Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- Economic think-tank, Organisation for Economic Co-operation and Development (OECD) in its May 2021 Economic Outlook, raised its global Gross Domestic Product (GDP) growth forecast to +5.8% in CY21 (upgrade of 0.2% from the earlier March 2021 forecast) and +4.4% in CY22 (up 0.4% from the earlier estimates). The global growth prospect is improving following vaccine rollout in the advanced economies, which allowed businesses to resume operations and additional fiscal measures in these economies helped in boosting demand. However, OECD warns that the pace of the recovery is likely to be uneven and dependent on the effectiveness of vaccination programmes along with government's ability to beat the new Covid variants.
- OECD expects US economy to expand +6.9% in CY21 and +3.6% in CY22 versus previous forecast of +6.5% and +4%, respectively. Emerging economies like China will grow at +8.5% and +5.8% in CY21 and CY22. OECD however trims its growth projection for India for FY22 to 9.9% from 12.6% estimated in March 2021 Outlook, as country's nascent economic recovery was threatened by resurgence of the Covid cases and lockdowns restrictions.
- US non-farm payrolls in the month of May 2021 was weaker-than-expected and rose by 559,000 lower than the expectation of 675,000 and compared to revised 278,000 in the previous month. The unemployment rate fell to 5.8% in May 2021 versus 6.1% in the previous month.
- The US 10-year treasury yield fell from 1.63% at the end of April to intra-month low of 1.56% in May and finally closed the month at 1.61% in May due to lackluster US economic cues including weaker-than-expected non-farm payrolls data and retail sales unchanged for April. Further fall was however capped as rise in the US inflation raised some concerns. US consumer price inflation index (CPI) rose 4.2% on-year – sharpest increase since 2008.
- On the domestic front, Q4 FY21 GDP grew +1.6% YoY compared to upwardly revised +0.5% in the Q3 FY21. The economy witnessed a contraction of -7.3% for the entire FY21, which was better than earlier forecast of 8% contraction, and compared to +4% growth in FY20. Gross fixed capital formation (investments) growth picked up to +10.9% YoY in Q4 FY21 versus +2.6% YoY in the previous quarter, while for the entire FY21 fell 10.8% compared to +5.4% growth in FY20. Private consumption growth improved to +2.7% in Q4 FY21 from -2.8% in Q3 FY21. Government spending rose sharply to +28.3% in Q4 FY21 after -1% decline in the Q3 FY21.
- Gross Value Added (GVA) growth picked up +3.7% in Q4 FY21 compared to +1% in the Q3 FY21. GVA contracted 6.2% in FY21 compared to growth of 4% in FY20. In the Q4 FY21, Agriculture GVA grew +3.1% while industrial sector growth rose to 5.5% compared to 1.6% in Q3 FY21 led by strong manufacturing growth of 6.9% vs. 1.7% in the previous quarter. The service sector GVA saw a sharp rebound of +3.2% in Q4 FY21 from 0.2% in Q3 FY21 with construction sector GVA growing sharply at 14.5% compared to 6.5% in the previous quarter.
- The IHS Markit India Manufacturing Purchasing Managers' Index (PMI) dropped to 10-month low of 50.8 in May 2021 compared to 55.5 in April 2021. The Services PMI contracted for the first time in 8-months and came in at 46.4 in May 2021, compared with 54.0 in April 2021.
- In a major relief, India witnessed a significant moderation in the second Covid wave, with daily new cases falling from a peak of more than 4,00,000 in early May to near the 1,00,000 mark recently.
- Consumer price inflation (CPI) for the month of April 2021 fell to 4.3%YoY (helped by favourable base effect) from 5.5%YoY in the previous month. Food inflation (which has 39% weight in the CPI index) moderated to 2.0%YoY in April from 4.9%YoY in the previous month, but inflation in transport & communication and fuel segments was elevated. Core inflation (ex food and fuel) also moderated to 5.4%YoY in April from 5.9%YoY in the previous month.
- Brent crude oil price rose from $67.2/bbl at the end of April 2021 to close the month of May above $69/bbl—up around 3%. In the early June 2021, it breached the $71/bbl mark owing to rising optimism that fuel demand will grow in the next quarter and Organization of the Petroleum Exporting Countries (OPEC) and its allies agreed to restore supply to the market gradually.
- The rupee ended higher against the USD in nearly two months at INR 72.5/USD – up 2.1% following foreign portfolio equity inflows and gains in the domestic equities. Indian rupee outperformed Asian peers and emerging market currencies during the month amid signs that Covid crisis may have peaked in the country.

Equity market developments and Outlook

- Indian equity markets rallied to record highs and emerged as one of the top performers among the global indices in May 2021. Upbeat domestic cues including sharp decline in the coronavirus cases, pick-up in the vaccination drive, reasonably good corporate earnings, revival in foreign inflows, and RBI's liquidity measures boosted sentiments, and helped to drive the markets. The benchmark Nifty 50 index surged 6.5% and ended the month at a new peak at 15,583. The broader markets-- the Nifty Midcap 50 index and the Nifty Smallcap 100 index returned +7.1% and +8.2% respectively in May.
- The top sectoral performers during the month of May 2021 were power, capital goods, energy and auto.
- Global markets ended the month on a positive note. Emerging markets relatively outperformed with MSCI Emerging Markets index returning 2.1% while both the MSCI World index and MSCI Asia ex-Japan index returned 1.3% and 1.0%, respectively. For the US markets, the benchmark S&P 500 index recorded marginal gains of 0.6% during the month. Within Europe, major markets like UK and France ended in green. Emerging markets like Brazil, India, Russia, China rallied during the month.
- Foreign portfolio investors (FPIs) recorded a net equity inflow of ₹5,360 crore in the month of May compared to a net equity outflow of 12,810 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a marginal net inflow in the month of May of ₹2,067 crore compared to net inflow of ₹11,100 crore in the previous month.
- Corporate earnings for Q4 FY21 so far have been reasonably good, with the key driving sectors being information technology (IT), metals and banks. The corporate earnings outlook for FY22 remains healthy with a pick-up in vaccination drive and likelihood of the broad-based demand revival. Also, higher commodity prices will benefit FY22 earnings.
- With the second Covid wave seeing a significant moderation in recent days, we believe that the slowdown that was earlier seen in various high-frequency indicators may also have bottomed out, as various states start to gradually remove restrictions. We do not see much of a risk to FY22 corporate earnings estimate as of now, and the impact of lockdown in April & May 2021 may be recouped in the subsequent months.
- Going forward, RBI's accommodative monetary policy should benefit the equity markets by keeping borrowing costs in check for some time. The onset and progress of the South-West monsoon, the pace of vaccination and easing of the lockdown restrictions by some states amid decline in the Covid cases is likely to influence the market. Globally, inflationary trend in the developed economies and the policy stance of major global central banks can impact the market.
- Investors can continue to invest systematically in the equities. Any market volatility/dips can be used as an opportunity by them to increase their equity exposure gradually (as per their individual risk profile).

Fixed Income market developments and Outlook

- Bond yields ended flat during the month as investors remained on the sidelines ahead of the release of the domestic growth numbers on the last day of May 2021 and RBI Monetary Policy outcome on June 4, 2021. The 10-year G-Sec yield closed the month of April at 6.02%--down 1 bp. Bond prices continued to receive the boost after RBI announced liquidity measures for COVID-related healthcare infrastructure and services in the country and second tranche of open market purchase of government securities of ₹35,000 crore under the G-sec Acquisition Programme (G-SAP 1.0). Meanwhile, the central bank received a massive response as the market participants offered an amount totaling nearly ₹1.22 lakh crore against the notified amount of ₹35,000 crore
- RBI's Monetary Policy Committee (MPC) unanimously voted to keep the key policy rate (repo rate) unchanged at +4.0%, and the reverse repo rate unchanged at +3.35% in its early June policy review. The central bank decided to maintain an accommodative stance to revive and sustain growth on a durable basis and mitigate economic impact of Covid. Some of the key announcements/measures were as follows:
  - Announced the second tranche of its G-Sec acquisition programme (GSAP 2.0) of buying government bonds worth ₹ 1.2 lakh crore in Q2FY2022.
  - The central bank will also complete its planned bond purchase of ₹1 lakh crore under GSAP 1.0 by buying remaining quantum of ₹40,000 crore in June 2021 which includes purchase of ₹ 30,000 crore of central government bonds and ₹10,000 crore of state government bonds. The government has a large market borrowing programme for this year; hence, this may help to control the bond market volatility to some extent and keep borrowing costs in control.
  - RBI has raised the inflation forecast for Q2 FY2022 to 5.4% (from earlier forecast of 5.2%), 4.7% in Q3 (from 4.4%). The overall inflation forecast for FY22 is 5.1% which is within the 2-6% range (with 4% as the anchor target point).
  - The GDP growth forecast for FY22 is downgraded 9.5% from its earlier forecast of 10.5% in the April 2021 policy.
  - Other measures announced include on-tap liquidity window of ₹15,000 crore with tenor of upto 3 years for certain sectors such as hotels and restaurants, tourism related businesses etc. Special liquidity facility of ₹16,000 crore extended to SIDBI to meet credit needs of MSMEs and all issuers of Certificate of Deposits (CDs) will be allowed to buyback their securities subject to certain conditions to allow better flexibility to manage their liquidity
- India's fiscal deficit for the entire FY21 stood at 9.2% or ₹18.21 lakh crore of the GDP lower than revised estimate of 9.5% of GDP due to higher tax revenue according to the Controller General of Accounts (CGA) data.
- Finance Ministry data showed that GST collections in May 2021 recorded 27.6% drop at ₹1.02 lakh from record high of ₹1.41 lakh in the previous month. While this was eighth consecutive month of GST collections being above ₹1 lakh crore, it was also the lowest collection since September 2020.
- Foreign Portfolio Investors (FPIs) registered a net debt outflow of ₹ 1,309 crore in the month of May 2021, compared with the net outflow of around ₹1,033 crore in the previous month.
- The dovish tone in its latest policy meeting indicates that RBI will continue to support bond yields through regular open-market-operations and operation twists. The RBI's aim is to keep borrowing cost in control by flattening the yield curve to some extent, while providing ample liquidity and other impetus to support the economic growth recovery. Although we are the end of the rate cycle, the central bank will continue to remain accommodative for some time, with an eye on the inflation trajectory. However, rise in global bond yields and commodity prices could once again but some pressure on bond yields. From a fixed income perspective, we prefer the short to medium term part of the yield curve.