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Macro-economic developments

- US non-farm payrolls in the month of January 2021 increased by a lower than expected 49,000 compared to a decline of 227,000 in the previous month. The unemployment rate fell to 6.3% in January 2021 from 6.7% in the previous month.
- Global bond yields surged in the month of February 2021—with the US 10 year treasury yield crossing the 1.55% mark at one point and finally closing the month at 1.4%--up 33 bps. The sharp rise in bond yields was helped by recovery in economic activity, expectations of inflation rising (due to spike in commodity prices), and a massive Covid stimulus package of $1.9 trillion announced by the Biden administration.
- Domestically in India, Q3 FY21 GDP growth recovered to +0.4%YoY versus -7.3%YoY in the previous quarter. Gross fixed capital formation (investments) growth picked up to +2.6%YoY versus -6.8%YoY in the previous quarter. Private consumption expenditure and government expenditure also saw a healthy recovery during the quarter, although they continued to be in negative growth territory. The CSO also revised down the full year FY21 advance estimate to -8.0%YoY compared to -7.8%YoY earlier, indicating that growth may once again turn slightly negative in Q4 FY21.
- GVA growth in India also turned positive to +1.0%YoY in Q3 FY21 versus -7.3%YoY in the previous quarter. This was primarily helped by services sector, where growth was flat during Q3 FY21 versus -10.9%YoY in the previous quarter. Industry growth also turned positive during the quarter (helped by manufacturing) and agriculture sector continued to see a recovery in growth.
- India Manufacturing PMI came in at 57.5 in February 2021 versus 57.7 in the previous month (being in expansion territory for the seventh straight month). India Services PMI expanded at the fastest pace in a year to 55.3 in Feb 2021 from 52.3 in the previous month. PMI lower than 50 indicates contraction in activity.
- Industrial production data (which comes with a 2-month lag) showed that industrial output recovered to +1.0% in the month of December 2020 versus -2.1%YoY in the previous month. This was primarily helped by heavyweight manufacturing sector (78% weight in index) where growth recovered to 1.6%YoY in Dec 2020 versus -2.0%YoY in the previous month.
- Consumer price inflation (CPI) for the month of January 2021 moderated further to 4.1%YoY from 4.6%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) fell to 1.9%YoY in January from 3.4%YoY in the previous month. Core inflation (ex food and fuel) remained steady at 5.5%YoY during the month.
- Crude prices rose sharply during the month due to the large Covid stimulus package from the US, better than expected recovery in global economy activity and increased global risk appetite & demand. Brent crude price rose 18% in February, to close at $66.13/bbl.
- The rupee was stable for most of the month but depreciated towards the close of the month due to sharp spike in global bond yields & market correction (due to foreign outflows). However, the rupee fared better than most other peer emerging and Asian currencies and finally closed the month down 0.7% at INR 73.47/USD.

Equity market developments and Outlook

- Indian equity markets registered a strong rally in the first half of February on the back of a growth-oriented budget, strong Q3 FY21 corporate earnings, and robust foreign flows. However, at the end of the month markets registered a correction due to rise in global and domestic bond yields. Despite that, the benchmark Nifty 50 index returned +6.6% during the month. The broader markets fared much better, with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning +13.2% and +12.2% respectively in February.
- The sectors that outperformed during the month of February 2021 were metals, power and realty. The sectors that underperformed during the month were FMCG, IT and pharma.
- Global markets were subdued during the month. Developed markets relatively outperformed, with the MSCI World index returning +2.5% in February, while the MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +0.7% and +1.2% respectively.
- For the US markets, the benchmark S&P 500 index returned 2.6% during the month. Within Europe, major markets like France and Germany outperformed slightly. Within Asia—India, Indonesia and Taiwan outperformed during the month, while Malaysia and China underperformed.
- Foreign portfolio investors (FPIs) registered a strong monthly net equity inflow of ₹ 21,960 crore in the month of February (despite the large outflow on the last day of the month), compared to an equity inflow of around ₹ 14,500 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a net outflow of around ₹ 16,350 crore in the month of February, compared to a net outflow of around ₹ 12,000 crore in the previous month.
- Corporate earnings in Q3 FY21 have been above expectations, with earnings upgrade continuing from the previous quarter. We now expect Nifty index EPS growth at 19% for FY21 (compared to single digit growth earlier) and recover further to 25% in Fy22.
- While global central banks will continue to remain accommodative and maintain easy monetary policy--to support the ongoing economic recovery, we feel that rise in bond yields can lead to some volatility in equity markets. However, any fall in markets because of the volatility created by rise in bond yields should be used by the investor to increase equity allocation.
- 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 rose sharply in the month of February due to the large fiscal slippage & market borrowing announced in the Union budget, sharp rise in global bond yields and crude oil prices, devolvement of government bond auctions by the RBI (due to higher yields) and FPI debt outflows. The benchmark 10-year G-Sec yield closed the month at 6.23%--up 28 bps.
- In the Union Budget FY22 on 1st February 2021, 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. 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. This has put pressure on bond yields due to concerns of demand-supply mismatch.
- The RBI kept rates unchanged in its monetary policy on 5th February 2021 and continued with dovish undertone of maintaining an accommodative stance through next fiscal year. However, the RBI said that earlier CRR cut would be rolled back gradually, and also revised upwards inflation forecast for H1FY22.
- The central bank has announced OMO purchases to help improve market sentiments. However, the market is perhaps expecting a higher OMO purchase calendar, although the space for the same is getting constrained due to the surplus liquidity in the system. Also, the RBI has been devolving government auctions (or forcing underwriters to purchase the bonds) as it is not comfortable with the higher bids being placed in these auctions by market participants.
- Finance Ministry data showed that GST collections in February 2021 was above ₹ 1.1 lakh crore for the third consecutive month (7%YoY growth).
- Foreign Portfolio Investors (FPIs) registered a net debt outflow of ₹ 6,827 crore in the month of February, compared to a net outflow of ₹ 3,661 crore in the previous month.
- 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.
- However, rise in global bond yields, inflationary pressures emanating from rising commodity prices, and the large government borrowing may continue to put pressure on bond yields. 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.

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