Market Outlook

May 2023

Equity Market

Positive momentum continues

Amid global volatility, Indian markets delivered a healthy 2.6% return in May 2023. The mid caps and small caps outperformed the large caps with their respective indices being up by 6.2% and 5.1% respectively. During the month Realty, Auto, IT and Staples outperformed, while Infra, Energy and Pharma sectors were the laggards. Amid a challenging global macro backdrop, India Inc.'s profitability remained relatively healthy in 4Q-FY23. The NIFTY Index reported YoY Revenue/EBITDA/PAT growth of 13.2% /12.4% / 15.9% respectively for Q4-FY23. It ended FY23 with YoY Revenue/EBITDA/PAT growth of 23.4% /9.6% /10.4% respectively. For FY23 the corporate earnings were mainly driven by Financial & Auto sectors while global commodities such as Metals and Oil & Gas sectors were the key laggards.

On the macro side, Q4-FY23 GDP print came in at 6.1% (vs. 4.4% in Q3) and was higher than market expectations. The FY23 GDP growth stands at a healthy 7.2%. CPI print eased to 4.7% in April and was within the RBIs tolerance limit of 6%. Wholesale Price Index (WPI) continues to be muted and came in at -0.92% vs 1.34% in March lending some breathing space to the central bank. GST collections for May stood at Rs 1.57tn, witnessing a growth of 12% YoY and March Index for Industrial Production (IIP) came in at 1.2% versus 5.8% in February, highlighting continued improvement in macro fundamentals. The US Federal Reserve increased interest rates by 25 bps and hinted at a potential pause in the rate hike cycle, as it awaits the economy to respond to the monster hikes in rates undertaken in the previous year. In a routine currency management exercise, the RBI notified the withdrawal of Rs 2,000 denominated bank notes which will continue to be legal tender. IMD retained its forecast of a normal south-west monsoon at 96% of the long-period average (LPA), which will help in further improving the domestic inflation outlook and help elevate rural incomes. FII flows helped the market momentum, and they continued their buying spree to the tune of $4.9bn in the month, while DIIs turned sellers to the tune of $406mn.

Going forward

In the near-term, market focus would shift towards the general election schedule in 2024. As we approach closer to the date, we may see increased market volatility due to speculation about the election outcome. We are of the view that these are transient factors and would advise investors to look past these factors to benefit from the long-term India growth story. We continue with our positive stance on the Indian equity market from a medium to longer term perspective. With global economies seeing growth slowdown in an inflationary environment and uncertain geo-political situation, India appears favourably placed due to its relatively higher GDP growth rate and moderating inflation outlook. Higher proportion of working-age population, rising household income and stable government policy will act as structural growth drivers for the economy. Corporate India, by and large, is expected to see strong earnings growth on the back of this structural demand outlook coupled with its strong balance-sheet. From a valuation perspective while the equity indices are trading at a premium to their underlying fair values, due to strong growth in fair values the potential return remain reasonable for the medium to long term investors.

Debt Market

Bond rally runs full steam in May

The Bond market rally continued for the third consecutive month in May as the benchmark 10-yr bond yield touched a low of 6.96% as lower inflation buoyed sentiments. The yield curve bull flattened as investors' demand continued unbated for long tenure securities. The Indian bond rally which started in mid-March as a result of the fall in developed market bond yields on back of the regional banking crisis in the US has continued to run full steam despite the selloff in developed market yields where bond yields sold off in May with yields retracing back close to their March levels. The benchmark 10-yr bond yield has fallen by almost 50 bps since the highs of mid-March. Indian growth is proving to be resilient as the Q4-FY23 GDP number came in much higher than expected, largely because of the strong Q4 performance. The provisional estimate for FY23 GDP growth came in at 7.20% as compared to the second advance estimate of 7.00%. Sectors that contributed to the strong growth in Q4 were manufacturing, agriculture and construction. Manufacturing Purchasing Managers Index (PMI) for May also came in at a 31-month high of 58.7, following April's service Purchasing Managers Index (PMI) of 62-a multiyear high. RBI announced higher than expected dividend of Rs. 87,000 crore giving the government some fiscal space and this dividend payment will also infuse liquidity in the banking system. RBI also announced the withdrawal of Rs. 2,000/- notes though it continues to be legal tender. This will also result in increasing banking liquidity through increase in Bank's deposit. Inter-bank liquidity has improved in the last week of May to touch a surplus of Rs. 2 lakh crore. Internationally, inflation, especially 'core' Inflation continues to be sticky, and growth continues to be strong especially in the US. The US bond markets are currently pricing in a 25 bps rate hike by the US Fed by July. US Fed speakers have given mixed views, but the consensus is tilting towards a pause in June followed by a hike in the July FOMC Policy. Further policy tightening is expected from European Central Bank (ECB), Bank of England (BOE) and Reserve Bank of Australia.

We believe that RBI is in for a long pause though we think that the monetary policy stance will be changed to neutral either in the upcoming June MPC Policy meeting or the August MPC meeting to indicate RBI's comfort with the inflation trajectory.

INR was volatile and depreciated by 1% during the month as USD strengthened. RBI also bought USD to shore up FX reserves which may have contributed to the INR weakness. Equity portfolio flows continued at a robust pace in May. Crude dropped by 8.60% during the month on concerns of slack in demand as Chinese recovery remains lacklustre.

We expect the 10-yr benchmark bond to trade in a range of 6.90% to 7.20% over the next one month.

Fixed Income Market

	April 2023	May 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.90%	6.40%	-50
1 yr CD	7.45%	7.40%	-5
10 yr GOI Yield	7.12%	6.99%	-13
USD/INR	81.83	82.73	90 paise
IIP (Monthly with 2 month lag)	5.80%	1.10%	-470
CPI (Monthly with 1 month lag)	5.66%	4.70%	-96
5 Yr AAA PSU spread (bps)	31	31	0
5 Yr OIS	6.03%	6.06%	-3
US 10 Yr yield	3.42%	3.64%	22
CRR	4.50%	4.50%	0
REPO	6.50%	6.50%	0
SDF (Standing Deposit Facility)	6.25%	6.25%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg