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Macro-economic developments

- US Q4 GDP growth came in at 2.1% (annualized rate), along expected lines. Growth in consumer spending (accounts for almost 70% of GDP) helped, while domestic private investment fell during the quarter. For the full calendar year (CY) 2019 GDP growth clocked in at 2.3%, compared to 2.8% in CY 2018.
- The US Fed kept rates unchanged at 1.5% - 1.75% in its January 2020 meeting, and signaled that rates could remain unchanged through 2020. US 10 year bond yield fell sharply by 40 bps to close at 1.51% at the end of the month.
- According to the IMF World Economic Outlook Jan 2020 update, global GDP growth is expected to recover from 2.9%YoY in 2019 to 3.3%YoY in 2020. While growth in advanced economies in 2020 is expected to be similar to 2019, growth of emerging market economies is projected to recover from 3.7%YoY in 2019 to 4.4%YoY in 2020. IMF cut GDP forecast for India quite sharply to 4.8%YoY in FY20 and 5.8%YoY in FY21.
- The budget was a growth-oriented one, with an intent to increase disposable income in the hands of individuals and thus aid consumption. Also, some incentives and higher allocation were provided to agriculture/rural and infrastructure sectors. A new income tax regime introduced (with tweak in tax slabs, and removal of most deductions / exemptions), and individuals can choose to stay in the old regime or the new regime (whichever is more beneficial to them). Dividend distribution tax at the company level has been removed and is now taxable only in the hands of investors (at marginal tax rate). This would reduce tax burden for individuals in lower tax slabs, but will increase it for HNIs and super-rich. The govt. announced various measures to attract foreign capital.
- Some leeway in fiscal slippage was allowed, and the fiscal deficit for FY20 has been revised to 3.8% of GDP (vs 3.3% earlier), and for FY21 at 3.5% (from 3.0% earlier). This has been done to deal with the economic slowdown and due to lower tax collections. Market borrowing was along expected lines, and therefore beneficial for the debt markets.
- Tax revenue for FY20 was revised down (due to lower corporate tax and indirect tax collections). However, for FY21, gross tax revenue was budgeted to grow 12%YoY vs 4%YoY in FY20 (RE). Projections for divestment revenue (under capital receipts) and telecom revenue (under non-tax revenue) for FY21 are quite optimistic. Also, IPO of LIC and stake sale in IDBI bank announced. Total expenditure is budgeted to rise 13%YoY in FY21 vs 17%YoY in FY20(RE). This is being aided by capital expenditure, which is budgeted to rise 18%YoY in FY21 vs 13%YoY in FY20(RE).
- Consumer Price Index (CPI) headline inflation rose to 7.4%YoY in Dec 2019 from 5.5%YoY in the previous month. This was primarily due to rise in food inflation (weight of 39% in CPI) to 14.1%YoY in Dec 2019, from 10.0%YoY in the previous month. Meanwhile, core inflation (ex food & fuel) rose marginally to 3.8%YoY in Dec 2019 from 3.6%YoY in previous month.
- Index of Industrial Production (IIP) growth came in at +1.8%YoY in Nov 2019 vs -4.0%YoY in the previous month. The heavy-weight manufacturing sector (78% weight in IIP) growth recovered to +2.7%YoY, from -2.3%YoY in the previous month. For FYTD20 (upto November), IIP growth was significantly lower at +0.6%YoY, compared to +5.0%YoY in the corresponding period, a year ago.
- Crude prices rose initially during the month (with brent crude breaching the $69/bbl mark) on the back of geo-political tension between US and Iran. However, crude prices fell significantly later in the month as geo-political tensions eased, and due to the Coronavirus outbreak (which is expected to impact growth & trade, especially for China). Brent crude closed the month at $58/bbl, and fell further in early February as reported cases of the Coronavirus outbreak rose significantly.

  The rupee closed the month on a flattish note at INR 71.36 / USD, although it was a relative outperformer within the pack of peer Asian currencies.

Equity market developments and Outlook

- Indian markets delivered a polarized performance during the month. The benchmark Nifty 50 index returned -1.7% during the month, while the broader markets outperformed significantly--with the Nifty Midcap 50 index and Nifty Smallcap 100 index returning +4.6% and +6.7% respectively.
- Sectors that outperformed during the month included realty, consumer durables, pharma and capital goods. The sectors that underperformed during the month were metals, oil & gas and banking.
- Globally, markets witnessed a correction during the month (weighed down by the Coronavirus outbreak and geo-political concerns), although developed markets outperformed emerging markets and Asian markets. The MSCI World index returned -0.7% in January, while MSCI Emerging Markets index and MSCI Asia ex-Japan index returned -4.7% and -4.5% respectively.
- In the US, the S&P 500 index closed on a flattish note during the month. Most European markets delivered negative returns, with UK and France being the underperformers. Within Asia—India and Japan were the relative out-performers, while the under-performers within the region were Hong Kong, Indonesia and Thailand. The Chinese markets saw a truncated month, being closed in the last week of the month (due to Lunar new year), but witnessed a sharp correction once they opened in February—on the back of Coronavirus outbreak concerns.
- Foreign portfolio investors (FPIs) registered a net equity inflow of ₹14,095 crore in the month of January, compared to a net inflow of ₹ 6,118 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a net inflow of ₹2,250 crore in January, compared to a net outflow of ₹ 741 crore in the previous month.
- We feel that economic growth may have bottomed out, and expect a gradual recovery—going forward. Corporate earnings to also gradually recover (as the economy recovers), and Nifty earnings growth is projected to pick-up from 12% in FY20 to 19% in FY21. This will help to drive the markets going forward.
- Barring a few "quality stocks", where valuations are elevated, for the rest of the markets (especially mid/small-caps) valuations are in line with the long term average.
- Eye needs to be kept on progress of Coronavirus outbreak (and its impact on growth & trade, esp. for China), geo-political events, progress on US-China trade resolution, global monetary policy stance, global growth trajectory, and global risk appetite.
- From an investment perspective, we continue to prefer large-caps, but also see some attractive bottom-up opportunities in the mid-cap segment—from a valuation standpoint. Investors should continue to invest systematically in equities.

Fixed Income market developments and Outlook

- Bond yields remained a bit elevated due to some fiscal concerns ahead of the Union Budget on 1st February 2020. The 10 year yield closed the month of January 2020 at 6.60%--up 4 bps. In the Union Budget, the revised fiscal deficit and borrowing numbers were along expected lines and this benefited the bond markets, as yields fell. Net market borrowing for FY20 was revised to ₹ 4.74 lakh crore (from ₹ 4.73 lakh crore earlier) and for FY21 has been budgeted at ₹ 5.44 lakh crore. Also, some other positive announcements were announced for the debt markets, including increasing the foreign investor limit for corporate bonds from 9% to 15%.
- Post the close of the month, in the 6th February 2020 RBI monetary policy review, the central bank kept rates unchanged (along expected lines), but announced various measures to increase monetary policy transmission—as a result of which bond yields fell further.
- The RBI incentivized credit flow to certain stressed sectors like auto, housing and MSMEs, by exempting commercial banks from CRR (Cash Reserve Ratio) on incremental credit to these sectors till July 2020. The liquidity framework was tweaked to some extent, to allow long term borrowing through repo (1 year and 3 years) upto ₹1 trillion. This will provide banks with more durable liquidity at a lower cost.
- The central bank revised upwards CPI headline inflation projection to 6.5% for Q4 FY20, 5.0-5.4% for H1 FY21 (vs 3.8-4.0% earlier). But CPI inflation is projected to fall sharply to 3.2% in Q3 FY21. On the economic front, the RBI projects GDP growth to recover from 5%YoY in FY20 to 6%YoY in FY21.
- Overall, the policy has been positive for the bond markets with bond yields easing (especially at the shorter end). The RBI recognized that there is monetary policy space for future action, but it will be data–dependent.
- Fiscal deficit for FYTD 20 (upto December) was elevated at 132.4% of the budgeted estimate for entire FY20, compared to 112.4% in the corresponding period in the previous fiscal year. Tax revenue collections (both direct and indirect) have been tepid and below budgeted estimates so far.
- Recent government data showed that GST collections for the month of January 2020 (reflecting activity for the month of December 2019) once again breached the ₹ 1 lakh crore mark—for the third consecutive month.
- Foreign Portfolio Investors (FPIs) registered a net outflow of ₹11,104 crore in the month of January, compared to a net outflow of ₹ 5,350 crore in the previous month.
- The yield curve could steepen a bit, with short term yields easing more than long term yields. From an investment perspective, we continue to prefer the shorter to medium term part of the yield curve.