# MONTHLY UPDATE
# DECEMBER 2021

20 YEARS
Protecting India with Pride

HDFC Life
Sar utha ke jiyo!

December, 2021

"Chains of habit are too light to be felt until they are too heavy to be broken."

\- *Warren Buffet*

## Equity markets

| Indices | 31st Dec 2021 | 30th Nov 2021 | 1 Month Return (%) | 1 Year Return (%) |
|---|---|---|---|---|
| BSE Sensex | 58,254 | 57,065 | 2% | 22% |
| S&P CNX Nifty | 17,354 | 16,983 | 2% | 24% |
| BSE 100 | 17,625 | 17,319 | 2% | 25% |
| BSE Mid Cap | 24,970 | 24,688 | 1% | 39% |
| BSE Small Cap | 29,457 | 27,937 | 5% | 63% |

*Source: Bloomberg*

During Dec'21, domestic equity indices had a good performance - large cap and mid cap indices were up 1-2% MoM while small cap indices outperformed with the BSE Small Cap Index up 5% MoM. On a 1-year basis, the mid and small cap index have outperformed the large cap indices. Over the past one year, Sensex and Nifty were up 22% and 24% respectively while BSE Mid cap and Small cap index were up 39% and 63% respectively.

During Dec'21, performance across the sector indices was mixed. The performance ranged from -1% to +10%. IT and Capital Goods sector gained the most; up 10% and 7% respectively while Banking and FMCG sector underperformed; down 1% and +1% respectively. On a 1-year basis, Utilities sector is the best performing sector gaining 69% followed by Metals and IT sector respectively. FMCG followed by Banking are the bottom two sectors; up 9% and 13% each respectively.

The yield of benchmark 10-year G-sec moved to 6.45% at the end of Dec'21 from 6.33% at the end of Nov'21.

Global equity indices had a good performance during the month. The CAC 40 Index rose the most, up 6% followed by DAX, FTSE100 and DOWJONES Index which rose 5% each during the month. The HANGSENG Index was flat MoM and underperformed other indices. On a 1 year basis, CAC 40 has gained the most, up 29%.

| Commodities (USD) | 1 Month Return (%) | One Year Return (%) |
|---|---|---|
| Gold | 3% | -4% |
| Silver | 2% | -12% |
| Crude Oil | 10% | 50% |
| Copper | 4% | 27% |
| Aluminum | 6% | 42% |
| Lead | 1% | 17% |
| Nickel | 4% | 26% |
| Tin | -1% | 92% |
| Zinc | 11% | 31% |

Most major commodities rose during Dec'21 except Tin and Zinc. Crude Oil gained the most up 10% MoM.

On a YoY basis, most major commodities have posted YoY gains except gold and silver. Tin has appreciated the most.

*Source: Bloomberg*

## Macro Economic Data

| Indicators | Sep-21 | Oct-21 | Nov-21 | Dec-21 | Comments |
|---|---|---|---|---|---|
| **IIP (YoY, %)** | 3.1% | 3.2% | | | Industrial output grew 3.2% yoy in Oct'21 vs. 3.1% yoy increase in Sep'21. Mining, manufacturing and electricity recorded growth of 11.4%, 2% and 3.1% yoy, respectively. |
| **Core Sector (YoY, %)** | 4.4% | 7.5% | 3.1% | | Core sector output grew 3.1% in Nov'21, following 7.5% growth in Oct'21. The recovery was driven by coal output (up 8.2% yoy), natural gas output (23.7% yoy) and refinery products output (4.3% yoy). However, output of crude oil declined by 2.2% yoy and electricity generation witnessed only a 1.5% yoy rise. |
| **RBI monetary policy (Repo Rate) (%)** | 4.00 | 4.00 | 4.00 | 4.00 | RBI kept repo rate unchanged at 4% as in Dec'21 and maintained the monetary policy stance 'accommodative'. |
| **CPI inflation (%)** | 4.35% | 4.48% | 4.91% | | CPI inflation rose to 4.91% yoy in Nov'21 from 4.48% yoy in Oct'21. The food and beverages inflation inched to 2.6% yoy in Nov'21 from 1.8% yoy in Oct'21. |
| **Trade Deficit ($, bn)** | -22.9 | -19.9 | 23.3 | | In Nov'21, exports grew by 26.5% yoy to $29.9bn, while imports grew by 57.2% yoy to $53.2bn. As a result trade deficit widened to $23.3bn in Nov'21 vs. $19.9bn in Oct'21. |
| **GST Collection ($, bn)** | 1,170 | 1,301 | 1,315 | 1,298 | Total gross GST revenue collections in Dec'21 stood at Rs. 1,298bn, following Rs. 1,315bn collection in Nov'21. |
| **FII Flows-Equity ($, bn)** | 1.79 | -1.81 | -0.79 | -2.53 | On equity side, FPIs sold $2.53bn in Dec'21, following an outflow of $0.79bn in Nov'21. On debt side, FII sold $1.56bn in Dec'21, following an inflow of $0.13bn in Nov'21. |
| **FII Flows-Debt ($, bn)** | 1.74 | -0.21 | 0.13 | -1.56 | |
| **Exchange Rate (INR/USD)** | 74.25 | 74.88 | 75.16 | 74.33 | Indian Rupee appreciated by 1.1% against the dollar during Dec'21, as it closed at 74.33 in the end of Dec'21 from 75.16 at the end of Nov'21. |
| **GDP (%)** | 8.4% | | | | Real GDP grew by 8.4% in Q2 FY22 vs. 20.1% growth in Q1 FY22 (due to low base effect) led by the increase in investment (11% in Q2 FY22 vs. 56.7% Q1 FY22), HH consumption (8.6% in Q2 FY22 vs. 19.3% in Q1 FY22) and Government consumption (8.7% in Q2 FY22 vs. 4.8% contraction in Q1 FY22). |

**Outlook**

Markets ended CY21 on a brighter note, gaining 2% during December and further in January'22, and are now just 3% below its peak in October. Calendar year 2021 ended with strong 24% returns. However, Q3FY21 was a little soft with markets remaining largely flat. The outflows in the secondary market were higher at 1.7bn USD but were partly offset by their healthy participation in the primary market. DIIs, however, continued to support the market with buying of USD 4.1bn during the month.

First on the global front, Fed policy was the key event. In its December policy, Fed accelerated its tapering program and has now vowed to end asset purchases by March (vs. June earlier). Further, it is now guiding towards 3 rate hikes in 2022 (vs. 1 earlier) as indicated by the dot plot. Its policy advancement is essentially premised on very strong US labor market and persistently higher inflation. This in turn may cause volatility in asset prices.

With regards to economic data, supply disruptions now seem to be easing with shipping rates moderating. However, the new Omicorn virus has increased uncertainty and while the severity of infection is much lower, it remains to be seen how supply and demand get hampered.

On the domestic front, RBI maintained that it is on the path of policy normalization and continued to increase absorption through its Variable reverse repo facility (VRRR). As a result, money market rates and even long end rates have moved higher. However unlike Fed, RBI remains a lot more accommodative and to that extent domestic financial conditions should remain benign. However, government spending has moderated off-late both on capex as well revenue expenditure front.

Domestic economic recovery has slackened post the festive season. High frequency datapoints like cement production, e-way bills, steel consumption have slowed, while auto sales continue to remain weak with passenger vehicles plagued with chip shortages and two wheelers hurt by weak demand. Credit growth though is showing early signs of pick up. Going ahead Covid concerns have cropped up again. Cases seem to be rising at a much faster pace than that seen during the delta wave and needs to be monitored.

Overall, the bullish sentiments of 2020, continued in 2021 as well. As we go into 2022, the outlook is more sombre. Elevated valuations amid a more aggressive tightening by the Fed, could increase volatility. Also, earnings momentum is now narrow and could moderate in FY23. Consensus Nifty earnings are expected to record a 30% CAGR over FY21-23. Corporate earnings are on a structural upswing in India, supported by a shift in market share to organised players, cost control measures, disciplined capital allocation and a cyclical recovery in commodities. The risks to current expectations are demand slow down (pent-up demand subsides and base demand recovery is weaker than expectations) and persistent higher input cost pressure. Globally higher inflation expectations and faster than expected normalcy in monetary policy are the key risks for equities. And now then there is an additional uncertainty on the likely course the pandemic takes with emergence of Omicron. In this overall context, valuations at 20.2x FY23 earnings are quite full, making us cautious in the short term. However, we would be optimistic from a medium to long term point of view as we expect a cyclical recovery in the economy and earnings

# Fixed Income Market

**Fixed Income Market Review –**

Bond yields hardened during the month as RBI took more measures to mop up the excess liquidity in the system coupled with a lack of demand from investors amid low year-end volumes. In the Dec Monetary Policy meeting, RBI had announced its plan of mopping excess liquidity using short term VRRR from Jan 2022 onward, but surprisingly RBI implemented it in December itself, which was read by the markets as a sign of urgency in rolling back the easy policy measures. This move, after the US Fed had announced a faster winding down of its liquidity support measures, led the markets to price in a more aggressive roll-back by RBI. The 10yr benchmark bond rose to 6.50% during the month, before closing lower at 6.45%, though significantly higher from its previous close of 6.33%. The 10yr UST yield rose from its previous close of 1.45% to 1.51%, during the month. Brent Crude Oil price retraced from its previous close of USD 69.2 per barrel to USD 77.9 per barrel. Omicron has so far failed to dampen growth prospects as the health impact seen so far has been much milder than the earlier variants.

On the domestic front, RBI continued to absorb surplus liquidity through Variable Rate Reverse Repo (VRRR) auctions. The cut-offs for all the VRRR auctions, irrespective of the tenure, continued to come around the highest possible rate of 3.99%, just shy of the current Repo rate at 4%. Moreover, RBI has continued selling bonds in the secondary market as per RBI's weekly data to a tune of 1.5k – 2k crs.

Among data releases, India's CPI inflation rose by 4.91% yoy, in Nov-21 from its previous reading of 4.48% in Oct-21. On a sequential basis, the price index increased by 0.73%, nearly half the pace of October. Core inflation (CPI Ex-Food Ex-Fuel) continues to be sticky around 6%. Headline WPI inflation for November 2021 printed at an all time high (Current Series) of 14.2%, compared to 12.5% recorded in October 2021.

India's trade deficit in December came at $22 bn marginally lower than USD 22.90 bn of November. Among other economic data, Goods and Services Tax (GST) revenue collection for December came at Rs 1,29,780 cr. India's Nikkei Markit Manufacturing PMI rose to 55.5 in Dec 2021, against 57.6 in the previous month, and the Services PMI also eased to 55.8 in December from 58.1 in the previous month. Composite PMI eased to 56.4 in Dec vs 59.2 in the previous month.

Market Outlook –

CPI Inflation which has stayed low over the past few months, is expected to harden due to adverse base effects. Despite the low headline readings, core CPI inflation has anyway stayed sticky around the 6.0% levels. RBI forecasts CPI inflation to average around 5.7% in the last quarter of the current fiscal and ease again thereafter, which provides room for RBI to proceed gradually with its rate normalization process. Moreover, RBI is also concerned about the impact on growth from the rapidly spreading Omicron variant.

However, indication from other countries where the Omicron variant has caused widespread infections, show that the impact on economic activity is limited and also for a brief period. While the impact on growth is minimal, inflation, however, continues to stay elevated due to continuing disruptions in logistics and supply chains, prompting DM central banks to accelerate their monetary policy normalization. Markets currently are inclined to factor a similar pathway for India as well, and RBI's actions in December were taken to as a sign of possible acceleration of policy normalization by RBI as well.

Secondly, RBI has refrained from any secondary market measures like OMO purchases of bonds or OT, which would have provided support to the bond markets. For the last quarter of the year, States have indicated a huge quantum of borrowing, which is likely to put greater pressure on bond yields.

Lastly, fiscal concerns are again coming to fore. Though tax revenues have been significantly higher than budgeted estimates, the disinvestment revenues are likely to disappoint with a wide margin, if the large ticket items like the LIC IPO and the BPCL disinvestment are delayed to next year. Moreover, if the Government goes ahead with the additional spending of about Rs 3 trillion, as approved by the Parliament in December, that spending may need to be funded through additional borrowing. Overall, while the Omicron variant may delay some rate measures from RBI, bond yields are expected to continue hardening as the markets price in stronger economic recovery in the coming months.