India Equity & Fixed Income Markets

Market Commentary: July 2022

Global Economy

US GDP contracted an annualized 0.9% in Q2CY22, lower than 1.6% contraction in Q1CY22. This is the second consecutive quarter of GDP contraction witnessed in the US. The US Federal Reserve raised the benchmark federal funds rate by another 75bps to a range of 2.25-2.5% in its July policy meet.

Eurozone GDP expanded 4% on an annualized basis in Q2CY22, slower that 5.4% annualized growth in Q1CY22. The European Central Bank has raised interest rates for the first time since 2011, by 50bps to 0% and plans to further hike rates later in the year.

The UK's economy expanded 8.7% y-o-y in Q1CY22, up from 6.6% y-o-y growth in Q4CY21.

Japan's GDP contracted to a lesser extent, a revised estimate of -0.5% y-o-y in Q1 2022, as private consumption remained resilient. The Bank of Japan maintained ultra-low interest rates in its latest meeting and vowed to defend its cap on long term bond yields at 0% with unlimited buying, bucking a global wave of monetary tightening in a show of resolve to focus on supporting a tepid economic recovery.

China's government have implicitly dropped their official 5.5% GDP growth target for the year and shall strive to 'achieve the best possible results for the economy', without mentioning a hard growth target. China's GDP growth in the H1CY22 has meanwhile slowed to 2.5% y-o-y. (Source: CRISIL Research)

Indian Economy

The IMF slashed India's growth outlook for FY23 to 7.4% from 8.2% forecast in April saying that the revision reflects mainly less favorable external conditions and policy tightening.

High frequency indicators continued to remain robust, although they have come off from the highs of May 2022 as the lockdowns of May 2021 provided a favorable base in May 2022. All India south-west monsoon rainfall has swung from 10% below long-term average (LTA) in June to 11% above LTA in July. That said, there's been a notable deviation in spatial distribution of rainfall, which has led to a slightly below trend summer crop sowing this year up till now. (Source: CRISIL, MOSPI)

Equity Market Performance and Key Updates

Indian equities rose by 8.5% in July 2022 (USD terms) outperforming the broader markets (MSCI APxJ/EM: -0.4%/- 0.7%). Market performance in the month was buoyed by resilient corporate earnings and possibility of inflation having peaked. Midcaps outperformed Largecaps (+11.6%) while Smallcaps performed in line with Largecaps in the month (+8.2%).

All sectors barring Energy delivered positive returns with Materials, Financials, Industrials and Staples outperforming broader markets.

Foreign Portfolio Investors (FPI) turned buyers of Indian equities in July, albeit of a small quantum following 9 consecutive months of selling (+USD 0.7bn, following –USD 6.3bn in June). So far, India has witnessed FPI outflows of USD 32.7bn in the period up to July 2022. DIIs recorded inflows of USD 1.3bn in July, maintaining their buying trend observed since March 2021. Mutual funds and Insurance funds were both net buyers in July with USD 0.9bn inflows and USD 0.5bn inflows respectively.

MSCI India too rose by 9.3%, with its performance being amongst the best performing emerging markets in the past month. (Source: Morningstar; Currency: USD)

Bond Markets

India's 10Y yield fell by 13bps in the month, led by concerns of a spill over impact of global financial tightening and growth slowdown. Yields in AAA and AA rated corporate bonds also fell by ~9bps each in the month.

However, the most notable fact has been the significant jump in yields of short end papers, most notably the 91D T-Bill (+40bps), which has reduced the yield gap (10Y and short end papers). This has made the yield curve considerably flatter compared to the previous month.

This happened primarily on account of reduction in surplus liquidity in the system. System level liquidity surplus reached its lowest since 23rd September 2019, remaining between INR 492-499bn (0.3% of NDTL) on 26th and 27th Jul, as compared to ~INR 2.7tn in the beginning of the month. The sudden reduction in liquidity surplus was on account of higher credit growth, RBI's intervention and seasonal upshot of Government's cash balance (INR 5tn+ against +INR 3tn seen in the previous fortnight).

On the auctions front, RBI removed ~INR 2.78tn of liquidity via the sale of G-secs and T-bills in the month. (Source: CCIL, NSE, BSE)

Monetary Policy

The Reserve Bank of India (RBI) in its fourth meeting for FY2022-23 on 5th August, raised the repo rate by 50bps to 5.4%, maintaining its focus on tackling inflation. The rate hike seemed to be front loaded on account of elevated higher core inflation and current account deficit. The vote for 50bps hike was unanimous, with all but one members of the MPC also voting to" remain focused on the withdrawal of accommodation to ensure inflation remains within the target going forward, while supporting growth". Furthermore, the RBI maintained its FY23 inflation projection at 6.7%, reiterating its commitment to keep inflation expectations anchored. (Source: RBI)

Currency

INR depreciated sharply over the month (down 0.4% MoM) and ended the month at 79.27 per USD in July. The JPM EM FX Index was down -2.4% MoM in July. In the last 12 months, INR (-6.1%) though weaker, has performed better than the broader EM FX (-11.1%). (Source: Bloomberg)

Inflation

Headline CPI inflation eases further to a 5-month low of 6.71% y-o-y in July 2022 as compared to 7.01% in June due to moderation in food inflation. Sequential momentum however, persists as prices increased 0.46% m-o-m. Core inflation — the non-food, non-fuel component of inflation — was estimated at 5.80%, declining further from 5.95% last month. (Source: MOSPI, Reuters)

Bank Credit/ Deposit Growth

Bank credit grew at 14.5% y-o-y in the fortnight ended 29th July while deposit growth lagged at 9.1% y-o-y. Credit growth is mainly led by personal loans, which mainly constitutes home loans and vehicle loans. (Source: RBI, CRISIL Research)

Liquidity

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GST Collections

GST collections for July remained above INR 1.4tn for the fifth straight month. Gross GST revenue collected in the month of July 2022 at INR 1.49tn, which was the second highest collection ever since the introduction of the Goods and Services Tax. (Source: Ministry of Finance)

Government Deficits

India's fiscal deficit was 21.2% of the FY23 Budget Estimate (BE) on higher expenditure vs 18.2% of FY22 BE during the corresponding period last year (April-May).

Trade deficit expanded by USD 5bn m-o-m to a record USD 31bn in July as imports grew by 44% y-o-y, mainly led by the restocking of oil and coal. Exports moderated in the month on account of export duties on petroleum products.

India's current account deficit (CAD) for the quarter ended March 2022 was sequentially narrowed to USD 13.4bn (1.5% of GDP) as remittances from overseas citizens as well as software exports surged and the outflow from dividend and interest payouts moderated. For the entire FY22, the current account deficit has come in at 1.2% of GDP, against a surplus of 0.9% in FY21 as trade deficit widened to USD 189.5bn from USD 102.2bn a year ago. (Source: MOSPI, RBI)

Equity Outlook

Indian markets have rebounded in recent weeks despite heightened global macro volatility and recessionary fears driven by expectations of inflation bottoming and fairly robust demand commentary across sectors in recent quarterly earnings conferences. Globally though, central banks are now on a policy tightening course with recessionary fears increasing amidst an environment of persistently high inflation. 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.

Broad market valuation levels have moderated from their expensive levels back in October 2021, although they are still above their long term average levels. 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.

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

- RBI's latest 50bps rate hike was above consensus market expectations of 35bps. Moreover, the RBI continues to remain data dependent, aligned to its global peers. Inflation and growth projections remain unchanged.
- The yield curve post the policy has comparatively flattened. This means that the impact of any future rate hike might be visible across the curve, and may not be limited to the shorter-end.
- We expect rate hikes in the upcoming policies as Inflation is likely to remain above the RBI's target range of 4% +/- 2% on account of imported inflation due to dollar strengthening and elevated energy prices. Surplus liquidity from the banking system continues to be absorbed due to RBI interventions and strong credit growth. We expect this trend to continue and push overnight yields closer to the policy rate.
- Going forward, active management will play a key part in navigating fixed-income markets due to global central bank tightening, rising inflation levels and recessionary pressures.
- 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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