Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- System Liquidity continues in surplus mode by ~₹ 2.7 trillion (including MSS issuances). With RBI announcing Open Market Operations (OMO) sale of ₹ 70,000 crore till date, RBI is expected to take further measures such as issuances of securities under Market Stabilization Scheme (MSS), Open Market Operations (OMO) sale etc. to revert the system liquidity to a position closer to neutrality.
- Currency in circulation reduced by ~ ₹ 2.2 trillion from ₹ 17.7 trillion in October, 2016 to ~ ₹ 15.5 trillion on September 22, 2017 on account of government's demonetization move.
- August CPI inflation rose to 3.36% YoY as against 2.36% in July; primarily on account of higher food, fuel and housing (due to the impact of 7^{th} Pay Commission recommendations) inflation.
- IIP grew by 1.2% in July vs. 0.2% contraction in June. Manufacturing output grew by 0.1% in July (-0.5% in June), Mining picked up to 4.8% in July (0.4% in June) and electricity generation was at 6.5% (2.1% in June).
- Fiscal deficit for April - August 2017 was 5.25 lakh crore viz. 96.1% of 5.46 lakh crore of the budgeted fiscal deficit for FY17 (against 76.4% during the same period last year) due to front loaded expenditure by government on account of advancement of budget and reduction in RBI's surplus transferred to government. Poor GDP numbers have also added to the talks of possible fiscal expansion by the government.
- Brent crude price rose by 9.85% in September to close at USD 57.54/barrel; versus USD 52.38/barrel in August.
- INR depreciated by 2.15% in September to close at INR 65.28/USD; versus INR 63.91/USD in August.

Equity market developments and Outlook

- NIFTY fell another 1.90% in September, with the broader markets faring even worse – NIFTY Midcap fell 2.19% while NIFTY Smallcap closed 3.27% lower. With FII selling continuing in September, domestic institutions also sold equities sporadically while the macro situation continued looking dim – India's Q2 GDP growth fell to a 3 year low of 5.7%. Also, September marked more than ~$4bn of equity supply in the primary markets which could have impacted institutional liquidity and reduced the domestic institutional bid, contributing to the fall.
- The decline was uniform among sectors but the worst affected were NIFTY Realty (-5.17%) and NIFTY PSU Banks (-8.36%). Pharma stocks saw a rebound as investors try to bottom-fish this sector (NSE Pharma: +1.10%) while Metal stocks also closed marginally higher (NIFTY Metal: +0.22%) on a combination of positive China data, supportive industrial metal prices and some positive newsflow in the Indian steel manufacturers.
- FIIs continues to be net sellers of Indian equities in September – to the tune of $1.2bn in September, taking the total since August to $2.8bn – the largest within the EM Asia region. Most of this selling has been concentrated in Exporters, Industrials and Staples – consistent with high FII ownership in these sectors. While domestic MFs were sporadic sellers, newsflow around the fact that they received $4.6bn of inflows in August received a lot of attention. On a net basis, DIIs continued buying in September - $1.8bn taking their YTD total to $12.5bn
- Global markets diverged on idiosyncratic factors in September – the S&P closed 1.70% higher due to a combination of de-escalating geopolitics, lower-than-expected impact from Hurricane IRMA and expectations around Trump's tax proposals. FTSE was weak though (-0.89%) on a hawkish ECB and as inflows into Europe start ebbing. China also stayed weak (SHCOMP: -0.54% and HSI: -1.45%) on broader EM related outflows.

Fixed Income market developments and Outlook

- 10 year G-Sec yields closed higher at 6.66% in September v/s 6.53% in August, due to higher CPI inflation in August and excess supply concerns due to higher state government borrowings, OMO sales and concerns regarding fiscal slippage etc.
- With the surge in inflow into the banking system, RBI is expected to continue with measures to absorb the surplus liquidity through MSS issuances, OMO sales etc.
- We believe that CPI inflation readings would start edging up in H2FY18 due to waning favorable base effect impact & increasing rural wages and rise in inflation globally.
- Our view is that the interest rate easing cycle has broadly come to an end, possibly with some room for accommodation left, depending on the evolving growth and inflation trajectory over the coming months. We think the yield curve will steepen. The excess liquidity in the banking system and the upward movement in yields present a good investment opportunity in the shorter end of the yield curve.
- Key factors to watch out for will be – trajectory of growth and inflation, US Fed policy decisions, impact of farm loan waivers on fiscal situation of states, fiscal expansionary measures taken by the government to boost growth, implementation of GST framework and 7^{th} Pay Commission recommendations.
- In view of the improving macro-economic dynamics, policyholders would be well placed to benefit from the economic revival, if they continue to remain invested in the India growth story.