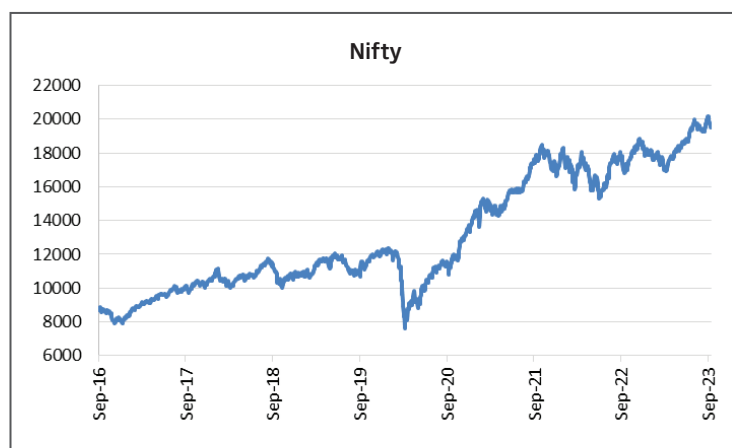
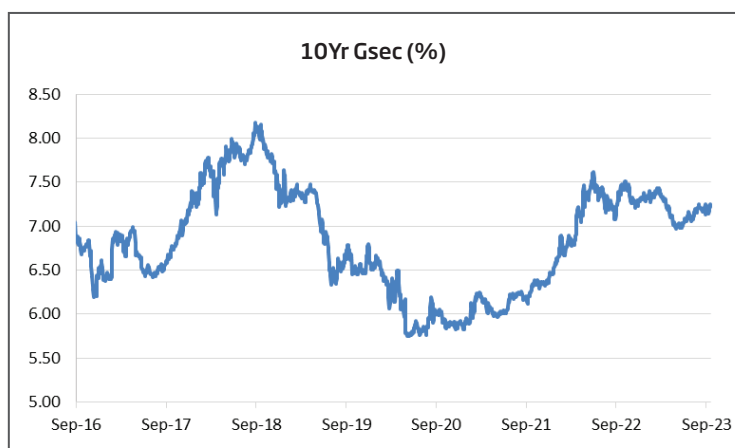


Market Outlook

Mr. Prasun Gajri

Chief Investment Officer, HDFC Life

Market Update



Domestic Markets

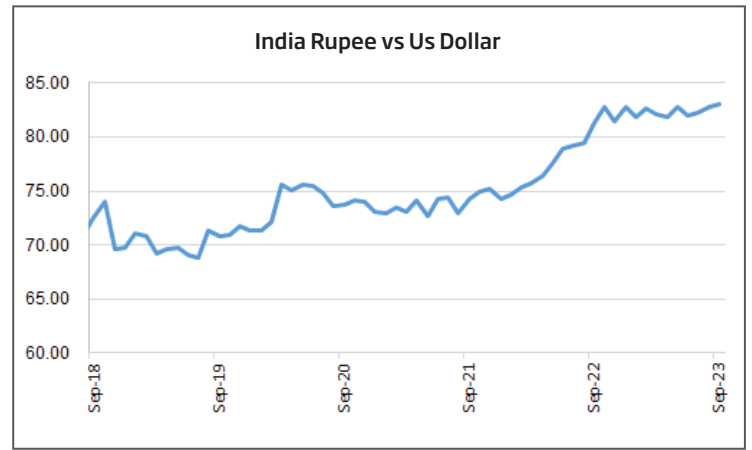
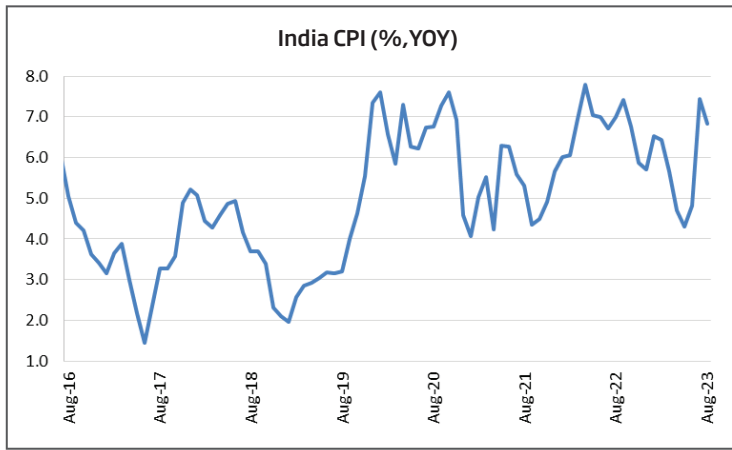
Bond Market:

- In 1HFY23, 10 year bond yields moderated as market expected an end to the rate hike cycle. The volatility in India bond market was less than DM due to better macro outlook, stable currency and a benign inflation. JP Morgan's announcement of inclusion of India in the EM- bond index supported a rally, which proved relatively short lived due to sharp rise in UST and crude. Short-term yields have hardened because of tighter liquidity conditions leading to a flattening of the yield curve. The tightening of domestic liquidity in the last 1-2 months is on account of the Incremental-CRR imposed on banks (10% of NDTL) on liabilities garnered between 19- May-2023 and 28- July -2023.

- The 10-year AAA Corp bond spread widened by ~10bps on average in 1HFY24 vs. 2HFY23 which may be attributed to some tightening of liquidity conditions.

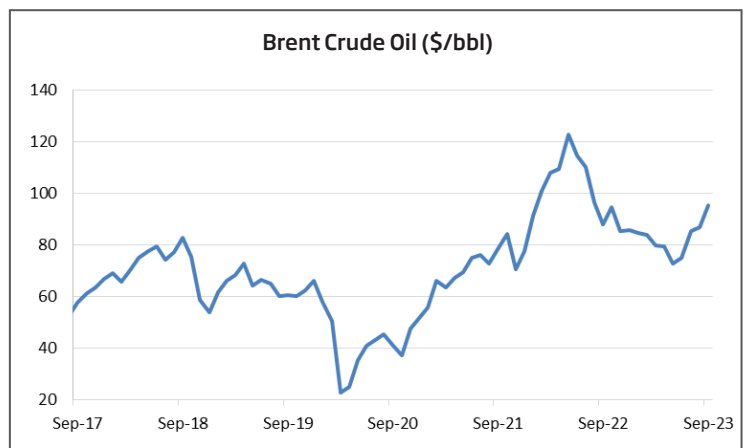
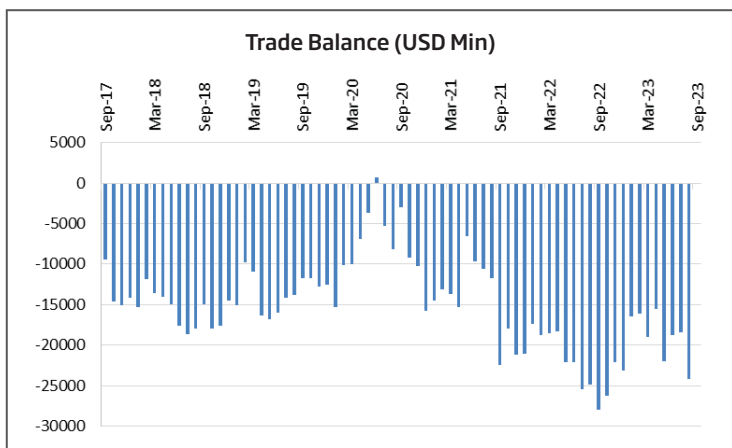
Equity Market:

- Indian equity markets were buoyant in 1HFY24 supported by the return of FPI flows and easy domestic liquidity for most of 1HFY24. Net FPI flows into Indian equities stood at US\$17.9bn in 1HFY24 although September saw outflows after five months of inflows. Meanwhile, DII flows stood at US\$5.5bn in 1HFY24. Broader markets outperformed. While Nifty 50 was up by 12.5% in 1HFY24, Nifty Midcap 100 was up by 33.5%. Resilient domestic earnings supported by government capex spending and lower NPAs in the financial sector have been tailwinds for Indian equities.



India CPI:

- India CPI inflation was on a moderating trend and averaged 4.6% in 1QFY24 before shooting up to 7.44% in July, on account of a surge in vegetable prices. Other food articles such as cereals, pulses and spices also witnessed upward pressure. However, the surge in vegetable prices proved temporary and has since begun to reverse. Meanwhile, Core CPI has been on a moderating trend and stood at 4.8% in Aug'23 down from 5.8% in March'23. RBI has indicated that it will look through this bout of food inflation as long as it does not spill over into higher core inflation.

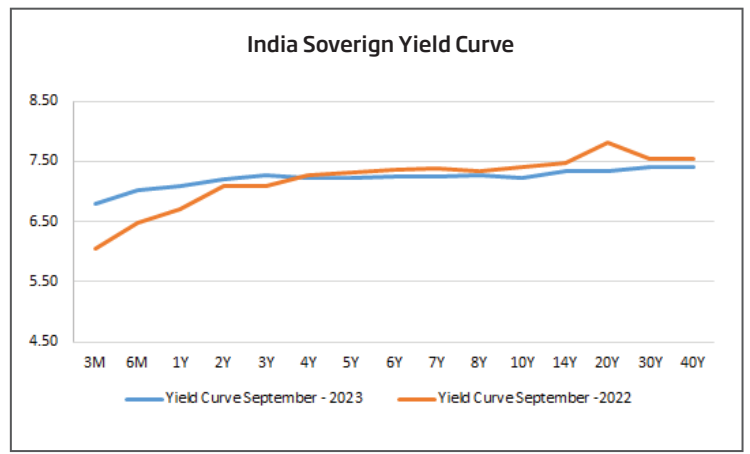
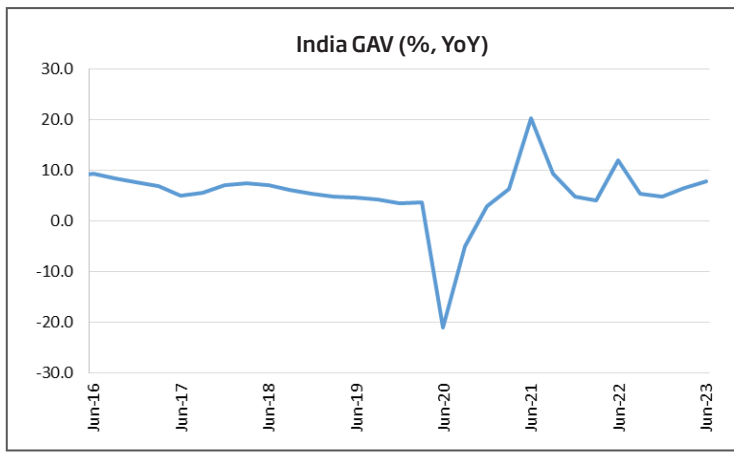


INR & India Trade Deficit:

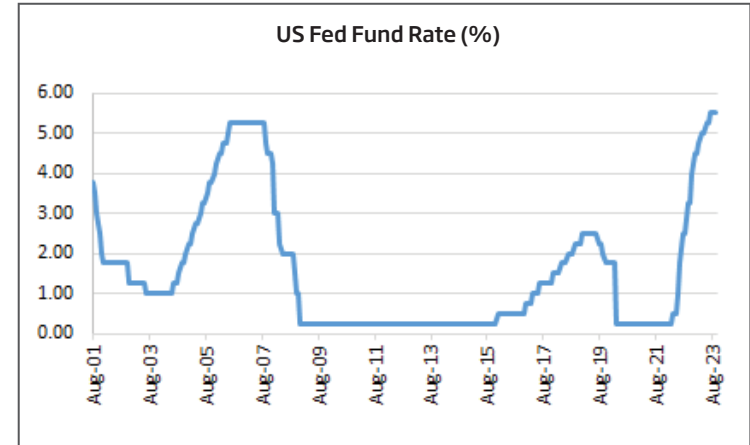
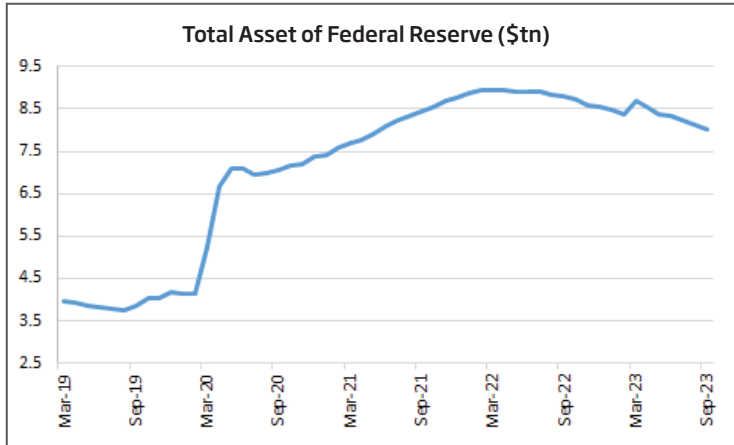
- The INR was largely flat in 1HFY24 and averaged 82.4 to the dollar vs. 82.2 in 2HFY23. Moderation in crude oil prices from 2022 highs, healthy services exports, a weaker dollar and the return of FPI flows in equities supported the INR in 1HFY24. Of late, the INR has witnessed some depreciation pressure on rising crude oil prices, a strengthening dollar and FPI outflows.
- India's trade deficit has remained largely flat at US\$19.8bn in 1HFY24 compared to US\$20.5bn in 2HFY23. Both exports and imports have witnessed a decline but non-oil imports have been relatively resilient supported by sustained domestic demand. The services surplus moderated marginally from a monthly average of US\$ 13.2bn in 2HFY23 to US\$12.5bn in 1HFY24. Services exports and remittances are slowing, reflecting slowing global growth. A widening of trade deficit and moderation in services exports and remittances led to a higher CAD at 1.1% of GDP in 1QFY24 up from 0.2% in 4QFY23.

India GDP:

- India GDP continued to show resilience and grew by 7.8%YoY in 1QFY24. Core GVA (excluding agriculture and government spending) grew by 8.7%YoY supported by sustained recovery in contact intensive services and strong growth in Financial, Real Estate & Professional Services. RBI has pegged GDP growth for FY24 at 6.5%.

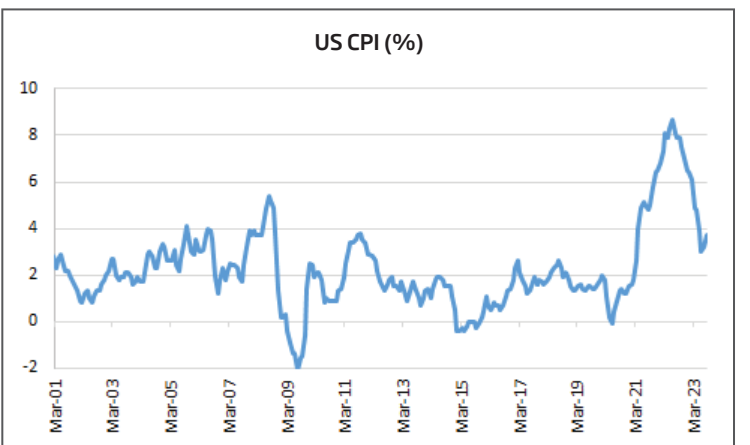
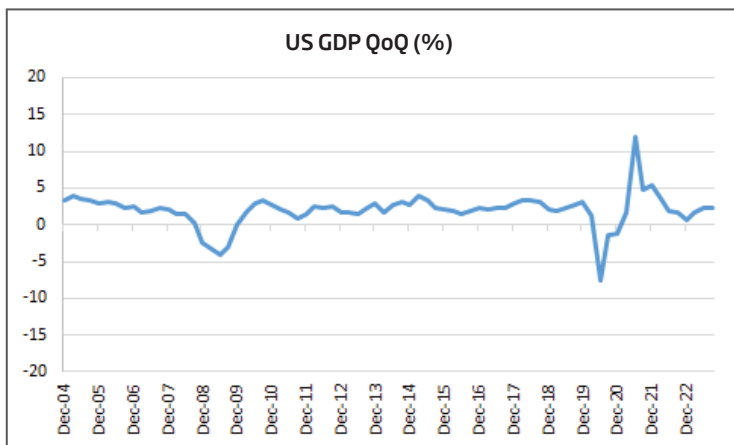


Global Macro Review



- US GDP grew by 2.1%YoY in 2Q2023 vs. 2.2% in the previous quarter. The increase in real GDP reflected increases in nonresidential fixed investment, consumer spending, and state and local government spending that were partly offset by a decrease in exports. US GDP growth has remained above trend and the Fed has revised up its GDP estimate for 2023 to 2.1% from 1% earlier. Euro area economic activity grew at a subdued paced in the first half of 2023, led by manufacturing sector and the unwinding of high energy prices. Euro area bank lending to households is now negative as tighter credit conditions have led to a fall in demand and supply of loans. Recent Euro strength is also curbing external demand. The ECB has pegged Euro area GDP growth in 2023 at 0.7%.

The recovery in China has largely disappointed, although GDP growth in 2Q2023 improved to 6.3%YoY from 4.5% in 1Q2023 supported by a low base. The authorities are largely relying on private consumption to support growth and have stayed away from any big-bang stimulus announcements despite some marginal rate cuts and reduction in the Required Reserve Ratio for banks. However, the continued property slump, weak consumer spending, high debt and geopolitical tension would continue to weigh on growth target



- The US Federal Reserve has raised rates by 50bps since April 2023 (25 bps each in May & July) taking total rate hikes to 525bps since the beginning of tightening cycle in Mar'22. The rate hikes have come on the back of a resilient labour market and above trend GDP growth. At the same time, CPI has been on a moderating trend although it remains above the 2% target. CPI inflation moderated from 4.9% in April'23 to 3% in June'23 before rebounding to 3.7% in August'23 mainly on account of rise in crude oil prices. Core inflation moderated from 5.5% in Apr'23 to 4.3% in Aug'23. The Fed dot plot is suggesting one more rate hike in 2023, although it remains data dependent. US Federal Reserve Chairman Jerome Powell indicated in his Jackson Hole Speech that above trend GDP growth or any signs of reversal in labour market moderation may warrant further rate hikes. The Fed has continued with quantitative tightening (although less than announced). In 2023, the Fed balance sheet has shrunk by ~US\$0.5tn. In the interim, the US government averted two shutdowns and lifted the debt ceiling.

Future Outlook

- In 2023, developed markets have managed to avoid recession so far, largely due to excess savings accumulated during pandemic era. Going forward, we expect global growth momentum to ease as the lagged impact of rate hikes kicks in.
- In the US, the end of moratoriums on student and other loans is likely to weigh on discretionary consumption and consequently growth. Nevertheless, the US Fed is assuming a soft landing scenario with 2024 growth pegged at 1.5% up from 1.1% in June. The soft landing scenario also assumes that the economy can sustain 'higher for longer' rates. US yields are up by over 100bps in the last six months and at 2007 levels. Higher global interest rates could have implications for equity valuations and also increases financial stability risks. The Indian economy and equity market are better-placed versus most other markets. Consequently, India could sustain premium valuations over other EMs. However, given global linkages in terms of trade and fund-flows, it is difficult to expect a decoupling of our economy and markets. Moreover, since the market rally in 1HFY24 has been driven by the return of FPI flows, volatility cannot be ruled out in an environment of rising global yields and a strong dollar. Nonetheless, the medium term outlook for Indian equities remains quite strong.
- Slowing global growth amid tight financial condition should keep commodity prices in check even though supply cuts and geopolitical tensions impart some uncertainty. Domestically food inflation remains a concern due to erratic weather even as the monsoon has been 'near normal'. However, the moderating trajectory for inflation is expected to sustain supported by benign core inflation. India's CPI inflation in FY24 is likely to average ~5.4% (RBI).
- The FED has hiked 525bp since March'22 and RBI has hiked 250bps in same period. We expect the RBI to likely remain on pause, given that the current inflation spike was majorly perishables led and core inflation provided comfort to RBI. RBI would want to continue to support the growth recovery and given that monetary policy works with long and variable lags, the current levels should be the terminal rate for this cycle unless crude prices shock further higher. The 'higher for longer' narrative from the Fed is likely to keep the RBI cautious in indicating a decisive turn in the domestic rate cycle. Since the policy rate is expected to remain at current levels in the near term, fixed income investments can earn a higher carry. However, in the medium term the economic cycles are expected to turn lower because of expected lower growth leading to decline in interest rates. Expectations of foreign fund flows into Indian debt (from Jun'24) may also lead to a moderation in yields towards the end of FY24.



Sar utha ke jyo!

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