Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- US non-farm payrolls in the month of March 2021 increased by a strong 916,000 (highest in 7 months) compared to 647,000 in the previous month. The unemployment rate fell further to 6.0% in March 2021 from 6.2% in the previous month.
- US treasury yields continued to rise in the month of March, with the benchmark 10 year treasury yield closing the month at 1.75%--up 35 bps. The sharp rise in bond yields was helped by recovery in economic activity, expectations of inflation rising (due to spike in commodity prices), passing of the massive Covid stimulus package of $1.9 trillion, and announcement of a large infrastructure spending plan in the US (over an 8-year period) by the Biden administration.
- Major central banks continue to maintain dovish / accommodative monetary policy stance. The US Fed, in its March 2021 meeting, indicated that it will leave rates unchanged through 2023, maintained its ongoing monthly bond purchase or QE (quantitative easing) programme at $120 billion per month, and signaled that inflation going above the 2% target may be transitionary and not meet the standard for increasing rates. The US Fed also significantly upgraded its 2021 GDP growth forecast for the US to 6.5% (from earlier projection of 4.2% growth). The European Central Bank (ECB) also delivered a dovish policy in March and said that it would step up its bond purchases or quantitative easing.
- Economic think-tank, OECD, in its March 2021 Economic Outlook update—projected global GDP growth to recover to +5.6% in CY21 (upgrade of +1.4% from earlier forecast) compared to -3.4% contraction in CY20. This is being helped by healthy economic recovery in developed economies esp. the US. (+6.5% growth forecast in CY21 vs -3.5% in CY20). India's GDP growth to recover strongly to +12.6% in FY22 (upgrade of +4.7% from earlier forecast) from -7.4% contraction in FY21. With that, India would be amongst the fastest growing major economies worldwide (helped to some extent by lower base effect).
- Domestically in India, current account turned into slight deficit at -0.2% of GDP in Q3 FY21, compared to a surplus of +2.4% of GDP in the previous quarter and a deficit of -0.4% a year ago. The current account turning into deficit during the quarter was primarily due to significant rise in trade deficit, as a result of sharp jump in imports (esp. oil imports). Capital account flows picked up strongly in Q3 FY21 due to healthy FDI flows and a strong pick-up in FPI flows. Capital account surplus widened to $33.5 billion in Q3 FY21, compared to $16.5 billion in the previous quarter and $23.6 billion in the corresponding year ago period. Balance of Payments (BOP) surplus widened to $32.5 billion in Q3 FY21, compared to $31.6 billion in the previous quarter and $21.6 billion in the corresponding year ago period. Current account is expected to turn into a deficit of around -1% of GDP in FY22 from a surplus of around +0.9% in FY21, although BOP is expected to remain in healthy surplus.
- India is seeing a second Covid wave, with cases escalating in the month of March. However, bulk of the new daily cases (55-60%) is from the state of Maharashtra, which is the worst hit, and has seen its daily case additions crossing the earlier peak seen in Sep 2020—by a significant margin. As result, the state has recently announced a partial lockdown. 10 other states in India have also seen a rise in Covid cases, although not to the same magnitude as that of Maharashtra. At all India level, daily new Covid cases has touched an all-time high recently (crossing the 1 lakh mark), but the mortality rate remains controlled so far at ~1.5%.
- Industrial production data (which comes with a 2-month lag) showed that industrial output fell to -1.6YoY% in the month of January 2021 versus +1.6%YoY in the previous month. This was primarily due to negative growth in heavyweight manufacturing sector (-2.0%YoY) and also the mining sector (-3.7%YoY).
- Consumer price inflation (CPI) for the month of February 2021 rose to 5.0%YoY from 4.1%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) rose to 3.9%YoY in February from 2.0%YoY in the previous month, and transport & communication segment too saw a sharp rise in inflation. Also, core inflation (ex food and fuel) further hardened to 6.0%YoY in February from 5.5%YoY in the previous month.
- Crude prices rose and breached the $70/bbl mark in the first half of March on the back of OPEC deciding to keep production cuts in place for another month, the large Covid stimulus package passed by the US (which is expected to boost growth), and healthy recovery of various economic indicators. However, later in the month--crude oil prices corrected, on the back of rising Covid cases (causing concerns of some demand slowdown), and finally closed the month at $63.54/bbl—down ~4%.
- Despite a fall in most peer emerging market and Asian currencies, the rupee outperformed in March and finally closed the month up 0.5% at INR 73.11/USD. This has been helped by strong foreign fund flows and healthy pace of economic recovery.

Equity market developments and Outlook

- Indian equity markets started the month on a positive note, but then witnessed some correction due to second wave of Covid cases (esp. in Maharashtra) and due to rise in global/domestic bond yields. The benchmark Nifty 50 index closed the month up +1.1%, while for the broader markets--the Nifty Midcap 50 index and the Nifty Smallcap 100 index returned -0.4% and +0.8% respectively in March.
- The sectors that outperformed during the month of March 2021 were defensive sectors like IT and FMCG. The sectors that underperformed during the month were cyclical sectors like banking, realty and oil & gas.
- Global markets delivered moderate returns during the month. Developed markets relatively outperformed, with the MSCI World index returning +3.1% in March, while the MSCI Emerging Markets index and MSCI Asia ex-Japan index returned -1.7% and -2.7% respectively.
- For the US markets, the benchmark S&P 500 index returned +4.2% during the month and was a relative outperformer. Within Europe, major markets like Germany and France also outperformed. Within Asia—Singapore and Thailand outperformed during the month, while Indonesia, Hong Kong and China underperformed (closing in the red).
- Foreign portfolio investors (FPIs) registered a net equity inflow of around ₹ 19,500 crore in the month of March compared to an equity inflow of ₹ 21,960 crore in the previous month. In FY21, FPIs registered the highest net equity inflow (of any fiscal year on record) of around ₹ 2,75,000 crore.
- Domestic Institutional Investors (DIIs) registered a net inflow in the month of March of ₹ 5,200 crore, making it the highest monthly net inflow since May 2020. DIIs registered a net outflow of around ₹ 16,350 crore in the previous month (Feb 2020). In FY21, DIIs registered a record net outflow of around ₹ 1,34,000 crore (primarily due to outflows from mutual funds), compared to net inflow of around ₹ 1,29,000 crore in FY20.
- Corporate earnings have been better than expected (leading to earnings upgrades) and we expect the recovery to continue. We now expect Nifty index EPS growth at ~21% for FY21 (compared to single digit growth earlier) and recover further to ~26% in Fy22.
- In the short term, we may see some market volatility if bond yields harden further or Covid cases continue to escalate. Any lockdowns and restrictions (due to the Covid second wave in India) may hamper the pace of economic recovery in the near term. However, we feel that the worst may be behind us now and investors can use any market volatility / dips to increase their equity exposure gradually (as per their individual risk profile).
- The outlook for economic and corporate earnings growth recovery looks promising for FY22. This coupled with continuation of global easy monetary policy and expansion of the Covid vaccination drive--helps to provide comfort for long term investors.

Fixed Income market developments and Outlook

- Bond yields were elevated in the first half of the March and the 10 year G-Sec yield breached the 6.25% mark at one point, on the back of sharp rise in US bond yields, inflationary concerns, rise in crude oil prices and FPI debt outflows.
- However, in the latter half of the month, bond yields softened a bit due to some softening in global bond yields, dovish monetary policy by major central banks like US Fed & ECB, some softening in crude & commodity prices, OMO purchases & Operation Twist announced by RBI and cancellation of the last bond auction of the month by the RBI. The 10 year G-Sec yield finally closed the month at 6.18%--down 5 bps.
- The government market borrowing calendar for H1 FY22 was released recently and it remains front-loaded with government scheduled to borrow ~60% of the full fiscal year gross borrowing of ₹ 12.05 trillion, in the first half of the fiscal. Net market borrowing for H1 FY22 stands at ₹ 5.85 trillion. The borrowing is concentrated in 10-year, 5-year and 14-year tenor segments.
- The government kept the CPI inflation target of the monetary policy framework unchanged at 2-6% range (with 4% as the anchor target point) for the next five years, until FY26. This inflation target range was approved by the RBI and government in 2016, and its validity expired recently.
- India's fiscal deficit for 11 months of the fiscal year (April 2020 to February 2021) stood at 76% of the revised annual estimate, compared to 135% in the corresponding period of the previous fiscal year.
- Finance Ministry data showed that GST collections in March 2021 rose to an all-time high of ₹ 1.4 lakh crore (27%YoY growth due to base effect), compared to ₹ 1.13 lakh crore collection in the previous month.
- Foreign Portfolio Investors (FPIs) registered a net debt outflow of around ₹ 4,700 crore in the month of March, compared to a net outflow of ₹ 6,827 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 no more space for rate cuts, and we are at the end of the rate cycle, although the central bank will continue to maintain its accommodative stance for some time. From an investment perspective, we prefer the shorter to medium term part of the yield curve.

Ver: Mar 2021