Market Outlook

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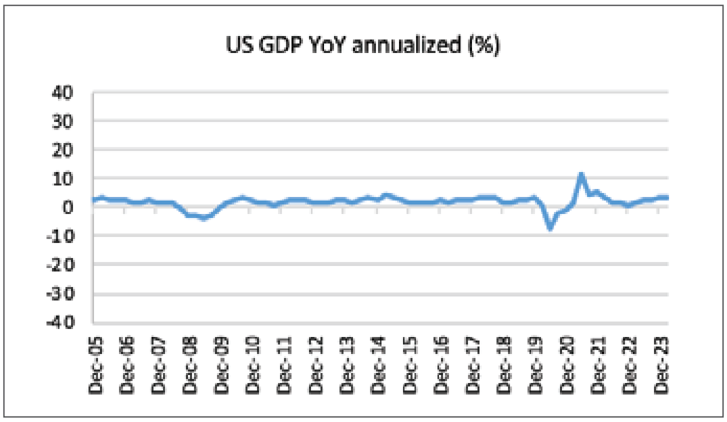
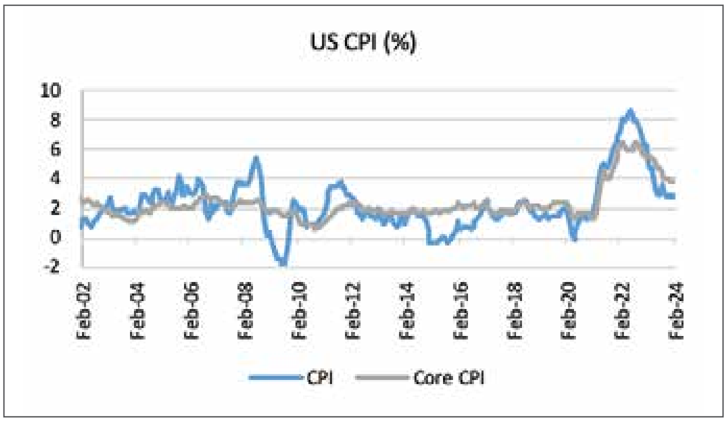
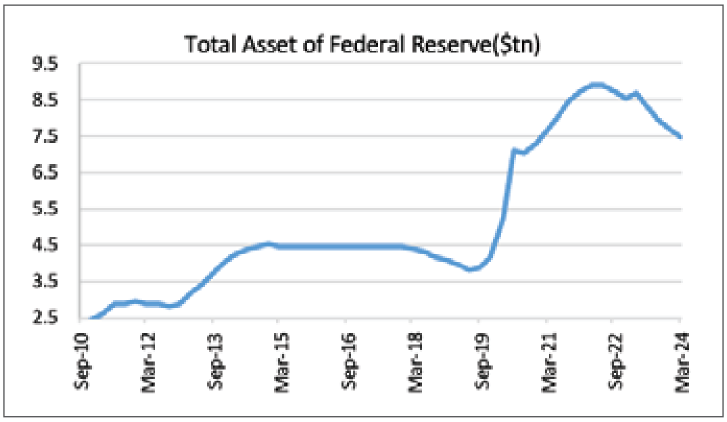






Global Macro Review

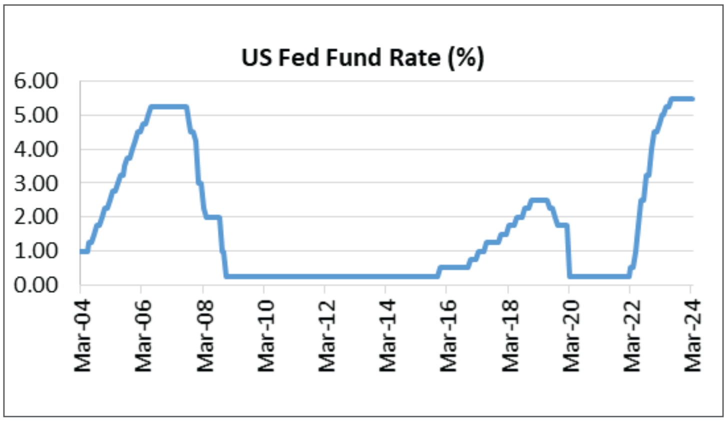
• US real GDP increased by 2.5% in 2023, compared with an increase of 1.9% in 2022. The increase in real GDP in 2023 primarily reflected increases in consumer spending, nonresidential fixed investment, state and local government spending, exports, and federal government spending that were partly offset by decreases in residential fixed investment and private inventory investment. US GDP growth has remained above trend throughout the year. However, growth was weaker in Europe. GDP growth for 2023 increased by 0.5% in both the Euro area and the EU. Germany's GDP contracted by 0.1% in 2023.

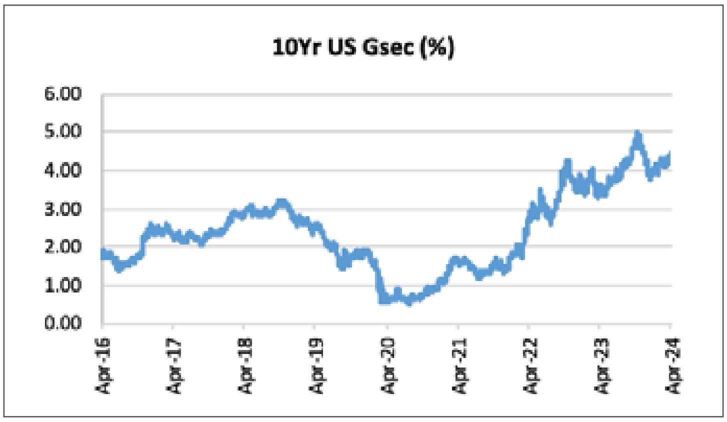
• US CPI inflation has been hovering above 3% since Oct'23. US Core CPI has also been sticky at ~4% levels. Last mile disinflation to return to the 2% target is proving challenging.

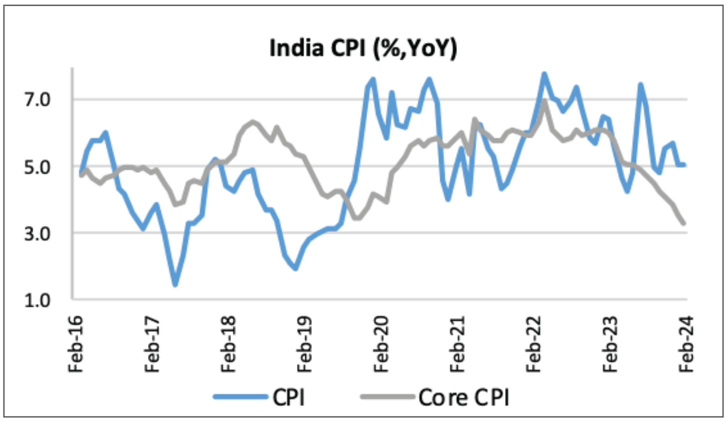
• The US Federal Reserve has kept rates unchanged since July'23 amid resilient growth and sticky inflation.

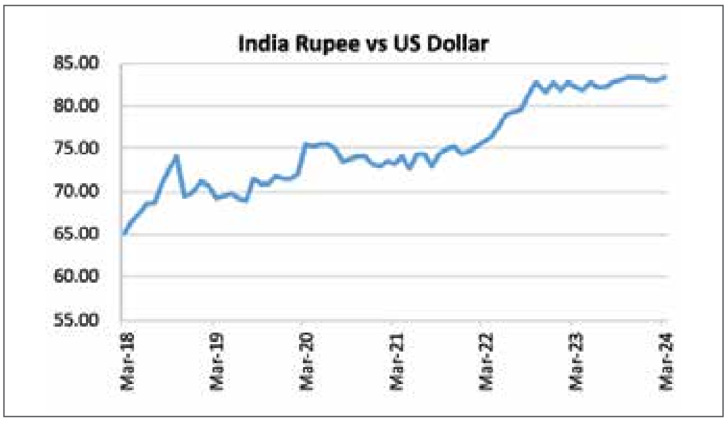
• The Fed has also continued with quantitative tightening, although actual tightening has lagged behind the Fed's announced target. The US unemployment rate has also held up so far, edging up only modestly from ~3.5% in Mar'23 to 3.8% in Mar'24.

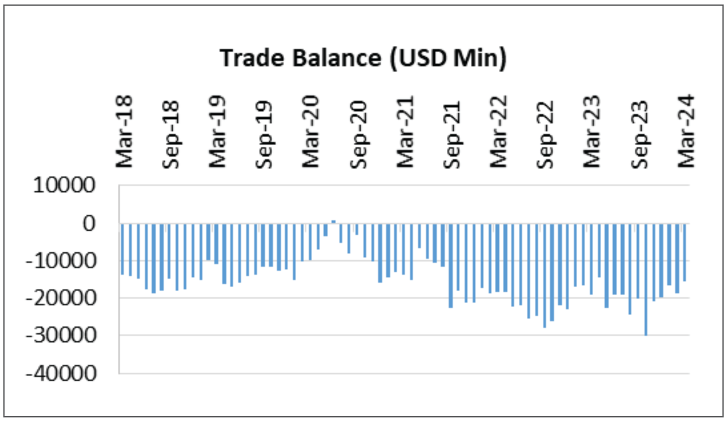
• China's GDP grew by 5.3% in 2023, slightly better than the official target, but the property sector remained sluggish while the country also faced deflationary risks. While there are some signs of improvement in the Chinese economy, with the return of inflation and some rebound in manufacturing, reviving the property sector











and consumer demand still remains a challenge. The Chinese economy is unlikely to be a major contributor to global growth and demand in the coming year. However, the opening up of China has put some downward pressure on prices globally, spurred by robust Chinese exports.

• US yields have moderated from the highs of 5% in Oct'23 with the Fed continuing to factor in three rate cuts in 2024 but remain volatile.

Domestic Macro Review

India CPI:

• India CPI inflation moderated from a high of 7.44% in July'23 and is currently hovering around 5%. Food inflation continues to remain volatile on vagaries in weather, which poses some upside risks to inflation. Meanwhile, Core CPI has been on a moderating trend and stood at 3.3% in Feb'24 down from 5.8% in March'23.

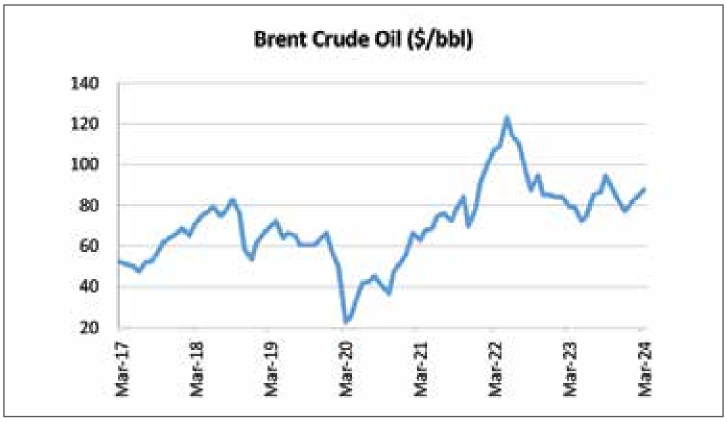
INR & India Trade Deficit:

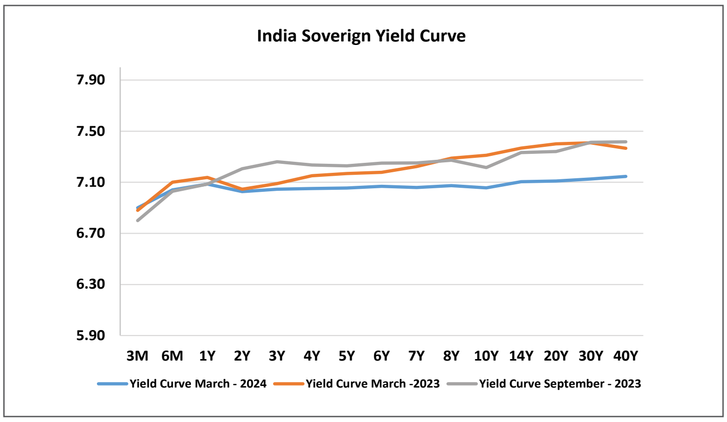
• The INR came under modest deprecation pressure in 2HFY24 and averaged ~83.2 vs. 82.4 in 1HFY24. Volatile crude oil prices, higher gold imports (which temporarily led to a spike in trade deficit), and some FPI outflows in mid-FY24 on the back of a rise in US yields coupled with a stronger dollar added to the pressure on the INR. Nevertheless, the INR has been relatively stable vs. EM peers.

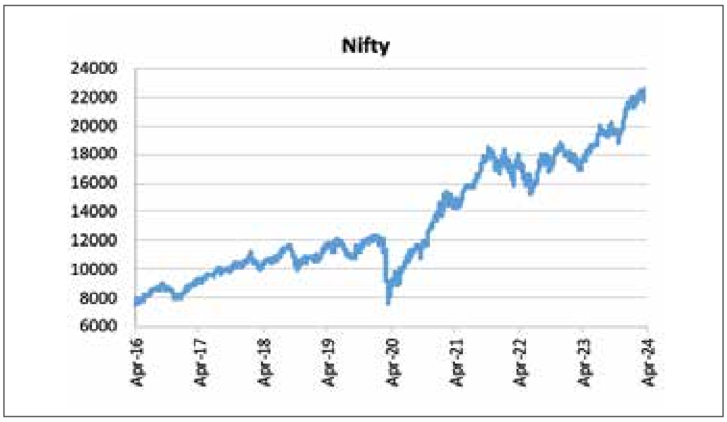
• India's trade deficit witnessed a spike in Oct'23 to nearly US$30bn but has moderated since. The trade deficit averaged ~ US$21.2bn in 2HFY24 vs. US$19.9bn in 1HFY24. Both exports and imports are now witnessing signs of bottoming out, while services exports and remittances have proven resilient. The services surplus has improved from an average of ~ US$12.6bn in 1HFY24 to US$15.6bn in 2HFY24. The CAD for 9M FY24 stood at 1.1% of GDP but may moderate further for FY24 given the strong run rate in services exports.

India GDP:

• FY24 GDP growth is pegged at 7.6% by NSO while GVA growth is seen lower at 6.9%. The wedge between GVA and GDP growth is mainly due to higher net indirect tax collections (on account of lower subsidy payouts). However, GDP growth in India has proven resilient, and there are no signs of a meaningful slowdown. GVA growth in 3QFY24 stood at 6.5% vs. 7.7% in 2QFY24, led by a 0.8% YoY decline in agriculture and some moderation in







manufacturing sector growth. Core GVA (ex. agriculture and government) was however steady at 8.4% in 3QFY24 vs. 8.7% in 2QFY24.

Domestic Markets

Bond Market:

• In 2HFY24, 10 year bond yields witnessed some volatility on RBI's announcement of the possibility of OMO sales. However, yields are largely moderated, supported by some softening in crude oil prices and domestic inflation, a reversal in US yields, and fiscal consolidation. Budget 2024 pegged the fiscal deficit for FY24 at 5.8% (budgeted at 5.9%) and for FY25 at 5.1%. Liquidity remained in deficit for most of 2HFY24, yet 10-year bond yields were largely range-bound. The yield curve flattened further in 2HFY24 on higher short-term rates, despite a downward shift.

• The 10-year AAA spread was largely steady in 2HFY24 at ~40 bps, below historical levels.

Equity Market:

Indian equity markets remained buoyant in 2HFY24, supported by strong domestic flows and some rebound in FPI flows (after some outflows) on expectations of eventual rate cuts by global central banks. Net FPI flows into Indian equities stood at US$7.4bn in 2HFY24 vs. US$17.9bn in 1HFY24. Meanwhile, DII flows stood at ~US$20bn in 2HFY24 vs. US$5.5bn in 1HFY24. Broader markets outperformed. While Nifty 50 was up by 16.4% in 2HFY24, Nifty Midcap 100 was up by 34.5%. Domestic earnings have been supported by moderation in commodity prices and consequent margin expansion despite muted revenue growth. Government capex spending and lower NPAs in the financial sector have also been tailwinds for Indian equities.

Future Outlook

• In 2023 and 2024, global growth has been far more resilient than expected, supported by the continuing impact of pandemic-era fiscal stimulus (especially in the US), strong labor markets, growth in real wages due to a fall in inflation, excess savings with households, and relatively favorable financial conditions despite higher interest rates. The willingness of policymakers to provide support at early signs of distress has also been an important factor in the resilience of the global economy. Going forward, global growth may see marginal moderation or some flattening out.

• While expectations of rate cuts are getting pushed back post the latest CPI print, markets have started pricing in only two cuts for this calendar year versus three cuts, which were envisaged by Fed officials last month on resilient growth and sticky inflation, though central banks continue to hint at the possibility of rate cuts in 2024. The Fed dot plot continues to indicate three rate cuts in 2024, even as growth expectations have been revised up and inflation is expected to persist above 2%. Fed policymakers have also sharply upgraded the US growth outlook for 2024 to 2.1%, from 1.4% in December. The Fed Governor reiterated that risks to achieving its dual goals are moving into better balance but that it does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably down to 2%.

• US yields remain volatile but are off highs of ~5% seen in 4Q2023. Continued quantitative tightening and an elevated fiscal deficit are also adding to the pressure on yields. US yields are likely to see some moderation with the start of the rate-cut cycle. Equity markets have also remained buoyant in hopes of rate cuts, but some volatility cannot be ruled out. The Indian economy and equity market are better placed vs most other markets. Consequently, India could sustain premium valuations over other EMs. FPI flows could also be volatile with still elevated global yields, uncertainty at the start of the rate cut cycle, and some repositioning of EM flows towards China. Nonetheless, the medium-term outlook for Indian equities remains quite strong, and hence long-term investors should use any volatility to their advantage. In the Indian context, given the recent run-up in the broader market, large caps offer relative valuation comfort.

• Geopolitical risks are contributing to volatility in commodity prices and keeping them elevated. However, a sharp rally is unlikely given some flattening out of global growth given growth and inflation divergence in many other larger economies. Moreover, planned supply cuts are propping up prices, and any rally in prices is likely to be met with increased supply. Domestically, food inflation remains a concern due to erratic weather, particularly for products such as vegetables. A good Rabi harvest and a good monsoon may help to moderate food prices. Core inflation, on the other hand, has been on a moderating trend and is hovering ~3–3.5%, far below headline inflation, which is still at ~5%. CPI inflation is expected to average ~4.5% in FY25, according to the RBI's estimate.

• High-frequency indicators in India suggest that growth momentum remains strong, and we have seen consistent GDP growth upgrades. FY24 growth is expected to come in above 7.5%, with FY25 also expected to be a strong 6.5–7%, which is keeping the RBI squarely focused on bringing inflation to the 4% target. Moreover, the back on rate cuts from global central banks is also keeping RBI cautious as it continues to maintain the stance of 'withdrawal of accommodation'. At the current juncture, the RBI is unlikely to precede the Fed in starting the rate-cut cycle. However, it is still reasonable to assume a modest rate cut cycle in 2HFY25, assuming some easing by the Fed. Since the policy rate is expected to remain at current levels in the near term, investors can expect higher carry of their fixed-income investments. However, a modest rate cycle is to be expected, especially given that high real rates can hurt the economy in the medium term. Expectations of foreign fund flows into Indian debt (from Jun'24), favorable demand-supply dynamics in GSec due to lower supply in 1H, expectations of rate cuts, and sustained demand from domestic investors will likely support a further rally in yields in FY25, although a near-term rally is likely to be constrained by still elevated global yields and the recent rally in crude oil prices.

HDFC Life

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