

MONTHLY UPDATE

JANUARY 2022



Jan, 2022

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

- Warren Buffet

Equity markets

Indices	31 st Jan 2022	31 st Dec 2021	1 Month Return (%)	1 Year Return (%)
BSE Sensex	58,014	58,254	-0.4%	25%
S&P CNX Nifty	17,340	17,354	-0.1%	27%
BSE 100	17,618	17,625	0%	28%
BSE Mid Cap	24,613	24,970	-1.4%	36%
BSE Small Cap	29,227	29,457	-0.8%	62%

Source: Bloomberg

During Jan'22, domestic equity indices had a mixed trend - large cap indices were flat MoM while the mid and small cap indices under performed with the BSE Mid and Small Cap Index down 1% 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 25% and 27% respectively while BSE Mid cap and Small cap index were up 36% and 62% respectively.

During Jan'22, performance across the sector indices was mixed. The performance ranged from -8% to +13%. Utilities and Banking sector gained the most; up 13% and 8% respectively while IT and Healthcare sector underperformed; down 8% each. On a 1-year basis, Utilities sector is the best performing sector gaining 96% followed by Metals and Realty sector respectively. FMCG followed by Auto are the bottom two sectors; up 10% and 19% each respectively.

The yield of benchmark 10-year G-sec moved to 6.68% at the end of Jan'22 from 6.45% at the end of Dec'21.

Global equity indices were weak during the month. The HANGSENG Index rose the most, up 2%. The NASDAQ and SHANGHAI Composite were the worst performing indices, down 9% and 8% respectively during the month. On a 1 year basis, CAC 40 has gained the most, up 30%.

Commodities (USD)	1 Month Return (%)	One Year Return (%)
Gold	-2%	-3%
Silver	-3%	-16%
Crude Oil	17%	69%
Copper	-3%	22%
Aluminum	9%	54%
Lead	-3%	12%
Nickel	9%	29%
Tin	10%	88%
Zinc	1%	41%

Most major commodities rose during Jan'22 except Gold, Silver, Copper and Lead. Crude Oil gained the most up 17% 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	Oct-21	Nov-21	Dec-21	Jan-22	Comments
IIP (YoY, %)	3.2%	1.4%			Industrial output grew 1.4% yoy in Nov'21 vs. 3.2% yoy increase in Oct'21. Mining, manufacturing and electricity recorded growth of 5%, 0.9% and 2.1% yoy, respectively.
Core Sector (YoY, %)	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 Jan'22 and maintained the monetary policy stance 'accommodative'.
CPI inflation (%)	4.48%	4.91%	5.59%		CPI inflation rose to 5.59% yoy in Dec'21 from 4.48% yoy in Nov'21. The food and beverages inflation inched to 4.5% yoy in Dec'21 from 2.6% yoy in Nov'21.
Trade Deficit (\$, bn)	-19.9	23.3	22.0		In Dec'21, exports grew by 37% yoy to \$37.3bn, while imports grew by 38.1% yoy to \$59.3bn. As a result trade deficit narrowed to \$22bn in Dec'21 vs. \$23.3bn in Nov'21.
GST Collection (\$, bn)	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)	-1.81	-0.79	-2.53	-3.79	On equity side, FPIs sold \$3.79bn in Jan'22, following an outflow of \$2.53bn in Dec'21. On debt side, FII bought \$0.58bn in Jan'22, following an outflow of \$1.56bn in Dec'21.
FII Flows-Debt (\$, bn)	-0.21	0.13	-1.56	0.58	
Exchange Rate (INR/USD)	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 (%)					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

India was a relative outperformer in January when compared to both developed and emerging markets, with MSCI world posting returns of -5.3% and MSCI emerging markets -1.9%. Within the developed markets, the US was a relative underperformer with S&P 500 and Nasdaq returning -5.3% and -9.0% respectively.

Despite a correction in global equity and bond markets, commodities had a strong month. Crude oil rallied 17.4% to US\$91 per barrel while Aluminum, Nickel and Tin were up between 7.6-10.7%. Only exceptions were HR Steel, Lead and Copper. High commodities are a major concern for a large importer like India with implications for external account as well as domestic inflation.

Inflation has emerged as a problem not just for India but also for several other economies. This has led to accelerated policy normalization and advancement of interest rate increases. In its first meeting in 2022, the US FOMC indicated that it would soon begin hiking rates, likely starting in March by which time the asset purchases will also conclude.

The sudden spurt in Covid infections in the second half of December continued in January as well. But thankfully, milder symptoms and relatively quicker recovery has resulted in a reduction in net active cases. In the period Jan 22 – Jan 28, India registered 1.95 mn cases as against 2.3 mn cases the week before and the active caseload stood at 2 mn. On the vaccination front, a total of 1.6bn vaccine doses have been administered till Jan 27 (935.3 mn first dose, 698.8 mn second dose, and 10.3 mn precautionary doses).

In the just presented budget, the government prioritized economic growth over fiscal consolidation and stressed on ongoing supply-side reforms to achieve higher medium-term GDP growth rates. It has targeted central GFD/GDP at 6.4% in FY23BE versus 6.9% in FY22RE, well above average GFD/GDP of 3.8% in FY15-20. The government has budgeted 10% increase in capital expenditure to Rs12.2 tn (including spending of PSUs and Rs1 tn support to states). Sector-specific proposals largely pertain to facilitation of investment in infrastructure and manufacturing through government incentives under various production-linked incentive (PLI) schemes for 'new' sectors, tariff protection through judicious use of high customs duties in the case of select sectors, establishment of policy framework to encourage private sector investment in emerging areas (clean energy) and coordinated policy approach with states in concurrent subject areas (electricity and real estate).

The ongoing Q3 results season has been pretty much on expected lines so far. Results of domestic consumer facing industries have shown a slowdown in volume growth because of significant price increases that have been taken to counter the rising raw material inflation. Gross margins have also taken a hit because of companies' inability to pass on the entire increase. IT companies have reported very strong revenue performance but have taken a hit on margins because of rising employee costs. Results in Financial sector have been very good because of a pickup in credit growth and good trends on asset quality. Nifty estimates have so far remained unchanged which is a good outcome as there was a fear of downgrades getting into the earnings season.

FII sold nearly \$3.9bn worth of Equities in cash markets during January. DIIs, on the other hand, were net buyers to the extent of \$2.5bn. For CY21, both FIIs and DIIs were net buyers worth \$3.8bn and \$12.4bn, respectively.

Nifty earnings are expected to grow at a CAGR of 21% from FY21-24. Near term is going to be volatile given multiple headwinds, ranging from US Fed taper to a potential negative surprise on course of interest rate hikes to margins from high commodity prices. And then there is an additional uncertainty on the likely course the pandemic takes. In this overall context, valuations at 20.3x 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 after several years of sub-par growth.

Fixed Income Market

Fixed Income Market Review –

Bond yields rose sharply during the month as US yields and crude oil prices continued to rise with no OMO / OT intervention from RBI to stem the rise in yields. In light of the continuously rising inflation in the US along with unemployment falling to pre-Covid levels, the US Fed chairman signaled a more aggressive reversal of the easy monetary policy. The 10yr UST yield rose sharply to a fresh high of 1.88% from its previous month's close of 1.51% before settling at 1.78%, for the month. Meanwhile, Brent Crude Oil price also rose from its previous close of USD 77.9 per barrel to USD 89.2 per barrel, based on expectations of stronger demand recovery, extreme winter weather and a rise in geo-political risks. The domestic 10yr benchmark bond rose to 6.75% during the month, before closing lower at 6.68%, though significantly higher from its previous close of 6.50%.

On the domestic front, RBI continued to absorb surplus liquidity through Variable Rate Reverse Repo (VRRR) auctions. Moreover, RBI continued selling bonds in the secondary market on a regular basis, unnerving the market participants with the additional supply.

Among data releases, India's CPI inflation rose to a 5-month high of 5.59% yoy, in Dec-21 from its previous reading of 4.91% in Nov-21. Core inflation (CPI Ex-Food Ex-Fuel) continues to stay elevated at 6%. Headline WPI inflation for December 2021 eased slightly to 13.6%, compared to 14.2% recorded in November 2021.

India's trade deficit in January came at \$18 bn lower than USD 21.7 bn of December. Among other economic data, IIP growth for November 2021 printed at 1.4%, lower than the revised reading of 4.0% in October 2021. Goods and Services Tax (GST) revenue collection for January came at Rs 1,40,986 cr. India's Nikkei Market Manufacturing PMI fell to 54 in Jan 2022, against 55.5 in the previous month, and the Services PMI also eased to 51.5 in January from 55.5 in the previous month. Composite PMI eased to 53 in Jan 22 vs 56.4 in the previous month.

Union Budget FY 2023 –

The Union Budget for FY 2023 was announced by the Finance Minister at the beginning of February. While the Budget was focused on putting the economy on a sustainable growth path through a strong focus on Capital Expenditure, with minimal rise in Revenue Expenditure, the assumptions for revenue growth were seen to be quite conservative. Consequently, the budgeted deficits were higher than the market expectations and had an adverse impact on the bond markets. Key factors from the Bond market perspective are -

- Fiscal Deficit for FY22 has been revised upward from 6.8% to 6.9% and for FY23 has been pegged at 6.4%.
- Gross borrowing for FY23 was announced at a whopping Rs 14.95trn (effective Rs 14.31trn after switch done by RBI with GOI directly). Net borrowing for FY23 stood at 11.2trn. T-Bill borrowing for FY23 is budgeted at 500bn. The borrowing numbers were far in excess of the market expectations of about Rs 12.0 12.5 trn gross borrowing.
- The government decided against tweaking capital gains tax rules for GSec transactions on global settlement platforms, which was a key hurdle for listing the bonds on those platforms and subsequently being included in global bond indices. An inclusion of the domestic bonds in global indices would have led to FPI investments to the tune of USD 25 – 30 bn into the domestic bond markets, thus helping absorb a significant portion of the huge supply of bonds.
- State governments have been allowed to borrow upto 4% of their GDSP, which is expected to lead to higher SDL issuances by the States.

Market Outlook –

Global Central Bankers have either started hiking or have hinted at hiking rates as inflation has been rising rapidly and the respective economies have almost fully recovered from the effect of the Covid pandemic. In a global tightening scenario coupled with rising commodity prices, Indian bond markets have already started factoring in rate hikes from RBI as well. With inflation near RBI's upper tolerance band and with growth gaining momentum, we expect RBI to gradually narrow the repo corridor followed by repo rate hikes. In line with the gradual withdrawal of liquidity, RBI has refrained from any secondary market OMO purchases of bonds, which would have provided support to the bond markets.

With the recent budget now pegging the next year fiscal deficit at 6.4% resulting in gross borrowing of Rs 14.3trn, markets are now wary of the bond supply overwhelming the demand for bonds by a wide margin. Expectations of India being included in global bond indices, which would have helped bridge this gap, too were quashed by the government, putting further pressure on domestic investors to manage the mammoth supply.

With both global and domestic factors turning negative, bond yields are expected to continue hardening as the markets price in stronger economic recovery in the coming months coupled with monetary policy normalization and a huge bond supply.