IIFL ASSET MANAGEMENT

MONTHLY FACTSHEET

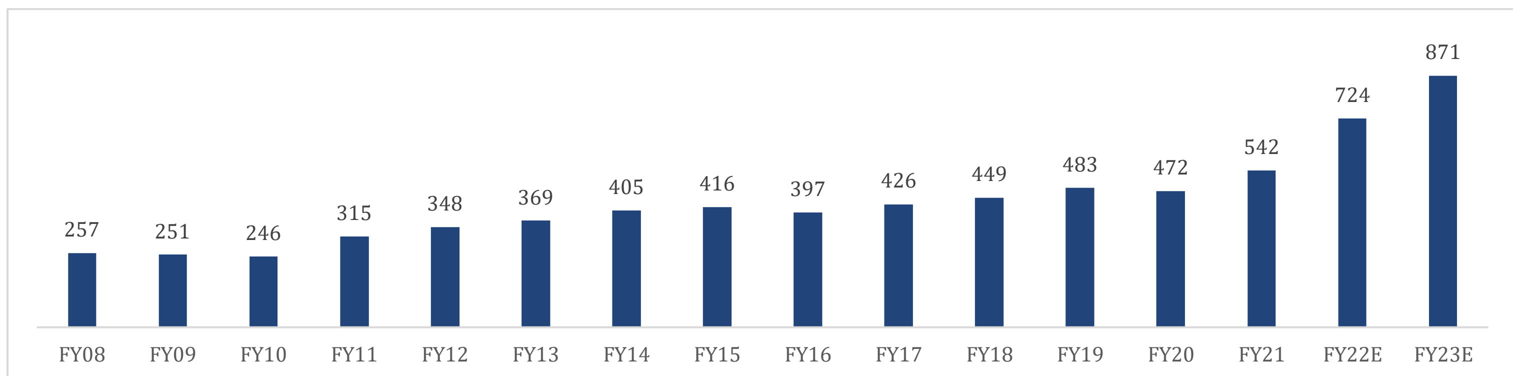
May 2022

Mutual fund investments are subject to market risks, read all scheme related documents carefully.

Macro Economy & Event Update

Macro-Economic Indicators	Apr-22	Mar-22	Feb-22	Jan-22	Dec -21	Nov-21
Consumption						
Two-wheeler sales (units - %YoY)		-20.9	-27.3	-21.1	-10.8	-34.4
Passenger car sales (units - %YoY)		-12.1	-13.9	-17.3	-23.1	-32.7
Personal Loans: Credit Card Outstanding (Rs. Mn % YoY)		12.6	9.9	9.3	13.0	6.8
Nominal Rural wages (% YoY)			-2.1	-1.7	0.0	6.0
Industrial Sector						
Industrial Output (%YoY)			1.7	1.5	0.7	1.0
Manufacturing PMI	54.7	54.0	54.9	54.0	55.5	57.6
Railway freight Container Service (Ton Mn - %YoY)	11.4	6.8	6.3	7.3	8.9	9.6
Energy Consumption (MU - % YoY)	11.5	5.9	4.5	1.1	2.8	2.1
Aviation Cargo* (in Th Tones - % YoY)		0.3	-2.8	0.5	6.9	6.2
Inflation						
CPI (%YoY)		7.0	6.1	6.0	5.7	4.9
WPI (%YoY)		14.5	13.1	13.0	14.3	14.9
Deficit						
Fiscal deficit (% of full year target)			82.7	58.9	47.7	43.7
Trade Balance ($ bn)	-20.1	-18.5	-20.9	-17.4	-20.6	-21.1
Services						
Air passenger traffic: Domestic (% YoY)		37.3	-1.3	-16.8	52.7	65.1
GST collections (Rs. Bn)	1675.4	1421.0	1330.3	1383.9	1297.8	1315.3
E-way Bill (Mn)	75.2	78.2	69.1	68.8	71.6	61.2
Direct tax collection (% YoY)			19.5	28.3	41.8	28.0
Money & Banking						
Bank Credits (Rs. Tn- %YoY)	9.5	8.6	8.1	7.1	9.4	6.9
Industry Credit (Rs. Mn - %YoY)		7.1	6.5	6.4	7.6	3.8
Deposits (Rs. Mn- %YoY)	8.9	8.9	8.6	8.3	12.1	8.9
Currency in circulation (Rs. Tn - %YoY)	10.4	9.9	8.6	8.0	7.6	7.9
Forex reserves ($bn)	597.7	607.3	631.9	629.9	633.6	638.0
INR/USD (month end)	76.4	75.8	75.3	75.0	74.3	75.1
10Y G-Sec yield (%)	7.1	6.8	6.8	6.7	6.5	6.3
Flows						
Net FPI flows: Equity ($bn)	-2.2	-5.4	-4.7	-4.5	-2.5	-0.8
Net FPI flows: Debt ($bn)	-0.6	-0.7	-0.4	0.7	-1.6	0.1
MF flows: Net Equity ($bn)	2.9	3.0	1.4	2.2	2.9	3.2
DII ($bn)	3.9	5.2	5.6	2.6	4.1	3.6

Nifty EPS



Source: Bloomberg, RBI, Motilal Oswal for EPS, Spark Capital.

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Equity Market

Indian Equity Markets: Looking beyond the war!

The markets began April'22 on an optimistic note with strong GST numbers, correction in crude oil prices and resilient underlying demand. However, downward revision in India's GDP growth by both World Bank & IMF, uncertainty on peace talks between Russia-Ukraine and Fed Chairman's statement hinting a 0.5% rate hike dragged the markets. The key benchmark indices S&P BSE-30 and Nifty-50 indices closed the month in red correcting 2.6% and 2.1% respectively. The indices down the capitalization curve outperformed the key benchmark indices. S&P BSE Mid-cap index and S&P BSE Small cap index registered monthly gains of 1.3% & 1.4% respectively. Amongst the sectoral indices, S&P BSE Infotech, Teck and Realty were amongst the biggest losers and registered a month on month loss of 12.1%, 11.7% and 4.2% respectively. Meanwhile, BSE Power, FMCG & Auto closed in green and recorded monthly gains of 18.1%, 5.6% and 4.8% respectively. FPIs continued to be net sellers for the seventh consecutive month, to the tune of $2.2 bn in April'22. However, DIIs were net buyers to the tune of $3.9 bn in April'22.

Amongst the key developments during the month, the RBI kept repo rate unchanged at 4% (though subsequently did a 40bps rate hike on 4th May 2022), World Bank cut India's FY2023 GDP growth forecast to 8% from 8.7%, IMF cut India's FY2023 GDP forecast to 8.2% from 9% earlier, US Fed chairman hinted 50 basis point rate hike, news about LIC IPO opening for public subscription in May'22 came to the fore and DCGI granted emergency use authorization to Covaxin for 6-12 years age group and Corbevax for 5-12 years age group.

The manufacturing PMI clocked a strong start to the financial year FY23 rising 54.0 in March'22 to 54.7 in April'22. The data released showed that the withdrawal of Covid-19 restrictions continued to support demand. The rate of new order growth was faster than that seen in March'22. Resonating the trend seen for new business, the rate of output growth quickened in April and outpaced its long-run average. Meanwhile, the gross GST revenue collected in April'22 stood at an all-time high of INR 1.68 trillion, highest since its roll out in July 2017. It surpassed the previous highest GST collections of Rs 1.42 trillion recorded in March 2022, implying strong economic activity despite the current geopolitical situation.

MPC hikes rates

While the sudden announcement of 40bps hike in repo rate and 50bps hike in Cash reserve ratio (CRR) came as a surprise, it was required to arrest the soaring inflation. Central bank showed a stronger intent of liquidity withdrawal by hiking CRR. Given the Inflation print of 7% in March, there were already expectations of repo rate hike in the April meeting itself but surprisingly RBI didn't act at that point of time. RBI expects significant upside risks to the inflation trajectory set out in the April statement of the MPC due to prolonged war conditions and supply-side challenges. Interestingly, this sudden announcement came just before the expected rate hikes from the upcoming US Fed meeting. Clearly, RBI did not want to stay behind the curve and let Indian rupee to weaken as Fed raise rates.

This is beginning of rate upcycle and gradual withdrawal of excess liquidity. It negatively impacts broader market valuations. Specifically, for banks, it seems this entire move would be margin accretive for banks having larger proportion of loans linked to Repo and sitting on comfortable liquidity. However, a series of potential rates hikes can slow down the recovery in system credit growth.

Technology stocks tumble – Is the pain over?

The correction in Indian IT services stocks has been largely due to decline in valuation multiples while earnings remaining largely stable. This is due to increase in risk premium due to Fed tightening, and rising margin headwinds owing to high attrition, salary hikes and resumption of travel costs. Also, the risk of cut in IT budgets of bulge bracket clients in US is being factored in. Post this correction, risk-reward has become decent as demand remains extremely robust and supply side constraints may reduce gradually over the next few quarters. Companies across market capitalizations having strong focus on cloud, digital transformation and data analytics can deliver reasonable returns over the next few years.

Earnings Season and expectations

It has been a mixed earnings season so far. IT services companies have reported a slight miss in operating performance. Leading banks have reported better than expected asset quality. Few Auto and Cement companies have reported better than expected margins though sustenance of the same is questionable. While earnings season is still underway, we see downgrades in earnings to set in and continue even in the subsequent quarter. The negative impact of the commodity price inflation on corporate margins would reflect more prominently in the first half of this financial year.

Spillover from Russia – Ukraine crisis

Russia-Ukraine war has led to incessant rise in energy prices due to supply disruptions especially when global demand is recovering. Energy has become the most critical sector amongst the commodity complex for our economy. In this commodity bull cycle, we are most negatively impacted by oil and gas prices. At current oil price of around $100/bbl, our current account deficit is likely to be around 2.8% in FY23 versus around 1.5% deficit in FY22. A $10 rise in crude negatively impacts current account deficit by 50bps. Also, rising fuel prices have incessantly raised inflation. Indian economy is becoming a victim of other nations' war. Any further supply shock-led rise of crude price for a long time could be quite detrimental. It not only impacts the twin deficits but also slows demand recovery.

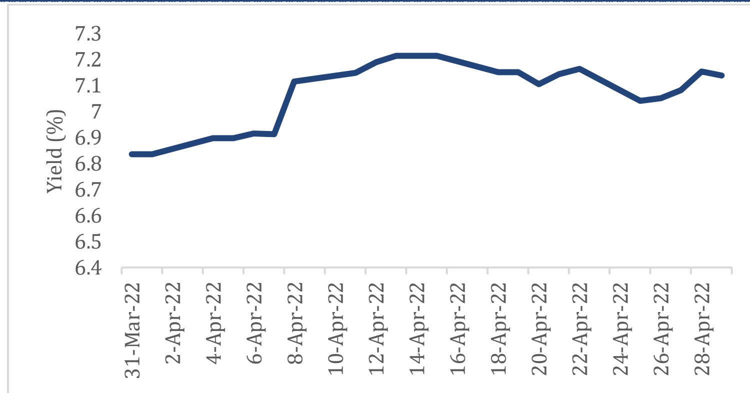
Outlook

Despite significant FII outflows ($17bn YTD), Indian equities have outperformed broader global markets on the back of strong domestic flows. While domestic investors' optimism on local factors has given strong support to the market, there are certainly emerging signs of worry. We do see downgrade risk to economic growth and corporate earnings emanating from rising inflationary pressure and slowing demand. Surge in commodity prices has led to a series of price hikes across sectors. This has already started to dent demand on the ground. While nominal revenue growth would remain supported by price hikes, volumes are likely to weaken. Combination of margin pressure and speed-breaker in demand recovery can lead to earnings downgrade in the short term.

Given the uncertainty in the short term and potential downgrades in corporate earnings, we would like to have a balanced approach in our portfolio strategy. We continue to have good mix of domestic cyclicals and defensives while maintaining core comprising of long term secular businesses.

Debt Market

10 Year Benchmark Bond Movement



Spread Movement

Spreads	Maturity Period	AAA	AA	A
29-Apr-22	1 Yr	5	73	281
	3 Yr	30	90	296
	5 Yr	3	68	291
	10 Yr	17	90	299
31-Mar-22	1 Yr	28	86	295
	3 Yr	15	83	274
	5 Yr	10	79	289
	10 Yr	34	111	300

Bond yields continued its northward journey in wake of rising U.S. rates and falls-outs of Russia-Ukraine war, the Indian 10-year benchmark paper rose by 30 bps to close at 7.14%. Surge in Dollar index to ~103.50 (last seen in 2002) on back of expectation of higher and faster rate hikes in U.S resulted in volatility across asset classes during the month.

Investors were relieved earlier in the month of April as RBI did not raise rates. The policy undertone was hawkish underpinned by the sharp upward revisions in MPC's inflation forecasts keeping stance unchanged and introduction of the Standing Deposit Facility (SDF) as monetary tool for sucking out excess liquidity. During the month, Bond yields rose 25-40 bps across the yield curve after March inflation print of 6.95% and financial year borrowing program began. Corporate bonds outperformed by smaller margin due to lower primary issuance from corporates and subdued demand from long-only investors been start of the financial year. On the money market rates, yields inched up by average 25 bps with sucking of excess liquidity through VRRRs and other monetary tools. From a high of INR 9.1tn in September 2021, system liquidity has come down to INR 5.3tn now (SDF and VRRR absorption at INR 6.4tn).

The trade data for Apr'22 trade was impressive as exports grew 24.2% YoY, while imports were up 26.55% YoY. India's exports continued to outperform the rest of Asia in Apr'22 (as they did in CY21, and Q1CY22): "Non-oil & G" imports (i.e., imports of products other than oil, gold, silver and jewellery) – an indicator of domestic demand – grew 29.7% YoY, suggesting a strengthening recovery in domestic demand. This was corroborated by the 11.1% YoY growth in bank credit (reported for the fortnight ending 22nd Apr'22), the first time since Aug'19 that bank credit had grown at a double-digit YoY pace. Strong government revenue growth (far above the government's own estimate for FY22) will ensure that the government's market borrowing requirement will be far lower than officially forecast, helping to crowd in private investment.

Indian economy is witnessing tax buoyancy currently, which is helping the Govt. navigate a tight fiscal situation. Tax buoyancy at 1.7x in FY22 increased to the highest level since FY08. The direct tax collection as % of GDP has increased sharply to 6.1% in FY22, the highest since FY09, vs. 4.8% in FY21. Also, indirect tax collections as % of GDP inched up to 5.6% in FY22, following 5.5% in FY21. A record-high GST collections in Apr'22 indicate that the tax buoyancy continues in FY23 as well. However, this data is for economic activities that took place in the month of Mar'22, which is the ending month of the fiscal year in India. The GST collection in Mar'22 was ~Rs. 200bn higher than the previous months. So, we can expect a monthly GST collection run rate of Rs. 1.4-1.45tn in FY23E, which is higher than the Govt.-budgeted GST collection run rate of Rs. 1.3tn a month.

In a surprise move, RBI MPC unanimously decided to hike repo rates by 40bps in an unscheduled meet on 2-4 May 2022 (next scheduled meet on 6-8 Jun). Stance remains accommodative with focus on "withdrawal of accommodation". This action reflects RBI's sense of significant upward inflationary risk that now requires a front-loaded response. Given the background of rising global and domestic inflationary pressures and an impending 50bps hike by US Fed along with announcement of QT, RBI chose to frontload the Indian monetary policy cycle where quantum was higher than our and market estimates for June meeting of 25bps hike.

Repetitive narration of "pre-covid levels" by RBI governor in his speech suggests RBI would be in hurry to reach the 5.15% repo rate levels. Given that the Governor had earlier stated in last 2 meetings that the RBI's actions would be "well calibrated and well-telegraphed", this sudden action within some weeks of previous policy when external factors have not changed much would make investors more nervous especially the duration bond buyers. The disappointment was evident, as yields rose across the yield by 40-50 bps both in G-sec, OIS and corporate bond markets leaving lot of questions unanswered like the rush to immediately suck back liquidity of 87k crore through 50 bps CRR rate hike while still maintaining the accommodation stance this would aid in the transmission of policy rate hikes in the economy. The revised inflation forecast at the next meet (8 Jun) might peg 40-50 bps higher inflation estimates for the financial year. Our view of 5.50% as the terminal repo rate was based on an assessment that RBI was willing to take repo rates towards Jun-2019 levels hence we built ~100 bps repo rate hike during this financial year—depending on where inflation is seen peaking off.

Outlook:

The long period of above- US$75/bbl crude oil price will inevitably induce higher production of shale oil in the US, thereby adding to global oil/gas supplies by Jul-Sep'22. These supplies will come onto the market just as the EU economy slows sharply (particularly in response to the impending EU ban on oil imports from Russia), thereby causing Brent crude prices to decline sharply hence we expect commodity prices and inflation to cool off in 2HFY23 in conjunction with lower growth and decreasing demand-side inflation outpacing the supply-side constraints across the major economies.

Outlook on inflation rate: Rising food inflation, which has 46% weightage in CPI, has exacerbated the inflation outlook for FY23. However, as the pass-through of higher oil prices would be fully built into the CPI in Apr'22, we see CPI inflation peaking out in May'22. The impact of rising raw material cost is reflecting across most categories as corporates continue to pass on higher input costs to final consumers Based on crude oil price assumptions, we built in three scenarios for CPI inflation in FY23: i) CPI to be 5.5% if crude oil @$80/bbl, ii) CPI at 6.5% if crude @$100/bbl and iii) CPI at 7.5% if crude @$120/bbl in FY23E. The pandemic-peak was 7.61% seen in Oct'20.

Fiscal outlook: As per our estimate, the central government could garner ~Rs. 2tn tax revenue over and above the budgeted targets for FY23 on account of higher-than-budgeted collections from GST (Rs. 600bn) and direct taxes (Rs. 1.4tn). In addition, there is a possibility of revenues from FCI's inventory gains (Rs. 550bn), higher dividend from RBI (Rs. 250bn), and higher divestment (Rs. 650bn). On expenditure front, Fertilizer subsidy could jump by an additional Rs. 1tn over the budgeted amount of Rs. 1tn. Also, the Govt. can absorb Rs. 5/ltr cut in excise duty (a total revenue loss of ~Rs. 700bn). Therefore, we believe that the additional revenue mobilization in FY23 is enough to offset the negative impact of high crude oil prices and higher fertilizer subsidy on Govt. fiscal math.

The historical spread between the 5 Year G-Sec and Repo rate is ~130 bps. However, the current yield curve is steep and spread between 5 Year G-Sec and Repo stands at record ~282 bps which factors in rise in some part of the expected rate hikes offering investors risk-adjusted yield. We expect RBI to increase rates further and the pace towards normalization is likely to be faster than expected. Bond yields may see upward pressure in the near term although a spike above 7.5% may be met with RBI intervention. A favorable credit to deposit ratio and liquidity will ensure that lending rates will only rise gradually, favoring bank credit growth. The second half with lesser supply, some softening in inflation and rate expectation well anchored could see some relief to yields. In near-term, market will focus on US Fed policy, slowing growth numbers, and geopolitical tensions. We expect 10-year bond yield in range of 7.25-7.75% in the near term.

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