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MARKET OUTLOOK APRIL 2022

April 20, 2022

Equity Outlook

- The BSE-30 and Nifty-50 gained 4% each in March. Mid-cap and small-cap indices were up 5% and 6%. Among sector indices, IT, Oil & Gas and metals were up 9%, 8% and 8% respectively, while auto and consumer durables ended lower, falling 2% each. While global macro saw headwinds with continued geopolitical tensions, recovery post fall in February and BJP winning four of the five states in assembly elections led to rally during the month.
- January Index of Industrial manufacturing (IIP) came in at 1.3% YoY, as expected, but activity levels remain quite weak. On a YoY basis, manufacturing was dull at 1.1%, despite a supportive base and healthy exports. This could partly be due to the Omicron impact. Cyclical components such as capital goods and consumer durables contracted on a contracting base, although infra did well on the back of government spending. Tepid non-durable goods production could be reflecting poor sentiments in rural India.
- Consumer Price Index (CPI) rose to 6.1% in February, from January's 6.0%. Food inflation rose further by 30bp to 5.9%, despite a rising base, helped by vegetables. Core inflation remained sticky at 6% with elevated goods and energy related inflation (>6%), while services remained benign at 4%. Petrol and diesel prices stayed constant due to government price controls, despite a 10% rise in global prices in February. Spike in global oil and food prices, if sustained, pose clear upside risks to CPI, taking it potentially above the RBI's trajectory. Also, domestic fuel price hike adds to the upside. However, weak demand could restrict any sharp rise in core inflation.
- Globally Federal Reserve raised rates by 25 bps, Bank of England raised its key policy rate by 0.25%, Bank of Japan and European Central Bank maintained status quo on rates. The easy global liquidity scenario is receding. In terms of flows, Foreign Portfolio Investors (FPI) remained net sellers for the month, with outflows of USD4.8bn. FPI have been net sellers for six consecutive months now. Domestic institutional investors remained net buyers to the tune of USD5bn. Year to date, FPIs have sold equities worth USD14.6bn while DIIs have bought equities worth USD13.7bn.
- On a year-to-date basis, Nifty 50 is up 1%. NSE Midcap index is up 1,4% while Small Cap index has corrected by 5%. Near term markets likely to remain volatile given headwinds from geopolitical issues and monetary tightening from FED. Historically wars have been temporary deterrent for equities with indices bouncing back within 12-15 months post conclusion of war. Retain cautious positive stance on equities.

Debt Outlook

- Debt market witnessed sharp volatility in the month of March due to War in Ukraine, hawkish US FED, higher crude and commodity prices. The 10-year yield hardened by 7 bps to 6.84%. The yield curve moved by 6-12 bps across the curve in the month of March. The liquidity tightened due to advance tax and GST payment in the mid of the month but eased towards the end on the back of government spending. The short-term rates were volatile but ended at almost similar level as that of in end of February. The 3 month and 1 year T-Bill were trading at 3.72% and 4.55% respectively in the end of March.
- US FED has turned very hawkish and is expected to increase rates and unwind its balance sheet aggressively. Therefore the 10-year US yield has gone up by 40 bps to 2.32%. US FED is expected to raise rate by 50bps in the next policy meeting and may unwind balance sheet by US $ 95bn per month.
- Government of India is going to borrow INR 8.45 lakh crore in the H1 of FY23 which is 59% of total borrowing requirement. Therefore, supply of government bonds could remain a concern for the bond market.
- April-February fiscal deficit is at 82.7% of full year RE FY 22 target, as compared to last year's 76% of FY21 deficit. Gross tax revenues remain strong, with particularly strong performance of direct tax collections. Non-debt capital receipts continue to remain weak at just 36% of Budget Estimate target, as LIC IPO is pushed to the next fiscal. Government should be able to meet the deficit target for FY23 due to higher tax revenue which should offset increase in expenditure due to higher subsidy payments and expenditure due to free food grain distribution.

- In the Monetary policy in April, The MPC maintained status quo on rates and stance. Repo rate unchanged at 4%. Reverse repo and MSF rate unchanged at 3.35% and 4.25% respectively. RBI introduced standing deposit facility (SDF) rate at 3.75 per cent, which will now be the floor of the LAF corridor. All members voted in favor of to remain "Accommodative" while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

- MPC revised the growth projection down to 7.2%. The concern in the growth mainly seems due to geopolitical tension, rising commodity prices, tightening of global financial condition, weaker external demand and supply side disruption. MPC increased inflation forecast sharply to 5.7% for FY23 from 4.5%. The forecast assumes a normal monsoon and average crude oil price of US$100.

- RBI increased the limit under held-till-maturity (HTM) category to 23% from 22% of NDTL (net demand and time liability) till 31st March 2023. The held-till-maturity (HTM) limit would be restored from 23% to 19.5% in a phased manner starting from the quarter ending 30th June 2023. Enhancement of HTM limit is expected to absorb some of supply of government security in FY23 and provide support to the yield curve.

- The policy was very hawkish as there was sharp increase in inflation forecast, RBI's focus on inflation overgrowth and introduction of Standing Deposit Facility (SDF) at 3.75%. The governor in his post policy press conference said that the "sequence of priorities has changed with inflation now in front of growth" which is a deviation from the strategy of preference to growth in last two years. The market is getting prepared for a liftoff in the REPO rate in the next policy. With focus on inflation, MPC may hike REPO rate by 100bps (25bps 4 times) in FY23. We expect the 10-year yield to trade in the range of 7.15%-7.40% in near term due to concern on higher supply, hawkish RBI, higher inflation and sharp increase in rates by US central bank. Having said that, increase in HTM limit and Operation Twist (OT) may cap any sharp upward movement in the yield. The yield curve may bear flattened due to faster normalization by RBI. The corporate bond spread is at very low level and may widen with increase in supply.

Source: Edelweiss Securities, Kotak Securities
