Bajaj Allianz Life Insurance Co. Ltd.

Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- US non-farm payrolls rose by 128,000 in the month of October, beating expectations quite significantly. The unemployment rate rose marginally to 3.6%, from a 50-year low of 3.5% in the previous month.
- The US Fed cut rates for the third time this year by 25 bps in its October-end meeting, and indicated that future policy action will be data-dependent.
- US GDP growth for Q3 2019 came in at 1.9%YoY (slightly ahead of expectations), compared to 2.0%YoY growth in the previous quarter. Consumer spending, which accounts for more than two thirds of U.S. economic activity grew by 2.9%YoY in Q3 2019, slowing down from a robust 4.6%YoY in Q2 2019. A slowdown in private domestic investment and government expenditure also weighed on the GDP data.
- IMF cut global growth forecast to 3.0% in 2019 vs 3.6% growth registered in 2018, in its World Economic Outlook October 2019 report. However, some recovery in growth to 3.4% is expected in 2020. Emerging economies growth is also forecasted to slowdown to 3.9% in 2019 from 4.5% in 2018, but recover to 4.6% in 2020. IMF cut India's GDP growth forecast for FY20 by 0.9% to 6.1%, but expects growth to recover to 7% in FY21. IMF forecasts China's GDP growth to slow down from 6.6% in 2018, to 6.1% in 2019 and further to 5.8% in 2020.
- India's ranking in the World Bank "Ease of Doing Business report 2020" improved further to 63rd position (out of 190 countries) from 77th position in the previous year. The improvement in ranking was helped due to categories like resolving insolvency / bankruptcy, construction permits and trading across borders. India's ease of doing business ranking has improved quite significantly under the present government, as it stood at 142nd position in 2014.
- Consumer Price Index (CPI) headline inflation rose to 4.0%YoY in Sep 2019 from 3.3%YoY in the previous month. This was primarily due to rise in food inflation (weight of 39% in CPI) to 5.1%YoY in Sep 2019, from 3.0%YoY in the previous month. Meanwhile, core inflation (ex food & fuel) continued to fall to 4.2%YoY in Sep 2019 from 4.3% in Aug 2019, and 4.5%YoY in Jul 2019.
- Index of Industrial Production (IIP) has been lackluster and growth slowed down to -1.1%YoY in Aug 2019, from 4.6%YoY in the previous month. The heavy-weight manufacturing sector (78% weight in IIP) growth dipped to -1.2%YoY, from 4.5%YoY in the previous month. Other sectors like mining and electricity already registered a contraction during the month of Aug 2019. For FYTD20 (upto August) IIP growth was lower at 2.4%YoY, compared to 5.3%YoY in the corresponding period a year ago.
- During the month, crude prices rose a bit on hopes of some US-China trade deal, but later softened to close the month on a flattish note. Brent crude closed the month at $60.23/bbl, compared to $60.78/bbl at the end of the previous month.
- The rupee closed the month on a flattish note at INR 70.93 / USD, albeit underperforming most other peer Asian currencies.

Equity market developments and Outlook

- Indian markets delivered healthy returns during the month of October. The benchmark Nifty 50 index closed the month with a gain of 3.5%, while the broader markets also fared well, with the Nifty Midcap 50 index and Nifty Smallcap 100 index returning +5.6% and +2.7% respectively. Sectors that outperformed during the month included auto, PSU, oil & gas and pharma. The sectors that underperformed during the month were IT, capital goods, metals and power.
- Most global markets fared well and registered positive returns during the month. The MSCI Asia ex-Japan index and MSCI Emerging Markets index returned +4.5% and +4.1% respectively in October. Meanwhile, developed markets underperformed a bit, with the MSCI World Index returning around +2.4% during the month.
- In the US, the S&P 500 index rose by 2.0% in October. Among European markets, Germany was among the top performers, while UK was one of the bottom performers during the month. Within Asia—Taiwan, Japan, Singapore and India were the out-performers, while the under-performers within the region were Thailand, China and Malaysia.
- Foreign portfolio investors (FPIs) registered a strong net inflow of ₹14,657 crore in the month of October, compared to a net inflow of ₹6,674 crore in the previous month.
- Domestic Institutional Investors (DIIs) flows continued to slow down, and they registered a net investment in equities of ₹ 4,675 crore in October, compared to a net investment of ₹12,491 crore in the previous month.
- Q2 FY20 corporate earnings results announced till now have broadly been above expectations, and the corporate tax cut has helped to provide a boost in some sectors. We expect the pace of recovery in corporate earnings to pick-up from H2FY20, and that should help to drive the markets.
- With the past correction in the broader markets, the Nifty Midcap index is trading at a healthy discount to the headline Nifty index (from a forward P/E valuation perspective), compared to a steep premium at the end of year 2017. We are now seeing some attractive bottom-up opportunities in the mid-cap segment. As we believe that the corporate earnings and capex cycle are recovering, we also expect the broader markets to recover.

Fixed Income market developments and Outlook

- Bond yields remained range-bound during the month with a slight downward bias, helped by comfortable liquidity and foreign debt inflows—although fiscal concerns still continued to weigh. Early in the month, a new 10-year G-sec was auctioned with a coupon of 6.45% and maturing in 2029. The new 10-year G-Sec yield closed the month flat at 6.45%. The old 10-year G-Sec yield closed the month at 6.65%--down 5 bps.
- The RBI Monetary Policy Committee (MPC) voted to cut the policy repo rate by 25 bps in early October, with all MPC members unanimously voting for a rate cut (5 members for 25 bps cut and 1 member for 40 bps cut). The MPC decided to continue with an 'accommodative' stance as long as it is necessary to revive growth, while ensuring that the inflation remains within the target. Since February 2019, the central bank has cut the policy rate by a cumulative 135 bps.
- RBI's inflation projection has been revised slightly upwards to 3.4% for Q2 FY20 (from 3.1% earlier), while projections were retained for H2 FY20 at 3.5-3.7%. On the economic front, the central bank revised down the GDP growth forecast for FY20 sharply to 6.1%YoY, from 6.9%YoY earlier.
- Fiscal deficit for FYTD 20 (upto September) stood at 93% of full year target versus 95% in the corresponding period in the previous fiscal year. Even though the fiscal deficit is lower than corresponding period of previous fiscal year, it is still elevated, primarily due to lower indirect tax collections (esp. GST), and partially due to recent pick-up in government expenditure.
- GST collections for the month of October 2019 (reflecting activity for September) remained below the ₹1 lakh crore mark—coming in a ₹ 95,380 crore, compared to ₹91,916 crore in the previous month.
- Foreign Portfolio Investors (FPIs) registered a net inflow of ₹ 5,056 crore in the month of October, compared to a net outflow of around ₹1,900 crore in the previous month.
- With liquidity in comfortable surplus and credit-to-deposit ratio declining lately, we feel that rate transmission by banks will gather pace. Although, inflation has risen marginally, it still remains within the RBI's target. With the central bank's focus turning to addressing the slowdown in macro-economic environment, we feel that there is still room for some more policy action—although it will be data dependent.
- From an investment perspective, we presently prefer the shorter to medium term end of the yield curve.