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Macro-economic developments

- Global Manufacturing PMI remained unchanged at a 33-month high of 53.8 in December 2020, marking the sixth consecutive month of expansion. PMI data below 50 means contraction in activity.
- The World Bank, in its January 2021 Global Economic Prospects report, revised global GDP growth for CY20 upward to -4.3% (compared to earlier forecast of -5.2%). This is primarily due to upgrade in forecast for advanced economies, esp. the US-- where GDP growth is now expected at -3.6% for CY20 (compared to earlier forecast of -6.1%). World Bank projects emerging market economies to contract only 2.6% in CY20, primarily helped by China—which is expected to register positive growth of 2.0% during the year. The global think-tank projects global GDP growth to recover by a healthy +4.0% in CY21.
- The US congress approved a second $900 billion stimulus package in December to deal with the Covid pandemic. The US Federal Reserve kept rates unchanged (near zero) at its December 2020 meeting and indicated it will leave rates unchanged for the next few years. However, with stronger than expected economic recovery in the US, treasury yields have risen, with the benchmark 10 year treasury yield rising from 0.65% in September to 0.84% in November, and further to 0.92% at the end of December. In early Jan 2021 US 10 year treasury yield breached the 1% mark.
- The European Central Bank (ECB) expanded its flagship QE programme called as Pandemic Emergency Purchase Programme (PEPP) by €500 billion to a total of €1.85 trillion and extended its duration by 9 months to at least the end of March 2022.
- India's current account surplus narrowed to 2.4% of GDP in Q2 FY21, compared to 3.8% in the previous quarter and a deficit of 1.1% a year ago. The current account surplus during the quarter was helped by greater fall in imports (relative to exports)—leading to a reduction in the trade deficit, compared to corresponding period of previous fiscal year. Capital account flows picked up strongly in Q2 FY21 due to robust FDI flows and a pick-up in FPI flows. Capital account surplus widened to $15.4 billion in Q2 FY21, compared to $1.0 billion in the previous quarter and $13.6 billion in the corresponding year ago period. Balance of Payments (BOP) surplus widened to $31.6 billion in Q2 FY21, compared to $19.8 billion in the previous quarter and $5.1 billion in the corresponding year ago period. In FY21, current account could be in surplus, if oil prices remain stable and do not rise much from current levels. BOP is also expected to be in healthy surplus due to strong foreign capital flows.
- India Manufacturing PMI was at 56.4 in December versus 56.3 in November (being in expansion territory for the fifth straight month). India Services PMI fell to 52.3 in December vs to 53.7 in November (but being in expansion territory for third consecutive month). PMI lower than 50 indicates contraction in activity.
- Consumer price inflation (CPI) data for the month of November 2020 moderated to 6.9%YoY from 7.6%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) moderated to 9.4%YoY in November from 11.0%YoY in the previous month. Core inflation (ex food and fuel) remained steady at 5.8%YoY in November.
- Crude prices continued to rise in the month of December on the back of healthy recovery in global economic activity, and positive news on Covid vaccines—leading to increased global risk appetite. Brent crude price rose 8.8% in December, to close at $51.8/bbl.
- The rupee appreciated 1.3% during the month to close at INR 73.07/USD. Dollar weakness, rally in most peer emerging and strong foreign equity inflows helped during the month.

Equity market developments and Outlook

- Indian equity markets delivered healthy returns in the month of December. The benchmark Nifty 50 index rose +7.8% during the month. The broader markets also fared well, with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning +5.7% and +7.8% respectively in December.
- The sectors that outperformed during the month of December were realty, metals, consumer durables and IT. The sectors that underperformed during the month were power and auto.
- Global markets also fared well during the month. Developed markets relatively underperformed, with the MSCI World index returning +4.1% in December, while the MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +7.2% and +6.6% respectively.
- For the US markets, the benchmark S&P 500 index returned +3.7% during the month. Major European markets like France, UK and Germany relatively underperformed in December. Within Asia—South Korea, India and Taiwan outperformed during the month, while Singapore, China and Thailand relatively underperformed. Emerging markets like Russia and Brazil also delivered robust returns in December.
- Foreign portfolio investors (FPIs) registered a robust monthly net equity inflow of ₹53,500 crore in the month of December, compared to record-high net equity inflow of around ₹71,000 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a substantial net outflow of around ₹37,000 crore in the month of December, compared to a record-high net outflow of around ₹48,000 crore in the previous month.
- For the Nifty index, we expect ~7% corporate earnings growth in FY21 followed by a robust ~30% earnings growth in FY22. We expect the earnings growth in FY22 to be front-ended in nature due to the lower base effect.
- With the sharp rally in markets, the Nifty index currently trades at around 22x (FY22 EPS), which is on the higher side. Ceteris paribus, we feel market valuations have largely achieved optimization, and any material market movement from hereon would be determined by changes in earnings estimates, and/or any material changes in the cost of capital.
- At this juncture, investors should systematically invest in equities, or use an asset allocation approach (based on their risk profile).

Fixed Income market developments and Outlook

- Bond yields were range-bound in December, with the benchmark 10 year G-Sec yield closing the month on a flattish note at 5.89%--down 2 bps. Liquidity remained in substantial surplus but rise in global crude oil prices and hardening of US bond yields weighed on domestic bond prices.
- The RBI announced monetary policy on 4th December 2020. The key highlights were as follows:
  - ➢ RBI kept policy rates unchanged as widely expected. It continued with dovish undertone of maintaining an accommodative stance through next fiscal year—to support growth on a durable basis.
  - ➢ RBI mentioned that inflation outlook has turned adverse relative to expectations in the past two months, and revised upwards its inflation forecasts quite substantially. It now projects headline consumer inflation at 6.8% for Q3 FY21 (vs 5.4% earlier), at 5.8% in Q4 FY21 (vs 4.5% earlier), and at 5.2% to 4.6% for H1 FY22.
  - ➢ A positive development on the economic front, was that the RBI upgraded the GDP growth forecast for India to -7.5%YoY, compared to earlier forecast of -9.5%YoY in the October 2020 monetary policy. The central bank now expects GDP growth to turn positive in Q3 FY21 compared to earlier forecast of GDP growth turning positive in Q4 FY21.
- India's fiscal deficit for first eight months of the fiscal year (April 2020 to November 2020) stood at 135% of the budgeted estimate, compared to 115% of the annual target in the corresponding period in the previous fiscal year. The high fiscal deficit has been due to sharp drop in non-tax revenue, although tax revenue collections have seen some recovery in the past two months. Total receipts (upto November) were tepid at 37% of the budgeted estimate so far, compared to 49% in corresponding period of previous fiscal year. However, total expenditure (upto November) was at 63% of the budgeted estimate vs 65% in the corresponding period of previous fiscal year—thereby causing the relatively shortfall/deficit this fiscal so far.
- Finance Ministry data showed that GST collections in December hit an all-time high of ₹1.15 lakh crore (11.6%YoY growth) compared to ₹1.05 lakh crore in the previous month. This is the third consecutive month this fiscal year that GST collections have been above the ₹1 lakh crore mark and has recovered strongly from the April 2020 lows (amidst the stringent lockdown).
- Foreign Portfolio Investors (FPIs) registered a net debt inflow of ₹5,636 crore in the month of December, compared to a net outflow of ₹2,888 crore in the previous month.
- Liquidity in the banking system is still in abundant surplus, and the central bank could continue with its current liquidity stance to help support the economic growth recovery. However later in FY22, when the growth recovery becomes more pronounced, we may see some tweak or moderation in the current liquidity stance by the RBI.
- Despite inflationary pressures, the RBI still maintained that it will continue with its accommodative stance through next fiscal year—indicating that it lays importance to supporting economic growth recovery.
- However, with the RBI mentioning that inflation is expected to remain elevated (compared to mention of "transient" in previous policy) it provides limited space for further rate cuts, and future monetary action will be dependent on how the inflation trajectory pans out. From an investment perspective on the fixed income side, we continue to prefer the medium-term part of the yield curve.

Ver: Dec 2020