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Macro-economic developments

- In its July 2021 World Economic Outlook update, the IMF kept its GDP growth forecast for CY21 unchanged at 6.0%, but upgraded the growth forecast for CY22 to +4.9% (up 0.5% from the earlier estimate). The growth forecast for the US was upgraded to +7.0% and +4.9% in CY21 & CY22 respectively. For India, the growth forecast was downgraded to +9.5% for FY22 (down 3% from the earlier estimate). However, India is still projected to be among the fastest growing major economies during the period. India's growth forecast for FY23 was upgraded to +8.5% (up 1.6% from the earlier estimate). The IMF projects China's economy to grow +8.1% and +5.7% in CY21 and CY22 respectively.
- The US 10-year treasury yield fell sharply from 1.47% at the end of June to 1.23% at the end of July, and further softened below the 1.2% mark in early August. The US 10 year treasury yield has fallen from a level of ~1.7% in May 2021. The unusual fall in bond yields (amidst rising inflation) has been contributed by dovish remarks by the US Fed, some soft economic data and concerns of rising Delta variant Covid cases. The US Fed's preferred inflation gauge (core PCE price index) rose 3.5%YoY in June 2021 and is the biggest move since 1991; well above the Fed's 2% desired target rate. However, the Fed has indicated that the inflation surge is expected to be transitionary in nature and contributed by supply chain bottlenecks—contributing to the decline in bond yields.
- On the domestic front, the IHS Markit India Manufacturing Purchasing Managers' Index (PMI) rose to a 3-month high of 55.3 in July, after slipping into contraction (at 48.1) in June. The Services PMI continued to be in contraction territory; but rose to 45.4 in July from 41.2 in June.
- India has 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 40,000 mark recently. Mortality rate and hospitalizations have also come down significantly, with India's vaccination drive continuing to expand. However, there are some concerns of a third wave due to the Delta variant in various countries, but we will have to see how that pans out in India.
- Consumer price inflation (CPI) for the month of June continued to be elevated at 6.3%YoY compared to the same level in May and a reading of 4.2%YoY in the month of April. Food inflation (which has 39% weight in the CPI index) continued to remain elevated at 5.1%YoY in June while inflation in transport & communication and fuel segments remained high at 11.6% and 12.7% respectively. Core inflation (ex food and fuel) moderated to 6.1%YoY in June from 6.6%YoY in the previous month.
- Brent crude oil price closed the month of July up 1.6% at $76.3/bbl, but has moderated recently in early August on the back of some soft economic data and rise in Covid cases in some developed countries.
- The rupee closed the month of July on a flattish note at INR 74.4/USD, despite seeing foreign portfolio outflows. It managed to outperform most other Asian peers and emerging market currencies during the month amid signs of economic recovery.

Equity market developments and Outlook

- Indian equity markets ended on a flattish note during the month of July, but still managed to outperform most other peer Asian and emerging markets. The benchmark Nifty 50 index closed the month with a flat gain of +0.3%. The broader markets outperformed—with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning +2.5% and +8.1% respectively in July.
- The top sectoral performers during the month of July 2021 were realty and metals, which closed with double-digit percentage gains. The bottom performing sectors during the month were auto, power and oil & gas.
- Global markets ended the month on a mixed note, with developed markets outperforming emerging and Asian markets. The MSCI world index returned +1.7% in July, while MSCI Emerging Markets index and MSCI Asia ex-Japan index returned -7.0% and -7.8%, respectively.
- The US markets outperformed, with the benchmark S&P 500 index recording a gain of 2.3% during the month. Within Europe, major markets like France and Germany ended in green. Within Asia, Indonesia, Singapore and India relatively outperformed in July. However, Hong Kong and China markets registered large losses of 9.9% and 5.4% respectively, due to the regulatory clampdown on technology companies by the Chinese government.
- Foreign portfolio investors (FPIs) recorded a net equity outflow of ₹ 12,622 crore in the month of July compared to a net equity inflow of ₹ 10,932 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a strong net inflow in the month of July of ₹ 18,394 crore compared to net inflow of ₹ 7,044 crore in the previous month.
- Corporate earnings continue to fare well, and despite the lockdown in April – June 2021, Q1 FY22 earnings so far have been along expectations. This is despite the favourable base effect and provisions increasing for financials and especially for some NBFCs.
- Despite the elevated valuations in markets, the corporate earnings recovery, healthy pick-up in economic activity post the second wave, and the dovish undertone of major central banks like the Fed & ECB—has helped markets remain buoyant and touch new record highs.
- There are some concerns of a third Covid wave in India due to the delta variant that is causing a rise in cases in some countries. However, we will have to see if and how it pans out. The expansion of the vaccination drive should help to deter the severity of a third wave hopefully, if it indeed transpires in India.
- 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 hardened during the month on the back of inflationary pressures. The benchmark 10 year G-Sec yield closed the month up 15 bps at 6.20%.
- 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 August policy review. The MPC voted 5-1 in favour of maintaining 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:
  - The RBI announced that the absorption of liquidity under the variable reverse repo rate (VRRR) auctions will be gradually increased from ₹ 2.5 trln to ₹ 4 trln every fortnight upto September 24, 2021. However, the RBI governor reiterated that this should not be misconstrued as reversal of the accommodative policy stance or tightening of liquidity.
  - The RBI proposes to conduct 2 more GSAP auctions of ₹ 250 bln each in the month of August 2021. Further, the central bank will continue to conduct Operation Twist & Open Market Operations (OMOs).
  - Despite the recent rise in inflation above the 6% tolerance limit, the central bank's assessment is that the inflationary pressures are transitory in nature and largely driven by supply side issues. However, the RBI increased its headline inflation forecast for FY22 to 5.7% from 5.1% earlier.
  - The RBI said that various high frequency indicators suggest that consumption, investments and external demand are gaining traction. Therefore, it maintained its GDP growth forecast for FY22 at 9.5%.
  - Some other liquidity measures announced by the RBI were that the on-tap TLTRO and the relaxation in MSF has been extended by a period of 3 months till end of December 2021.
  - Bond yields moved up post the RBI policy review as the market started to price in growing inflation risk. The shorter end of the yield curve could see some hardening with the announcement of a gradual increase in quantum of VRRR auctions to absorb additional liquidity.
- India's fiscal deficit for first quarter of FY22 (April – June 2021) improved to 18% of the budgeted estimate for FY22 compared to 83% in the corresponding period of previous fiscal year. This was helped by revival in tax revenue, which stood at 27% of the budgeted estimate for the fiscal year. Non-tax revenue picked-up strongly due to upfronting of RBI dividend to the government and stood at 52% of the full year budgeted estimate.
- Finance Ministry data showed that GST collections in July 2021 recovered to ₹ 1.16 lakh crore (with Covid restrictions being eased) after dropping to 0.93 lakh crore in the previous month.
- Foreign Portfolio Investors (FPIs) registered a net debt outflow of ₹ 876 crore in the month of July 2021, compared with a net outflow of around ₹ 4,317 crore in the previous month.
- The RBI's priority is to still provide impetus to support the economic growth recovery. We expect that the RBI will continue to intervene to support bond yields and keep them in check, to ensure an orderly and efficient completion of the large market borrowing programme. Therefore, we believe that the central bank will continue to be accommodative for some time (at least through this calendar year), with an eye on the inflation trajectory.
- From an investment perspective we prefer the shorter to medium term part of the yield curve.

Ver: Jul 2021