Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- Global recession in 2020 is not as deep as feared earlier, and a healthy recovery is expected in 2021. As per the IMF, in its World Economic Outlook--January 2021 update, global GDP growth is expected to contract by 3.5% in CY20 vs earlier projection of 4.4% contraction (as per Oct 2020 forecast). This is being helped by healthy economic recovery in developed economies esp. the US. Emerging market economies are also expected to contract 2.4% in CY20 vs earlier forecast of 3.3% contraction. The economic think-tank projects healthy recovery of +5.5% in global GDP growth in CY21. India's GDP growth forecast for FY21 has been upgraded to -8.0% (vs. -10.3% earlier), due to better than expected economic recovery post the lock-down. Also, India's GDP to grow at one of the strongest pace of 11.5% in FY22 (vs projection of 8.8% earlier), helped to some extent by lower base effect.
- After taking over as US president, Joe Biden announced a massive Covid stimulus package of $1.9 trillion in January 2021. US Q4 2020 GDP declined by 2.5% (on a year on year YoY basis) versus a 2.8%YoY contraction in Q3 2020. Overall in CY20, US GDP contracted by 3.5% (vs +2.2% growth in CY19), making it the worst annual GDP performance since 1946. However, the contraction in CY20 has been lower than projected earlier, due to the faster than expected economic recovery.
- The Indian government announced the Union Budget FY22 on 1st February 2021, which was growth-oriented and expansionary--allowing fiscal slippage (higher than market estimates) for FY21 & FY22—to aid in economic growth recovery. The govt. has indicated that it wants to gradually bring down fiscal deficit to 4.5% by FY26.
- Some of the other key highlights of the budget were as follows:
  - The govt. has re-iterated its push to infrastructure, with capital expenditure (capex) budgeted to grow by a healthy 26% in FY22.
  - Total healthcare & wellness outlay in budget increased by a lofty 137% in FY22 to ₹2.24 trillion.
  - With capital markets being buoyant, the govt. is back with its privatization push--with an ambitious divestment budget of ₹1.75 trillion for FY22.
  - The govt. has made various announcements to benefit the financial sector (including PSU bank re-cap, increase in FDI limit for insurance sector to 74%, bad bank proposal to help deal with stressed assets of banks, and affordable housing benefits extension by a year).
  - Gross tax revenue for FY22 budgeted to grow at 16.7%YoY vs -5.5%YoY in FY21 (RE). FY22 is expected to see both direct and indirect taxes growing at a healthy pace.
  - Nominal GDP projected to grow by a strong 14.4%YoY in FY22 compared to a contraction of 4.4%YoY in FY21.
  - Despite drop in revenue collections, total expenditure growth for FY21 (RE) has been strong at 28.4%YoY helped by capex and strong revenue expenditure (primarily due to higher food & fertilizer subsidy). For FY22, total expenditure growth is flat--with revenue expenditure normalizing (lower food & fertilizer subsidy), although capex growth is strong.
- India Manufacturing PMI rose to 57.7 in Jan 2021 versus 56.4 in Dec 2020 (being in expansion territory for the sixth straight month). India Services PMI rose to 53.3 in Jan 2021 from 52.3 in Dec 2020 (being in expansion territory for fourth consecutive month). PMI lower than 50 indicates contraction in activity.
- Consumer price inflation (CPI) for the month of Dec 2020 moderated substantially to 4.6%YoY from 6.9%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) fell sharply to 3.4%YoY in December from 9.5%YoY in the previous month. Core inflation (ex food and fuel) fell marginally to 5.5%YoY in December from 5.7%YoY in the previous month.
- Crude prices continued to rise in the month of January on the back of healthy recovery in global economy (particularly the US), large Covid stimulus package from the US, and increased global risk appetite & demand. Brent crude price rose ~8% in January, to close at $55.9/bbl. Post the close of the month, Brent crude breached the $60/bbl mark in early Feb 2021—rising to a 1 year high.
- The rupee closed the month on a flattish note at INR 72.95/USD.

Equity market developments and Outlook

- Indian equity markets saw some minor correction in the month of January 2021. The benchmark Nifty 50 index returned -2.5% during the month. The broader markets fared better, with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning +2.2% and +1.3% respectively in January. Post the budget on 1st February 2021, the markets registered a strong rally in early February—with the budget being a growth-oriented and expansionary one, and the government not curtailing spending just to meet fiscal targets in the near term.
- The sectors that outperformed during the month of January 2021 were auto, capital goods and IT. The sectors that underperformed during the month were metals, pharma and banking.
- Global markets were subdued during the month and some of them also registered a minor correction. Developed markets relatively underperformed, with the MSCI World index returning -1.1% in January, while the MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +3.0% and +4.0% respectively.
- For the US markets, the benchmark S&P 500 index returned -1.1% during the month. Major European markets like France, Germany and UK also registered losses in January. Within Asia—Hong Kong, South Korea and Taiwan outperformed during the month, while Malaysia, India and Indonesia underperformed.
- Foreign portfolio investors (FPIs) registered a monthly net equity inflow of around ₹14,500 crore in the month of January, compared to a robust net equity inflow of ₹53,500 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a net outflow of almost ₹12,000 crore in the month of January, compared to a substantial net outflow of around ₹37,000 crore in the previous month.
- We are turning positive on domestically focused sectors like Infrastructure and cement and continue to like private banks. We also believe global export-oriented sectors like IT and pharma would continue to do well.
- The equity markets have cheered the budget with it being growth-oriented, and no major tax changes or levy. Overall, FY22 will be the year of normalization (from the Covid-19 pandemic) and will set the stage for acceleration in future growth.
- Corporate earnings in Q3 FY21 have been above expectations and are expected to see robust growth of around 30% (for the Nifty index) in FY22. Even though market valuations are elevated, the recovery in corporate earnings and the easy liquidity scenario globally may help to support valuations for some time.
- 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 January, with the benchmark 10 year G-Sec yield finally closing the month at 5.95%--up 6 bps. Concerns of fiscal slippage in upcoming budget, rise in global crude oil prices and FPI debt outflows put some upward pressure on bond yields.
- However, post the Union Budget FY22 on 1st February 2021, bond yields hardened further due to the large fiscal slippage and higher market borrowing—in anticipation of demand-supply mismatch. In the budget, fiscal deficit was pegged at 9.5% for FY21 and budgeted at 6.8% for FY22—both of which are significantly higher than market estimates. FY21 fiscal deficit is elevated to some extent due to govt. bringing off-balance sheet items (FCI borrowing for food & fertilizer subsidy) on to its own books compared to previous years—indicating an increase in transparency. Due to the higher fiscal deficit, the market borrowing is also higher than market estimates—with gross market borrowing budgeted at ₹12.88 trillion and ₹12.06 trillion for FY21 and FY22 respectively.
- The RBI announced its monetary policy on 5th February 2021, and initially bond yields hardened post the policy announcement--as RBI said that CRR cut would be rolled back gradually, revised upwards inflation forecast for H1FY22 and didn't make any OMO announcement (as was being expected by the market). However, bond yields softened later--as the RBI devolved most of the auction for long term bonds on that day (indicating it is not comfortable with higher yields), and also later announced an OMO purchase of ₹20,000 crore (indicating it still wants to support the market on the liquidity front through OMOs).
- The key highlights of the 5th February 2021 RBI monetary policy review were as follows:
  - RBI kept policy rates unchanged as expected. It continued with dovish undertone of maintaining an accommodative stance through next fiscal year—to support growth on a durable basis.
  - RBI has revised its inflation forecasts--to 5.2% for Q4 FY21 (vs 5.8% earlier), 5.2% to 5.0% for H1 FY22 (vs earlier lower estimate of 5.2% to 4.6%); and headline inflation is expected to moderate to 4.3% by Q3 FY22
  - On the economic front, the RBI forecasts GDP growth for FY22 at a healthy 10.5%. However, this estimate is slightly lower than that of some other agencies (eg. IMF projects 11.5% growth in FY22).
  - The central bank announced that it will roll back the earlier Cash Reserve Ratio or CRR cut (of 1% in March 2020) in two tranches—to 3.5% by March 2021 and to 4.0% by May 2021.
  - However, the banking sector availing funds under MSF by dipping into additional 1% of SLR (which was earlier extended to March 2021 end) has further been extended by another 6 months to Sep 2021 end; and this should help to give access to ₹1.53 lakh crore of liquidity.
  - Also, to manage the higher government borrowing, RBI announced the extension of enhanced HTM limit for banks upto Mar 31, 2023 in order to address the demand-supply mismatch & manage the large sovereign borrowing program.
- Finance Ministry data showed that GST collections in January 2021 hit an all-time high of ₹1.2 lakh crore (8%YoY growth) compared to ₹1.15 lakh crore in the previous month.
- Foreign Portfolio Investors (FPIs) registered a net debt outflow of ₹3,661 crore in the month of January, compared to a net inflow of ₹ 5,636 crore in the previous month.
- Liquidity in the banking system continued to remain in healthy surplus. RBI has reiterated its commitment to ensure availability of ample liquidity to support the nascent economic recovery & manage the high government borrowing program in an orderly and non-disruptive manner—which provides some comfort.
- With the decent stimulus measures being taken by the government aiding in the strong economic recovery along with inflationary pressures emanating from rising commodity prices, we feel there is limited/no space for more rates cuts, and we are at the end of the rate cycle. From an investment perspective, we prefer the medium tenor of the yield curve from a risk-return perspective.