India Equity & Fixed Income Markets

Market Commentary: Oct 2022

Global Economy

The US GDP expanded at an annualized 2.6% in Q3 2022, compared with a contraction of 0.6% in Q2. The US Fed, in its November policy meeting, raised its target interest rate by 75 bps for the fourth consecutive time, taking its benchmark lending rate to 3.75% - 4%, highest since January 2008. The Fed chair also indicated that rates were likely to move up again, saying that any speculation that the Fed might pause was "premature".

The Eurozone economy expanded 2.1% 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 75 bps to 1.50%, its highest since 2009.

The UK's economy expanded 4.4% on an annualized basis in Q2 2022, lower from an upward revision of 10.9% in Q1 2022. The Bank of England in its November meeting raised interest rates by 75 basis points, its largest single hike since 1989. It also warned of a prolonged recession as policymakers looked to temper market expectations for further aggressive monetary policy tightening.

Japan's economy grew at a revised 3.5% on an annualized basis in Q2CY22, supported by private consumption. The Bank of Japan kept its ultra-low rates unchanged at a policy meeting. (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, 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. India's factory output growth as measured by the Purchasing Manager's Index rose to 55.3 in October from September's 55.1, maintaining robust growth despite global headwinds. Output of eight core sectors grew 7.9% in September as compared to 3.3% in August. (Source: CRISIL Research)

Equity Market Performance and Key Updates

Indian equities rose 2.6% in USD terms, while outperforming the region and its peers (MSCI APxJ/EM: -6.1%/-3.1%). Expectations that the US Fed might slow its pace of rate increases seemed to be the driver of equity market rallies in the month globally. Also, market sentiments were supported by the positive US growth data in Q3 2022, indicating a lower probability of an immediate recession.

Mid-caps (-0.7%) and Small caps (-0.6%) underperformed the Large caps during the month. (Source: Morningstar Direct; Currency: USD)

Foreign portfolio investors (FPI) participation in October was muted (USD 5.2mn net outflows, following USD 1.6bn of outflows in September). Domestic Mutual funds and Insurance funds were both net buyers in September with USD 0.9bn and USD 0.3bn of inflows respectively. (Source: JP Morgan research)

All sectors barring Consumer Staples rose in the month with Energy, IT, Financials and Discretionary outperforming broader markets.

Bond Markets

Government securities (G-secs) ended lower in October, with the yield on the 10-yr benchmark 7.26% IGB 2032 settling at 7.45% on 31st October, compared with 7.40% on 30th September. Yields rose mainly due to the delay in inclusion of local bonds in global indices, a spike in global crude oil prices and a rise in US Treasury yield levels.

Interbank call money rates remained below the RBI repo rate in October amid comfortable liquidity in the system. The RBI intermittently conducted variable-rate reverse repo auctions during the month to drain out excess liquidity. (Source: CCIL, 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)

Currency

INR depreciated sharply over the month (down 1.7%) and ended the month at 82.79 per USD in October. The JPM EM FX Index was up 0.8% m-o-m in October. In the last 12 months, INR (-9.6%) though weaker, has performed better than the broader EM FX (-10.9%). (Source: Bloomberg, JP Morgan research)

Inflation

October CPI print moderated to a 3-month low of 6.77% y-o-y from the previous month 7.41% print, as food prices decelerated to 7.0% from 8.6% in previous month. On the other hand, Wholesale price inflation (WPI) inflation decelerated sharply to 8.39% from 10.7% previous month, moving into single digits after 18 consecutive months. (Source: MOSPI, CRISIL)

Bank Credit/ Deposit Growth

Bank credit rose by 17.94% y-o-y as of 7th October to reflect festive and quarter-end demand, while the deposits at banks increased 9.62% y-o-y as of 7th October. (Source: RBI)

Liquidity

Overall system liquidity has now moved into deficit, with the average daily absorption under the liquidity adjustment facility now at INR -0.2tn as of 31st October 2022. (Source: RBI)

GST Collections

Goods and services tax (GST) collections in October came in at INR 1.52tn, second highest monthly collection ever. (Source: Ministry of Finance)

Government Deficits

Federal fiscal deficit in the H1FY23 (April to September) rose to USD 74.91bn (37.3% of annual budget). Rising tax collections helped offset a higher subsidy bill. Net tax collections during April-September rose to INR 10.1tn , about 10% higher than a year before.

Merchandise trade deficit widened to USD 25.71bn in September 2022, the country's merchandise exports rose 4.82% to USD 35.45bn and imports rose 8.66 % to USD 61.16bn. (Source: MOSPI, RBI)

Equity Outlook

Investors' anticipation of a Fed pivot has attracted capital back into equity asset class, with a bias towards Largecaps. Indian equities have benefitted from this risk-on mood and continues to see optimism in the near future amidst relatively robust economic activity and demand momentum.

However, global uncertainties remain with the war in Europe continuing to disrupt supply chains and global liquidity tightening which may lead to a risk-off sentiments from EM equities.

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

- Yields continued to ascend higher due to tight liquidity conditions and rise in bond yields globally. However, yields at the shorter end of the curve moved more than the longer end.
- A similar trend was visible in corporate bond yields – the shorter end of the duration rising higher than the longer end – leading to compressed term-premiums and a flat yield curve. In the near term, we expect a similar flattening of the G-Sec yield curve.
- We expect liquidity conditions to tighten further on the back of RBI's forex interventions and accelerating credit growth in the banking system.
- Also, going forward, we expect the RBI to continue hiking rates due to inflation persisting above the RBI's comfort level; and also to offset the US Fed's rate hikes in a bid to protect the INR against a stronger US dollar.
- Credit spreads over G-Secs have widened due to a greater rise in corporate bond yields. In this phase, accrual strategy is more attractive compared to duration.
- The curve has flattened out meaningfully, and the 10-yr corporate bond spread over G-sec is still very compressed, and hence we prefer any additional duration exposure in the fund through G-secs only. Also, carry on the 1-2 yr corporate bonds are quite attractive,
- We continue to hold 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.
- The funds have initiated position in US 10-year treasury, currently trading at 4.09% levels, with our entry point at ~4% levels. The yield spread between the US and Indian 10-year treasury bonds has narrowed significantly from recent peak of ~500bps levels to about ~340bps currently, which makes a case for investing in US treasury security at this point. Also, the US 10-year security is offering a real yield of ~1.5% over the 10Y breakeven inflation rate of 2.5%, thus making our entry point attractive.

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