Sampath Reddy, CFA
CIO, Bajaj Allianz Life Insurance

Macro-economic developments

- In its annual Jackson hole meeting the US Fed chairman indicated that the central bank is likely to start tapering its quantitative easing (bond purchase) program before the end of the calendar year, as the economy has reached a point where it no longer needs as much policy support. However, he clarified that taper doesn't mean an imminent rate hike, but rather a gradual reduction in its current monthly bond purchases of $120 billion. The Fed chairman also said that they have some ground to cover to reach maximum employment. Even though the US unemployment rate has dropped to 5.4% in July 2021 from record high of 14.8% in April 2020 (amidst the pandemic); it still remains above pre-pandemic levels of around 3.5%.
- The Fed chairman indicated that inflation has gained ground, but he continues to think that the current inflation rise is transitory in nature and will eventually drop to the targeted level of 2%. The Fed's preferred gauge of inflation (US Core PCE inflation) rose 3.6%YoY in July 2021—making it the biggest jump in around 30 years. The US benchmark 10 year treasury yield dipped below the 1.2% mark in early August 2021, and finally closed the month at 1.31%.
- On the domestic front, Q1 FY22 GDP growth in India came in at a strong 20.1%YoY on the back of favourable base effect (Q1 FY21 GDP contracted by a record 24.4%YoY amidst the pandemic lockdown, a year ago). Sequentially, GDP fell by 6.3% QoQ sa. Gross Fixed Capital Formation (or Investments) grew by a strong 56.7%YoY in Q1 FY22 vs -46.6%YoY contraction in Q1 FY21. Private consumption expenditure (which has the highest weight of ~55% in GDP) came in lower than expected at 19.3%YoY growth in Q1 FY22 vs -26.2%YoY contraction in Q1 FY21. Government expenditure disappointed and contracted by 4.8%YoY in Q1 FY22 vs a strong growth of 12.7%YoY in Q1 FY21, when the government supported the economy amidst the stringent lockdown.
- Q1 FY22 GVA growth came along expectations at 18.8%YoY vs a contraction of -22.4%YoY in Q1 FY21. Agriculture sector growth came in above expectations at 4.5%YoY in Q1 FY22 vs a growth of 3.5%YoY in Q1 FY22. Industry segment also registered a healthy growth above expectations of 40.4%YoY in Q1 FY22, primarily due to the manufacturing sector, which did not see as significant an impact during the second Covid wave and lock-down. However, services segment was more impacted amidst the second wave and growth came in below expectations at 16.1%YoY in Q1 FY22 vs a contraction of -24.9%YoY in Q1 FY21.
- The government announced a National Monetization Pipeline, which involves leasing of core central govt. assets of ₹6 trln (~2.6% of GDP) from FY22-25. The govt. has said that only brownfield projects will be considered (with most of the projects concentrated in roads, railways and power sectors) and that ownership of assets will ultimately remain with the government. It is expected that additional revenues from asset monetization will primarily be used for infrastructure spending.
- Consumer price inflation (CPI) for the month of July 2021 moderated to 5.6%YoY compared to an elevated level of 6.3%YoY in the months of May and June 2021, due to supply disruptions amidst the second Covid wave lockdown. Food inflation (which has 39% weight in the CPI index) moderated to 4.0% YoY in July from 5.1%YoY in June. Meanwhile inflation in transport & communication and fuel segments remained elevated in double-digit territory. Core inflation (ex food and fuel) moderated to 5.8%YoY in July from 6.1%YoY in the previous month.
- Brent crude oil price were quite volatile during the month--falling from ~$76/bbl at the end of July 2021 to around $65/bbl in mid-August, and finally closing the month of August at $73/bbl.
- The rupee registered strong appreciation during the month (and was among the top performing currencies) on the back of return of global risk appetite, global weakness in US dollar, resurgence in foreign portfolio inflows and healthy economic data from India. The rupee closed the month at INR 72.9/USD—up around 2%.

Equity market developments and Outlook

- Indian equity markets were among the top performing global markets during the month of August. The benchmark Nifty 50 index closed the month with a healthy gain of +8.7%. The broader markets underperformed—with the Nifty Midcap 50 index and the Nifty Smallcap 100 index returning -2.0% and -2.5% respectively in August.
- The top sectoral performers during the month of August 2021 were power, technology and oil & gas, which closed with double-digit percentage gains. The bottom performing sectors during the month were realty, metal, PSU and auto.
- Global markets ended the month with moderate gains. The MSCI world index returned 2.4% in August, while MSCI Emerging Markets index and MSCI Asia ex-Japan index returned +2.4% and +2.1%, respectively.
- For the US markets, the benchmark S&P 500 index recorded a gain of 2.9% during the month. Within Europe, major markets like Germany, UK and France also ended in green. Asian markets relatively outperformed in August, with markets like India, Thailand, Malaysia and Thailand topping the charts during the month. However, within Asia, markets like Singapore, Hong Kong and South Korea underperformed in August.
- Foreign portfolio investors (FPIs) flows reversed and they recorded a net equity inflow of ₹7,455 crore in the month of August compared to a net equity outflow of ₹12,622 crore in the previous month.
- Domestic Institutional Investors (DIIs) flows slowed down to a net inflow of ₹6,895 crore in the month of August compared to net inflow of ₹18,394 crore in the previous month.
- Corporate earnings during Q1 FY22 have broadly been in-line with elevated expectations—benefiting from a favourable base effect, and a less stringent lockdown during the second Covid wave. Cyclical sectors like metals and oil & gas benefited from rise in commodity prices and the IT sector continued to see healthy revenue growth. However, higher commodity prices impacted margins of auto, consumer staple and consumer durable companies, and NBFCs reported results below expectations as asset quality stress built up amidst the second wave.
- Despite the elevated valuations in markets, the corporate earnings recovery, healthy pick-up in economic activity post the second wave, and global liquidity—has helped markets remain buoyant and touch new record highs. We expect corporate earnings and economic recovery to be healthy going forward.
- 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 other countries. However, we will have to see if and how it pans out in India, and we believe that the impact of the same on economic activity and corporate earnings will be much less severe than the first Covid wave. The expansion of the vaccination drive in India should also benefit.
- 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 remained stable during the month on the back of moderation in domestic inflation, fall in global crude oil price, appreciating rupee and strong foreign inflows into the debt markets. The benchmark 10 year G-Sec yield closed the month on a flattish note at 6.22%--up 2 bps.
- 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 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 maintained its GDP growth forecast for FY22 at 9.5%.
- India's fiscal deficit for first four months of FY22 (April – July 2021) came in at only 23.1% of the budgeted estimate for FY22 compared to 103.1% in the corresponding period of previous fiscal year. This was helped by revival in tax revenue, which grew by 161%YoY over the previous year corresponding period--due to base effect (as there was a more stringent lock-down last year, leading to sharp fall in tax revenues). Non-tax revenue picked-up strongly by 468%YoY due to upfronting of RBI dividend to the government and better than expected dividend.
- Finance Ministry data showed that GST collections in August 2021 was at ₹1.12 lakh crore compared to ₹1.16 lakh crore in July 2021 and ₹0.93 lakh crore in June 2021 (amidst the partial lockdown during the second Covid wave).
- Foreign Portfolio Investors (FPIs) registered a strong net debt inflow of ₹16,480 crore in the month of August 2021, compared with a net outflow of ₹876 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.