

# Market Outlook

June 2024

## Equity Market

### We are more comfortable with valuations for Large Caps versus Mid and Small Caps

After high volatility in the first week of June, the equity market saw a sharp rally with the Nifty50 index ending the month with 6.6% return, and the NSE Mid Cap 100 and NSE Small Cap 100 indices generating returns of 7.8% and 9.7% for the month, respectively. Market witnessed a sharp correction on the day of the declaration of Union Election results, which saw incumbent the BJP-led NDA government coming back to power for the third consecutive term with a lower majority versus previous term, and also versus the exit poll predictions. However, the index rebounded in subsequent sessions with market getting more confident about the stable government policy continuity.

During the month, indices for Realty, Auto and Information Technology sectors outperformed the broader market, while indices for Energy, FMCG and Pharma sectors underperformed. The month saw the RBI and US FED maintaining status-quo on policy rates, Indian telecom companies announcing the much-anticipated tariff hikes, news-flow of consolidation in the cement sector in India, and Fitch Ratings raising India's GDP growth forecast for FY25 to 7.2% from 7% earlier. On the macroeconomic front, the CPI inflation print for May came at 4.75% compared to 4.83% for April, and IIP growth print for April came at 5%, compared to 5.4% for March. During June, Foreign Portfolio Investors were net buyers to the tune of USD 2.7 bn, while Domestic Institutional Investors remained net buyers to the tune of USD 3.4 bn.

### Going forward

While the ruling BJP-led NDA government has come to power for the third time with a lower majority versus the previous term, recent policy actions and announcements signal stable government policy continuity as seen during the previous two tenures. Corporate earnings announcement for Q1FY25 and the upcoming Union Budget are key near-term monitorable. The recent record dividend pay-out of INR 2.1 tr by the RBI to the Union Government will enable the later to continue on the path of fiscal consolidation in spite of increasing government spending towards reviving rural demand. Steady macroeconomic indicators accompanied by strong corporate earnings growth and stable policy environment have buoyed the markets to their all-time highs. We remain optimistic on Indian equity markets on medium- to long-term basis. However, valuations make us cautious on the near-term return potential. We are more comfortable with valuations for Large Caps versus that of the Mid Cap and Small Cap segments. Limited triggers for further valuation re-rating necessitates focus on capability of the companies to grow cash flows and earnings while reinvesting the same at high rates of return. Companies that can deliver on this potential may continue to benefit from the broader macroeconomic and demographic tailwinds.

## Debt Market

### We expect the 10 yr benchmark yield to keep drifting lower gradually

The month of June 2024 marked a watershed event in the history of the Indian bond markets, as the sovereign FAR securities got formally included in the JP Morgan GBI-EM Index. Though the bond markets had fully factored in the bond inclusion since its announcement last year, nonetheless it marks an important milestone for Indian markets in general, and the bond markets in particular. FPI flows into bond markets had turned positive after the announcement of the inclusion into the JPM GBI-EM Bond Index last year, with more than USD 12 bn flowing into Indian bonds since then. Incrementally also, inflows to the tune of USD 15-20 bn can come in over the course of FY25.

Bond yields were range-bound in June, as the unexpected results of the General Elections cooled off the expectations of further reduction in the fiscal deficit which the bond markets had started to expect after the bigger than expected dividend to the government declared by Reserve Bank of India (RBI) in May. Apart from this, the Monetary Policy Committee (MPC) meeting also did not provide much cheer to the bond markets, as MPC members continued to sound cautious on the risks posed from food inflation even as two of the three external MPC members voted for a rate cut citing high real rates. The bond markets bull flattened during the month as the

longer end of the curve outperformed, with yields at the longer end of the curve falling by 5-7 bps, whereas yields were higher by 2 bps in the belly of the curve and yields at the shorter end of the curve were down by 3 bps. The benchmark 10 yr bond ended the month at a yield of 7.02% - 2 bps higher from previous month's closing. The longer end of the curve outperformed on the back of strong investor demand from Insurance and PFs, apart from higher trader interest ahead of the index inclusion. Demand supply also favours the longer end of the curve. The bond market is expecting the government to stick to the fiscal deficit target of 5.10% as was stated in the Interim Budget. Global Bond yields also cooled off with the benchmark US 10 yr bond yield down by 10 bps on back of relatively softer economic data.

CPI inflation came in line with expectations at 4.75% with further deceleration in core inflation, which came in at 3.10%. With respect to food inflation, monsoons will be the key variable to watch out for over the next couple of months. Meanwhile RBI continued to sound cautious on credit growth, especially the growth in unsecured lending as the RBI Governor, in an address, cautioned banks to be wary of risks while pursuing growth opportunities. Perhaps this caution is justified by the growth seen in unsecured loans, as according to a report by The Associated Chambers of Commerce & Industry of India and ICRA on NBFCs, the unsecured loans by NBFCs have grown by a CAGR of 32% during FY17-24, which is double the rate of growth seen in secured loans like vehicle, home and gold loans. RBI, in its latest Financial Stability Report, reiterated the resilience of the Indian financial system with NPAs at decadal low levels, and even under extreme stress the GNPA and CET1 for the banking system will be 3.40% and 10.80% respectively compared to the current levels of 2.80% and 13.80%. Personal loans and credit card delinquencies have gone up and there is stress in the less than INR 50,000/- loan ticket-size. After RBI increased the risk weightages last year, bank lending to the NBFC sector has moderated to 14.6% in April 2024 from 18.90% in November 2023. The Financial Stability Report also highlighted rising financial liabilities of the household sector with overall savings dropping to 18.4% of GDP in FY23, compared to an average of 20% in the previous 10 fiscals. The current account recorded a surplus of 0.60% of GDP for quarter ended March 2024 compared to a deficit of 1% of GDP for quarter ended December 2023. During FY25, the current account deficit is expected to be in the vicinity of 1% of GDP.

Banking sector liquidity tightened due to advance tax and GST outflows in June, but RBI actively injected liquidity to prevent any sharp spikes in short-term rates. INR was range-bound during the month, though on the back of general emerging markets and Asian currency weakness it hit an all-time low of 83.65 during June before recovering and ending the month at 83.39 as compared to last month's closing of 83.47.

The OIS curve was also range-bound during the month with the 1 yr OIS down by 3 bps, ending the month at 6.82% while the 5 yr OIS was flat at 6.44%. The 1 yr OIS is not pricing in any rate cuts over the course of the year.

Strong GDP growth rate, stable inflation and stronger external position underscore the current strong macroeconomic position of India providing a tailwind for markets.

Going ahead, we believe that RBI is likely to be on a long pause and is likely to start cutting rates only after the developed market central banks start their rate cutting cycle. In this context the ECB has reduced its policy rates and the BOE is also expected to cut rates soon. Given the current growth-inflation dynamics in India, we believe that rate cuts will start from Q4-FY25 onwards. Markets tend to react before the start of a rate cutting cycle, and any retracement in the yields offers a good opportunity to investors to increase their allocation to fixed income, as real and nominal yields remain attractive with favourable demand-supply dynamics playing out in the sovereign bond market. We expect the 10 yr benchmark yield to keep drifting lower gradually and converge with the policy repo rate before the start of the rate cutting cycle.

## Fixed Income Market

	May 2024	June 2024	Change (in bps)
Overnight rate (NSE MIBOR)	6.76%	6.86%	10
1 yr CD	7.65%	7.67%	2
10 yr GOI Yield	6.98%	7.00%	2
INR/USD	83.47	83.39	8 paise
IIP (Monthly with 2 month lag)	5.40%*	5.00%	-40
CPI (Monthly with 1 month lag)	4.83%	4.75%	-8
5 Yr AAA PSU spread (bps)	40	45	5
5 Yr OIS	6.44%	6.44%	0
US 10 Yr yield	4.50%	4.40%	-10
CRR	4.50%	4.50%	0
REPO	6.50%	6.50%	0
SDF (Standing Deposit Facility)	6.25%	6.25%	0

\*revised from 4.90%

Source: RBI Weekly Statistical Supplement & Bloomberg

**Note:** IIP has been revised lower for the previous reading.