

Annual Report for Policy Holders - Economic Update

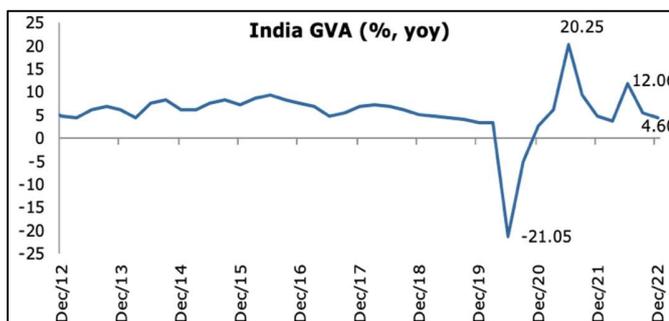
March 2023



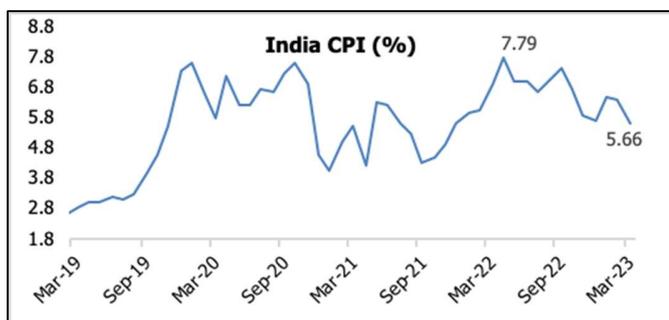
Sar utha ke jiyo!

Economic Update

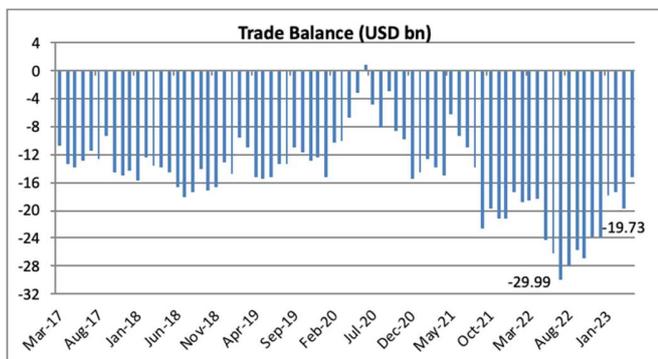
The financial year 2022 – 23 saw the complete restoration of normalcy in economic activity after about 2 years of Covid induced restrictions. The opening up of economies around the world saw a strong surge in pent up consumer demand. In case of the large developed economies, the demand was also fueled by the generous fiscal stimulus during the pandemic period. The supply side response was, however, slow in responding to the surge in demand, as the supply and logistics chains, that stretched across the world, were hampered by the asynchronous relaxations of the Covid curbs. Economic growth received a boost from the pent-up demand. The resultant supply-demand imbalance also led to a sharp rise in inflation, across almost all economies. The US saw peak CPI inflation at 9.1%, while inflation in the European countries tipped into double digits.



India’s GDP growth numbers reflected the steady improvement in activity, though the ‘base effect’ caused significant volatility in the quarterly numbers. India’s GDP is estimated to have grown 7.0% in FY 2022-23, taking the total size of the economy above the pre-pandemic level.

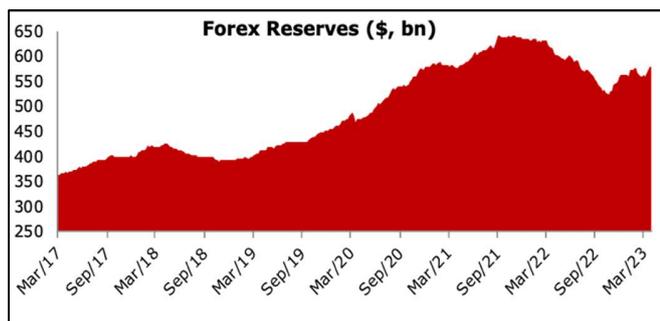


India’s CPI inflation reached a peak of 7.79% at the beginning of the year, in April, and eased from the elevated levels through the year. The trend of inflation, though, was quite uneven, as the seasonal variations in food items led to some volatility in the trend. By the end of the year, the trend was firmly downwards, providing some relief to the markets.



India’s external sector, too, saw a sharp improvement during the year. Monthly trade deficit contracted to levels below \$20 bn per month during the last quarter, against the peak deficit of almost \$30 bn in July. Moreover, the ‘invisibles’ component of the Current Account deficit also improved, bringing the full year CAD to about \$61 bn, which is about 1.8% of estimated GDP. The Capital Account

surplus is estimated to be more than sufficient to cover for the Current Account Deficit, leaving a positive Balance of Payments for the year. The positive BoP is reflected in RBI's foreign currency reserves, which saw a dip during the year and recovered partially by the end of the year. Total forex reserves stood at \$578 bn at the end of the year, with the y-o-y dip largely



attributed to the valuation losses on the foreign currency assets.

Market Update

Equity Markets

After the sharp double-digit gains in equities over the last 2 years, FY23 proved to be a flat year, with interim volatility driven by global macro factors. The large cap Nifty index delivered a return of -0.6% for the full year, while the mid-cap indices fared only slightly better, delivering about 1.0% for the year. The synchronized and sharp tightening of the monetary policy by RBI as well as the large global central banks, led to subdued risk appetite. The sharp rise in rates across the developed economies, also raised fears of a significant slowdown in these large economies, with concerns of the weakness spilling over to emerging markets as well. FII flows remained volatile, though, on the full year basis, they withdrew about \$9bn. Indian markets remained quite unfazed by this large withdrawal, as domestic investors more than compensated for these outflows. Domestic Institutional investors invested about \$32bn in the same period.

The sharp increase in inflation in the initial part of the year, also had an adverse impact on corporate earnings, across a number of sectors. A rise in input prices, which was not fully passed on to the end prices, led to a contraction in margins for companies in the manufacturing space. Services companies, though, saw limited impact, with IT companies grappling with elevated wage costs, while banks and financial companies delivered sharply higher margins on the back of low credit costs and wider interest margins. The cooling off of inflation towards the end of the year, led to expectations of an improvement in margins, for the manufacturing companies, though the outlook for topline growth remains modest.

Portfolio positioning and Risk Management

The equity portfolios were positioned cautiously to benefit from the recovery in economic activity. The portfolios were largely over-weight on financials, on expectations of continued improvement in asset quality aiding margins, pharma, cement, etc. The portfolios also maintained an under-weight allocation in the metals, oil & gas and consumer sectors over concerns of weak demand outlook. The portfolio positions are dynamically managed to account for the changes in outlook for the investee companies and the corresponding changes in valuations. We regularly make appropriate changes to the portfolio within the overall risk management framework.

We follow robust risk management policies in our funds. The portfolio deviations with respect to the respective benchmarks is maintained within defined risk limits. We have defined stock and sector level underweight / overweight positions limits vis-a-vis the benchmark and we actively track such deviations. Deviations are highlighted to portfolio manager and corrective action, if required, is taken in timely manner.

Fixed Income Markets

The fixed income markets witnessed a steady rise in bond yields in the initial part of the year. The surge in inflation in April led RBI to commence its rate hiking cycle at an unscheduled meeting, which led to expectations of more aggressive rate hikes in the subsequent MPC meetings. RBI raised policy repo rates by a cumulative 250 bps through the year, though the tightening of the effective overnight rates was even higher, as liquidity in the banking system steadily dipped into deficit.

The key feature of the rapid rate hikes by RBI was change in the shape and slope of the bond yield curves. The yield curves 'flattened', as the short end yields rose more than the long end yields. The key measure of 'flatness' – the difference between the 10-year benchmark GSec and the 1-year T-Bill yield, contracted from about 217 bps in March'22 to about 17 bps in March'23. The 10-year benchmark GSec yield rose from 6.84% at the end of the previous year, to an intra-year high of 7.61%, before ending the year at 7.28%.

Despite the rise in yields, credit spreads for corporate bonds remained steady at very tight levels, as the overall issuance of corporate bonds remained subdued. A number of large government owned issuers, refrained from accessing the bond markets as they received funds through budgetary allocations. The spreads are expected to remain tight as demand for bonds from long term investors remains strong while the quantum of issuances are likely to remain relatively lower.

Portfolio Positioning: Duration Strategy and Risk Management

The bond portfolios were dynamically managed with active duration management through the year. However, as the bond yields set upon a hardening path, the portfolio duration was maintained at an under-weight position with respect to the benchmark, for most of the year. The cautious positioning in the portfolio, however, adversely affected returns as the effect of the 'flattening' of the yield curve outweighed the duration effect of the rise in yields at the longer end of the curve. We also maintained an under-weight position in credit exposures, as the spreads had narrowed significantly.

During the year, investments were maintained as per our investment policy and all prudential limits and regulatory guidelines were adhered to at all points during the year. Credit risks in the portfolios were also monitored closely. Addition of new credit exposures were made after a thorough analysis and due diligence process. Existing credits were monitored regularly for any developments that could be beneficial or detrimental to the companies' financials.