services Tax (GST) revenues crossed the INR 1.5tn market for the first time and touched a new record of INR 1.67tn in April on the back of increased compliance, better tax administration and improved economic activity. (Source: Ministry of Finance)

Fiscal Deficit

Fiscal deficit for FY23 has been budgeted at 6.4% of GDP by the Government. (Source: Union Budget FY23 documents)

Equity Outlook

Globally central banks are now on a policy tightening course with RBI too finally beginning its rate hike cycle. The war in Europe too continues to elongate with supply chain bottlenecks persisting amidst COVID related lockdowns in China. 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. Foreign Portfolio investors have pulled out ~USD 17bn from Indian equities since the beginning of the year, which is one of the highest in comparison to its Asian peers.

Broad market valuation levels have moderated from their expensive levels back in October 2021, however, they still remain elevated with few pockets and across sector which remain reasonably valued. We would 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 real estate, banks, auto and telecom 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. On YTD basis, domestic institutional investors have been strong buyers of Indian equities with cumulative net flows of more than USD 18bn, thereby providing support to equity markets. (Source: Bloomberg).

Going forward, the pace of US Fed rate hikes in their further meetings and quantitative tightening, crude oil prices and the geopolitical developments in Europe and RBI's own pace of rate hikes 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

Post RBI's previous meeting in April, we had highlighted the change in RBI's policy language which pointed towards a rate hike. Through the latest rate hike, RBI has moved quickly to address the inflation challenge with an unscheduled meeting.

The hike in the policy is expected to push the overall yields up and expect longer-end to more protected compared to shorter-end due to the high term premium. We expect a faster transmission of rate hikes to borrowers given the increased lending in repo-rate-linked loans.

Going ahead, we expect the RBI to prioritize containing inflation over supporting growth with a series of rate hikes in the upcoming meetings. Also, we expect a withdrawal of surplus liquidity from the system and hiking CRR by 50 bps is a strong step towards it with about INR 870bn of liquidity expected to be absorbed.

We expect yield curve to flatten and shorter-end to elevate in a bear flattening scenario. 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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