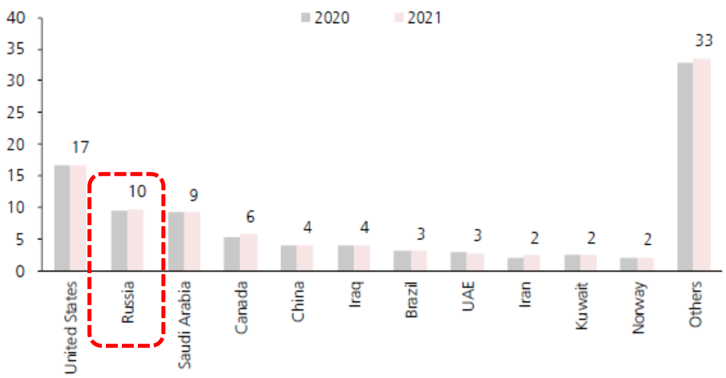
Russia – Ukraine conflict increases geo-political tensions, but India growth story remains intact

- Mr. Sampath Reddy, Chief Investment Officer, Bajaj Allianz Life

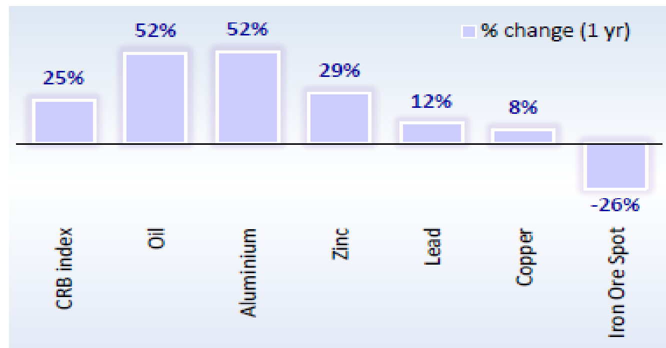
The escalating Russia – Ukraine conflict has increased geo-political tensions worldwide and led to some volatility in global markets and especially in commodity prices. Brent crude oil prices have comfortably crossed the $100/bbl mark, with Russia being a large oil producer—accounting for around 10% of global crude oil production and around 16% of global natural gas production.

Country-wise Contribution in Global Crude Oil Production (in %)



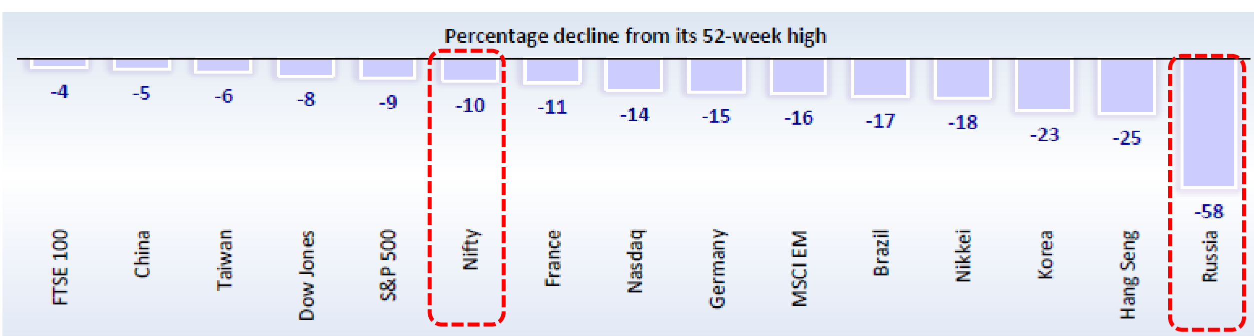
Source: IEA, Kotak Institutional Equities

Performance of Global Commodities over 1 Year



Source: Bloomberg, Motilal Oswal

Global markets have also seen some volatility and registered some correction from their 52-week highs. Rising crude oil and commodity prices, expectations of increased pace of normalization of monetary policy by global central banks (esp. the Fed), sharp rise in global inflation and the recent Russia-Ukraine conflict have contributed to the same. However, the Indian market (Nifty 50 index) has roughly corrected around 10% from its 52-week high, which is relatively less than some of the other emerging and Asian markets. The broader markets in India (mid/small-cap indices) have fallen relatively more from their 52-week highs (15-18%).



Source: Bloomberg, Motilal Oswal. Performance is denominated in USD terms.

Impact on Russia

Western nations have stepped in and levied various sanctions on Russia as a response to its Ukraine invasion. Among the various sanctions-- they have banned some Russian banks from SWIFT, which is a global interbank payment platform. They have also prohibited transactions with Russia's central bank and frozen its assets. This has a significant economic impact on Russia and makes it difficult to carry out international transactions and trade. The sanctions also make it difficult for Russia to use its large foreign exchange reserves of more than $630 billion.

As a result of this, the Russian Ruble plunged by 30% at one point on Monday (28th February) falling to a record low. As mentioned before, the Russian markets have also seen a sharp fall and trading has been suspended on Russia's stock exchange. The central bank of Russia hiked the key interest rate sharply from 9.5% to 20% in an emergency move to deal with the Ruble depreciation and prospects of rise in inflation.

Movement of USD / Russian Ruble

Source: Marketwatch

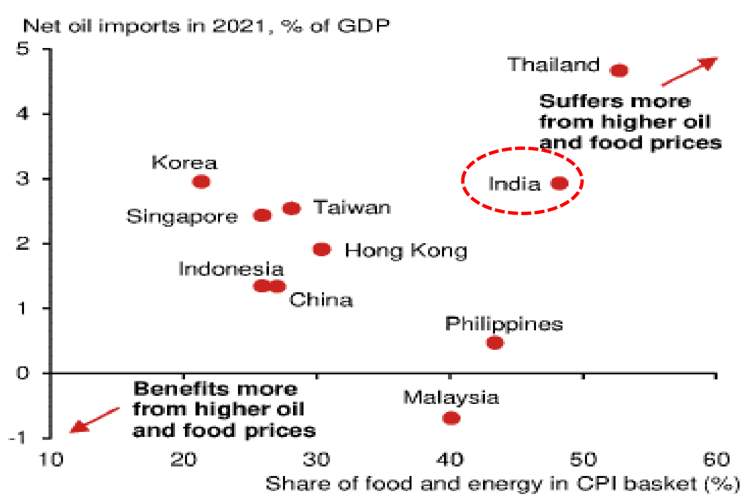
Movement of MSCI Russia Index

Source: Bloomberg, Kotak Institutional Equities

Impact on India

The Indian markets have also seen some volatility, but the correction has been relatively less than other EM and peers, as mentioned earlier. The Indian rupee has also not been much impacted so far and moved in the range of 74-76/USD.

2021 net oil imports vs share of food and energy in CPI basket – India Vs Asian countries



Source: Nomura

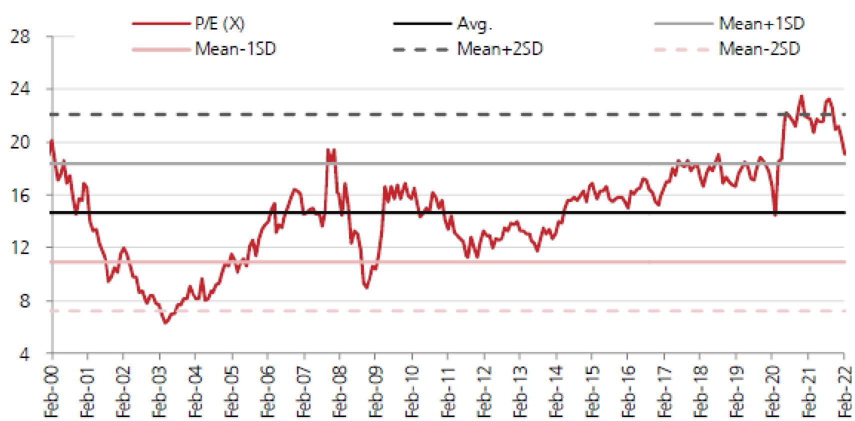
However, if crude oil prices remain elevated for longer period then it will impact India's trade deficit, current account deficit (CAD) and inflation. India is a large net oil importer, and food and energy have a relatively higher share in the CPI inflation basket—which may cause some upward pressure on inflation. Presently, CAD and inflation are quite stable in India.

India's biggest imports from Russia are crude oil, coal and other petroleum products. The largest exports from India to Russia are pharma and electrical apparatus. Meanwhile, India's largest exports to Ukraine is pharma while the largest imports are sunflower seed, cotton seed oil.

Outlook:
With the market correction in India, market valuations have moderated from their highs, albeit it is still above the long-term average. This provides an opportunity to investors to increase their equity exposure a bit and use any further market volatility as a buy-on-dips opportunity (as per their individual risk profile). We presently prefer the large-cap segment from an investment perspective. The global monetary policy unwinding, geo-political risks, elevated crude oil prices, foreign outflows and global inflationary pressure may lead to some market volatility during the near term.

However, the corporate earnings revival in India will help market sentiments. Despite margin pressure from higher commodity prices, Q3 FY22 corporate earnings seasons were along expected lines, and didn't disappoint. The domestic economy has also seen healthy recovery and India is projected among the fastest growing major economies over the next two years. Despite foreign portfolio outflows from India, domestic investors have helped to support markets by pumping in a comparable quantum into Indian markets. The capex cycle and credit growth also seem to be on a recovery path in India, after fledgling for a while--with the economy returning to normalcy. Therefore, the long-term India growth story remains intact, although returns are expected to be more moderate in CY2022.

Nifty 50 index – 1 Yr Forward P/E ratio: Valuations have moderated



Source: Bloomberg, Kotak Institutional Equities

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