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Macro-economic developments

- Amidst the Coronavirus pandemic, US weekly jobless claims (indicating the number of people filing for unemployment insurance) hit a cumulative ~41 million jobless claims (since early March) for the ten weeks ended May 23, 2020. The unemployment rate in US hit 14.7% in the month of April (highest since the World War II era), compared to 4.4% in the month of March.
- Domestically in India, GDP growth for Q4 FY20 came in above expectations at 3.1%YoY vs 4.1%YoY in the previous quarter. GDP growth was supported by govt. expenditure, which grew at a robust 13.6%YoY during the quarter, while private consumption and investments were a drag on GDP. For full FY20, GDP growth came in at 4.2%YoY vs 6.1%YoY growth in FY19.
- GVA growth for Q4 FY20 came in at 3.0%YoY vs 3.5%YoY in the previous quarter. Agriculture sector supported by registering a growth of 5.9%YoY during the quarter. The biggest drag was industry, and particularly the manufacturing sector which saw a growth of -1.4%YoY during the quarter. For full FY20, GVA growth came in at 3.9%YoY vs 6.0%YoY growth in FY19.
- The Indian government unveiled an economic stimulus package of almost ₹21 trillion (~10% of GDP) in five tranches, to deal with the Covid-19 pandemic. The package mainly consisted of loan and credit guarantees to MSME sector and partially to NBFCs, assistance/aid to migrant labourers, reforms and aid to agriculture sector & farmers, and also included earlier fiscal measures announced by the govt., and earlier monetary and liquidity measures announced by the RBI. Even though the overall package was quite large at ~10% of GDP, the actual fiscal outlay (govt. spending) has been estimated by economists at ~1% of GDP.
- Although the Indian govt. recently extended the lock-down till end of June, it has allowed a substantial phased relaxation of the lock-down and opening-up of the economy, except in the containment zones. The country has been in a national lock-down since March 24, 2020.
- Only partial consumer price inflation data was released for the month of April. Food & beverage inflation rose to 8.6%YoY in April vs 7.8%YoY in the previous month, possibly due to supply disruption amidst the lockdown. Tepid growth was seen in housing and medical care inflation during April.
- Index of Industrial Production (IIP) growth fell sharply to -16.7%YoY in March vs +4.6%YoY in the previous month. The heavy-weight manufacturing sector (78% weight in IIP) growth fell to -20.6%YoY, from +3.1%YoY in the previous month.
- As a result of the lock-down, India Manufacturing PMI came in at 30.8 in May vs a record low of 27.4 in April. India Services PMI came in at 12.6 in May vs a record low of 5.4 in April. PMI lower than 50 indicates contraction in activity.
- Crude prices witnessed a smart recovery in the month of May on the back of various countries around the world relaxing their lock-down, some recovery in global risk appetite, and with the growth rate of Covid-19 cases globally seeing some decline. Brent crude rose from $25/bbl at the end of April, to close the month of May at around the $35/bbl mark.
- The rupee remained mostly stable during the month on the back of foreign equity inflows and some return of global risk appetite. It closed the month of May at INR 75.62/USD vs INR 75.10/USD at the end of April.

Equity market developments and Outlook

- Rising Covid-19 cases in India, lock-down extension, weak Q4 FY20 corporate results and an underwhelming economic stimulus package weighed on Indian equity markets during the month of May, although they did see some recovery in the second half of the month. Indian equity markets underperformed most other global markets during the month.
- The benchmark Nifty 50 index returned -2.8% during the month. The broader markets fared better, with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning -0.2% and -1.8% respectively in May.
- The sectors that outperformed during the month of May were auto, pharma, capital goods and FMCG. The sectors that underperformed during the month were banking, consumer durables and PSUs.
- After the sharp rally in the month of April, global markets registered a healthy up-move in May as various countries started relaxing lock-down, and the growth rate of Covid-19 cases in some countries started to moderate—resulting in some return of global risk appetite. Developed markets outperformed during the month with the MSCI World index returning +4.6% in May, while MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +0.6% and -1.4% respectively.
- In the US, the S&P 500 index closed the month with +4.5% gain. Within the major European markets Germany's Dax index registered the largest gain of +6.7%. Within Asia—Hong Kong, Singapore and India were the bottom performers, while Japan, Malaysia, South Korea were the outperformers. Emerging markets like Russia and Brazil also fared well during the month, with both markets returning around +8.5%.
- Foreign portfolio investors (FPIs) registered a net equity inflow of ₹13,000 crore in the month of May, compared to a net outflow of ₹4,112 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a net inflow of ₹11,357 crore in the month of May, compared to a strong net outflow of ₹825 crore in the previous month.
- As mentioned earlier, the fiscal outlay of the govt's mega stimulus package is only around 1% of GDP as per market estimates. During lock-down (with demand/supply being suppressed) a large fiscal stimulus may not be helpful, as consumers may end up saving instead of consuming/spending. But with the lockdown being relaxed and the economy gradually opening up, there is need for greater fiscal stimulus from the govt. going forward (to prevent a large shock to the economy), even though the fiscal space may be limited. Various market projections indicate that India's GDP may contract by 4-6% in FY21, although this is still a developing situation and no official estimate for FY21 GDP growth has yet been given by the govt. or RBI.
- Q4 FY20 corporate results so far have been below expectations, and indicate the stress in the corporate sector, as the lock-down only affected a marginal part of the quarter. The next quarter's corporate earnings is likely to be a wash-out due to the lock-down, and we will have to see how earnings growth trajectory pans out after that.
- The number of Covid-19 cases in India has also been rising, which is a cause of concern. However, the fatality rate has been low/controlled at below 3% and the recovery rate has also been good (above 40%).
- India has announced a phased relaxation of the lock-down and opening up of the economy, except in the containment zones. This should help in some gradual resumption in economic activity, although return to normalization is still quite away.
- The markets have recently witnessed a healthy rally from the bottom in March, and we advise investors to use an asset allocation approach to investing, or use a staggered approach to invest in equities--at this juncture. We continue to prefer large-caps, but investors can also consider some partial allocation to mid-cap segment—but should note that they are generally more volatile.

Fixed Income market developments and Outlook

- Bond yields softened during the month with the RBI cutting rates, liquidity continuing in healthy surplus, and rupee being stable. However, increase in government borrowing for FY21, concerns of rising fiscal deficit and foreign debt outflows capped gains. The 10 year yield closed the month of May at 6.01%--down 10 bps. During the month the RBI issued a new 10 year G-Sec with a coupon rate of 5.79% and maturing in 2030. The new 10 year G-sec closed the month at a yield of 5.76%
- The RBI delivered another mid-meeting policy rate cut on May 22, 2020 along with some other regulatory easing measures. Some of the key RBI policy announcements were as follows:
  - The RBI cut the repo rate (key policy rate) by 40 bps to 4.0%, with 5-1 majority. The reverse repo rate (rate at which RBI borrows from banks) was also cut by 40 bps to 3.35%.
  - RBI extended the moratorium on term loans by another 3 months (upto Aug 2020 end). Interest on working capital facilities was also extended by another 3 months.
  - The RBI increased bank's group exposure limit from 25% to 30% to facilitate easier financing of corporates.
  - The RBI extended a credit line of ₹150 bln to the Export Import Bank of India (EXIM) that provides financing to exporters and importers. It also extended a special refinance facility of ₹150 bln to SIDBI for on-lending/refinancing to small industries.
  - The central bank didn't give an official forecast for FY21 GDP growth but mentioned that it is likely to be negative. RBI also mentioned that inflation outlook is uncertain, but it is hopeful that a combination of normal monsoons, lower commodity prices and deficient demand should lead headline inflation to fall below 4% in H2 FY21.
- The government has announced an increase in the borrowing programme for FY21 from ₹7.8 trln (earlier) to ₹12 trln. Gross borrowing in H1 FY21 now stands at ₹6.79 trln against the original figure of ₹4.88 trln and will constitute around 56.6% of total borrowing for the year.
- Fiscal deficit for FY20 came in at 4.6% of GDP, compared to revised estimate of 3.8% projected earlier. For the month of April 2020, fiscal deficit stood at 35% of the full year budgeted estimate, compared to 22% in the corresponding period in the previous fiscal year. We are likely to see a substantial fiscal slippage in FY21, due to a sharp drop in revenue collections—as a result of the economic slowdown.
- On June 1, 2020, global ratings agency Moody's downgraded India's sovereign rating by a notch to Baa3, and retained a negative outlook. Moody's expects India's GDP to contract by 4% in FY21, and also projects India's public debt to GDP to rise to 84% in FY21 from 72% in FY20. With this downgrade, Moody's India rating is now somewhat at par with S&P and Fitch (both rate India at BBB-, a grade above junk category, but with positive outlook).
- Foreign Portfolio Investors (FPIs) registered a net outflow of ₹ 20,573 crore in the month of May, compared to a net outflow of ₹10,122 crore in the previous month.
- RBI has indicated that there is space for more monetary action if inflation remains within the projected trajectory. From an investment perspective on the fixed income side, we presently prefer the shorter to medium term part of the yield curve.