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Macro-economic developments

- US labour market improved, with 4.8 million jobs added in the month of June (higher than expected). Unemployment rate fell to 11% in June vs 13.3% in May & 14.7% in April.
- The US Fed kept the benchmark rate unchanged at 0%-0.25% in its July-end monetary policy meeting, as expected. The US Fed said that following sharp declines, economic activity and employment have picked up somewhat in recent months but remain well below their levels at the beginning of the year.
- US Q2 GDP contracted by a record 9.5% YoY or at an annualized rate of 32.9% during the quarter, making it the worst quarterly reading since 1947, from when the government started tracking the GDP data using modern methods. Personal spending, which makes up about two-thirds of GDP, contracted by a record annualized 34.6% during the quarter.
- Economic activity improved globally, and Global Manufacturing PMI rose to a six-month high of 50.3 in July from 47.8 in June, and a low of 39.8 in April (amidst the lock-down). PMI data below 50 means contraction in activity.
- Domestically in India, Covid-19 cases continued to escalate, which led to re-imposing of partial lockdown in certain states / districts. However, fatality rates remain in control so far at below 2.5% (at national level), and recovery rate is comfortably above 60%. The central government recently announced Unlock 3.0, where it further allowed some more relaxations and opening-up of business and economic activity.
- In its latest Financial Stability Report, the RBI forecasted that the consolidated Gross Non-Performing Assets (GNPA) of all banks in India could rise to 12.5% by March 2021, from 8.5% in March 2020; and in severe stress scenario could even rise to 14.7% by March 2021. This has raised some concerns on asset quality within the financial sector.
- India Manufacturing PMI slipped marginally to 46.0 in July from 47.2 in June, but is still significantly higher than a record low of 27.4 in April (amidst the lock-down). India Services PMI came in at 34.2 in July, vs 33.7 in June, and a record low of 5.4 in April. PMI lower than 50 indicates contraction in activity.
- Consumer price inflation (CPI) data for the month of June 2020 came in higher than expected at 6.1%YoY, compared to 6.3%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) came in at 7.9%YoY in June versus 9.2%YoY in the previous month. Core inflation (ex food and fuel) jumped to 5.4%YoY in June from 4.9%YoY in the previous month.
- Crude prices rose on the back of recovery in global economic activity, and risk appetite. Brent crude rose 5% in July, to close the month at $43.3/bbl.
- The rupee rose ~0.9% against the USD to close the month at INR 74.82/USD, helped by foreign equity inflows and with global risk appetite persisting.

Equity market developments and Outlook

- Indian equity markets fared well in the month of July, on the back of better than expected Q1 FY21 results so far, progress in Covid-19 vaccine trials, global liquidity & healthy foreign equity flows, and further normalization of economic activity.
- The benchmark Nifty 50 index returned +7.5% during the month. For the broader markets, the Nifty Midcap 50 index and the Nifty Smallcap 100 index returned +3.8% and +8.6% respectively in July.
- The sectors that outperformed during the month of July were defensive and export-oriented sectors like auto and pharma. The sectors that underperformed during the month were power, capital goods, realty and banking.
- Global markets continued to recover, with economic activity picking-up and liquidity being strong. With global risk appetite persisting, emerging & Asian markets outperformed developed markets during the month of June. The MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +8.4% and +8.0% respectively, while the MSCI World index returned +4.7% in July.
- For the US markets, the benchmark S&P 500 index returned +5.5% during the month. Major European markets like UK, France and Germany underperformed during the month, and ended in the red. Within Asia—China, Taiwan and India outperformed in July, while Japan, Singapore and Thailand underperformed.
- Foreign portfolio investors (FPIs) registered a net equity inflow of ₹8,590 crore in the month of July, compared to a net inflow of ₹18,684 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a large net outflow of around ₹10,000 crore in the month of July, compared to a net outflow of ₹2,434 crore in the previous month.
- Markets (both global and domestic) have seen a strong rally from their March 2020 lows. The market up-move has been helped by strong global liquidity, recovery in global risk appetite, improvement in high-frequency indicators & economic data, recent better than expected corporate results, and positive sentiment due to progress in vaccine trials.
- However, the recovery in India markets continues to be a bit polarized, especially in the large-cap segment, with some of the larger stocks contributing bulk of the gains. The banking & financial sector has relatively underperformed, and the Nifty index (excluding banking & financial sector) is back to pre-Covid levels at the end of July.
- Corporate earnings for Q1FY21 so far, have come in ahead of conservative estimates, largely led by cost control measures undertaken by Corporate India. Consensus estimates for FY21 earnings continue to be downgraded. As a result of that, and with the recovery in markets, forward market valuations don't appear reasonable at this juncture.
- Therefore, investors need to tread a bit cautiously in the short term, especially with Covid-19 cases continuing to escalate in India. Long term investors can continue to invest systematically in equities in a staggered manner.

Fixed Income market developments and Outlook

- G-Sec yields softened a bit during the month, with the benchmark 10-year G-Sec yield closing the month down 5 bps at 5.84%. However, higher than expected consumer inflation faded some hopes of a rate cut in the upcoming August monetary policy review, as it has been above the prescribed 6% upper-limit for the past few months. Corporate bond yields (esp. in the AAA segment) continued to relatively soften more during the month.
- The RBI has been taking various measures to soften long-term G-Sec yields and manage the yield curve— by undertaking another Operation Twist in which it purchases longer dated G-Secs and simultaneously sells shorter dated securities. Liquidity has reduced a bit from its earlier highs, but still remains in healthy surplus.
- The RBI auctioned a new 10-year G-Sec with a coupon of 5.77% and maturing in 2030 at the end of the month. This has been one of the shortest tenures for a 10-year G-Sec, with the earlier security being introduced only a few months back in May, with a coupon of 5.79%. However, the higher government borrowing this year, and total issuances in the earlier 10-year bond reaching a substantial amount in past few months, may have prompted the RBI to auction a new 10 year bond.
- India's fiscal deficit touched 83.2% of the full year target in Q1 FY21 (April – June), compared to 56.3% in corresponding period in the previous fiscal year. However, if we consider the revised market borrowing figure (till now) then the fiscal deficit comes to around 54% for Q1 FY21. The sharply higher fiscal deficit figure is due to plunge in revenues receipts (both tax revenues and non-tax revenues), and divestment proceeds have practically been Nil. Meanwhile, although government has tried to control expenditure, the same (esp. capital expenditure) has risen during the quarter YoY, causing the large fiscal gap.
- Finance Ministry data showed that GST collections in July fell to ₹87,422 crore from ₹90,917 crore in June. However, July collections are higher than ₹62,009 crore in May and ₹32,294 crore in April (amidst the lock-down).
- Foreign Portfolio Investors (FPIs) registered a net outflow of ₹1,833 crore in the month of July, compared to a net outflow of ₹1,691 crore in the previous month.
- RBI has indicated that there is space for more monetary action if inflation remains within the projected trajectory. Therefore, we may see further monetary easing in H2 FY21 when inflation is expected to subside. From an investment perspective on the fixed income side, we presently prefer the shorter to medium-term part of the yield curve.