

# 'Stasis' Or One Last Bitter Pill ?

18<sup>th</sup>Apr23

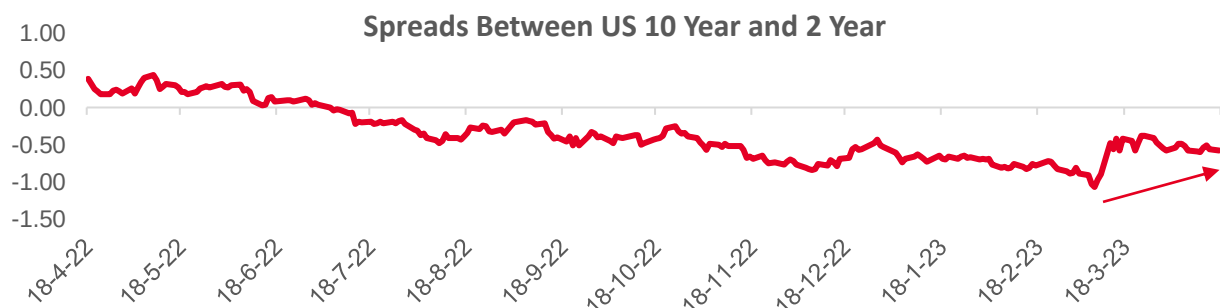
The US FOMC is scheduled to meet on the 2<sup>nd</sup> and 3<sup>rd</sup> of May'23 to deliberate and decide on the future interest rate trajectory. While this event will be keenly awaited as has been the case with all previous FOMC meetings, this may well turn out to be one of those epochal ones if market participants are to be believed as they anticipate the committee to deliver the last rate hike of 25 bps in this current hiking cycle or even decide to pause the rate hike cycle altogether. Let's check how data on the ground has been emerging over the past month in the US.

The jobs data for Mar'23 painted a robust picture yet again. While Non-Farm Payrolls added 236,000 jobs for the month, the unemployment rate fell to 3.5% from 3.6% last month. However hourly wage growth declined from 4.6% in Feb'23 to 4.2% last month (Slowest since Jun'21) while jobless claims rose by 13,000 to 251,000 which was the highest since Jan'22 hinting at some cool-off in job markets and the economy at large. The Tech sector has led the job cuts after witnessing aggressive hiring during and post the pandemic.

Mar'23 US CPI release hinted at moderation in the inflation trajectory, registering a YoY and MoM growth of 5% (exp 5.1%) and 0.1% (exp 0.2%) respectively. This compares favorably to last month's 6% YoY and 0.4% MoM growth. The decline was primarily led by a 3.5% drop in energy prices while shelter costs (which contribute 1/3<sup>rd</sup> to CPI) increased at the slowest pace since Nov'22, by 0.6%. Core inflation grew 5.6% YoY and 0.4% MoM, in line with market expectations.

The continued decline in headline CPI numbers along with moderating labor markets is anticipated to aid the FOMCs decision on a relatively benign interest rate trajectory ahead.

**Market Impact:** US 2-year and US 10-year yields witnessed steep corrections over the past month with the shorter end broadly holding below 4% levels for the past while US 10 Year yields below the 3.5% handle. Post favorable CPI release, both 2- and 10-year yields declined to 3.87% and 3.42% relatively but then gave up all the gains over the month to trade at 4.19% and 3.60% respectively as of 18<sup>th</sup> Apr'23. The spreads between US 2 and 10-year yields have witnessed moderation as can be seen in the graph below. All major US equity indices were up over the past month primarily buoyed by expectations of a change in policy stance as well as better than expected Q1CY'23 earning releases till now, with S&P 500, Dow Jones, and NASDAQ Composite posting gains of 5.0%, 5.4% and 4.1% respectively. USD Index weakened over the past month, falling sharply from 105 levels to trade around 101.7 levels highlighting the weakening of the USD against major currencies.



**BoJ continues accommodative stance, BoE at fag end of its hiking cycle while ECB upholds hawkish projections :**

The new Bank of Japan Governor Kazuo Ueda reiterated the continuation of Kuroda's accommodative monetary policy for the time being and his adherence to keeping 10-year yields at 0.5% and short-term rates at -0.1% to induce consumer spending and revive the economy. With CPI at the 3% mark, BoJ expects the same to realign to the targeted 2% range primarily owing to a reduction in import costs. The market anticipates the BoJ to relinquish the accommodative policy stance towards the latter half of the calendar year although the timelines are relatively opaque at this current juncture.

The European Central Bank (ECB) delivered on a much anticipated 50 bps hike in benchmark rates in their meeting held on 16<sup>th</sup> Mar'23, taking benchmark rates to 3%. CPI release for March though hinted at some relief with the headline inflation registering a YoY growth of 6.9%, significantly below an 8.5% spike in Feb'23. However, comments from all ECB members including the ECB chair Christina Lagarde hint at further tightening measures as they continue to target a 2% CPI level. We anticipate the ECB to deliver on a 25bps rate hike in their 4<sup>th</sup> May Policy decision which may be followed by another 50 bps rate hikes in two tranches till July'23, thereby taking the terminal rate to 3.75%.

Bank of England (BoE) also hiked benchmark rates by 25bps in Mar'23 to 4.25%, the latest one being the 11<sup>th</sup> consecutive hike in interest rates since Dec'21. The Monetary Policy Committee is scheduled to meet again on the 11<sup>th</sup> of May'23 and it is anticipated to deliver another 25bps hike in rates which could well be the last hike in the current cycle, thereby taking terminal rates to 4.5%. Inflation continues to flare in the UK, with Feb'23 CPI at 10.4% and expectations of a near 10% increase in Mar'23.

**Market Impact :**

**Japan** – Japanese Yen, continued its downward slide against the USD last month primarily owing to central bank policy divergence and currently trades around the 134 handle. 10 Year Japanese Government Bond yields are currently trading at 0.48% around the targeted 0.50% bps managed yield barometer while Nikkei continues to be upbeat, posting gains of nearly 7% over the past month.

**Euro Zone** – Euro/USD currency pair has witnessed a steady appreciation and currently trades near the 1.10 handle primarily owing to more hawkish ECB policy expectations vis a vis US Fed's policy actions. Euro Stoxx 50 continues to benefit from a relative 'risk on' environment, being up nearly 7% for the past month.

**England** – GBP USD has also benefitted from a broader decline in USD levels and currently trades around the 1.24 handle. Elevated inflation prints continue to keep 10-year yields higher around 3.75%. FTSE followed its major developed market peers and gained nearly 7% over the past month as well.

## Gold continues its up move :

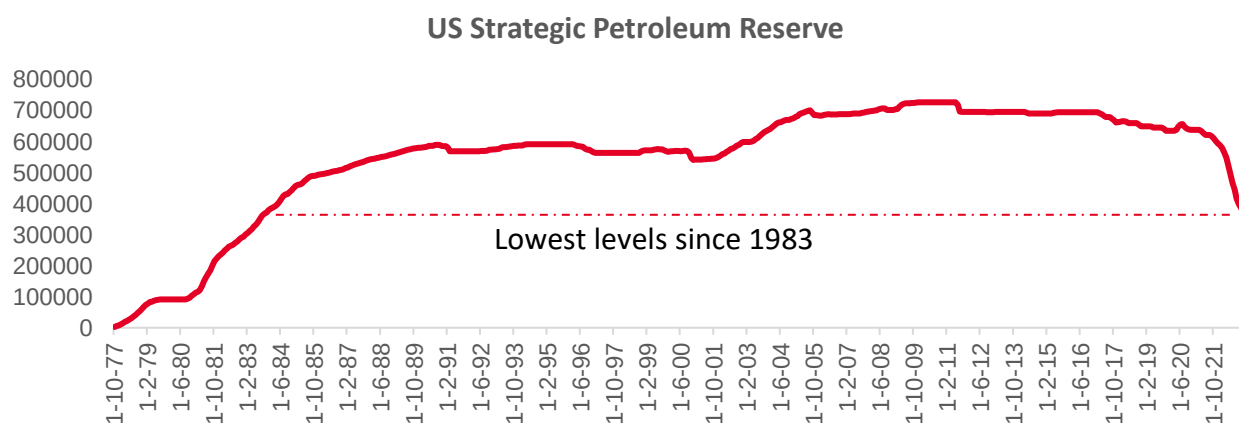
Gold prices surged over the past month primarily as a beneficiary of weaker USD levels even though global inflation levels continue to be steep. Gold per Ounce in USD terms gained 4.4% in this period and retraced the US\$2000/oz handle. We anticipate Gold to continue its current up move and hover in and around the US\$ 2100 levels.

## Silver witnesses sharp spike:

Silver prices witnessed a secular and sharp upward spiral over the past month, gaining 15% and trading around US\$ 25/Oz. A revival in Silver prices augurs well for global manufacturing turnaround with the industrial metal gaining significant ground. While there have been some takeouts in profits over the past couple of trading sessions, prices have continued to hold above the US\$25 handle which indicates a bullish trajectory for the near future.

## Crude prices surge on supply-side concerns:

Crude prices reared up from its deep slumber and recovered sharply post an unanticipated cut in output announced by OPEC+ members who decided on a further cut in supplies by 1.16 Mn barrels per day (Mbpd), taking overall cuts to 3.66 million bpd. This combined with an anticipated surge in demand driven by the Chinese economy reopening as well as expectations of the US having to replenish its strategic petroleum reserves which had been drawn down to its lowest levels since 1983 has led to Brent Crude spiking 25% over the past month. We anticipate crude prices to remain elevated and may impact global inflation control measures if it witnesses further surge to the historic highs seen in the recent past.



Source: US Energy Information Administration

## USDINR pair gives up on gains, retraces 82 handle against USD:

USDINR pair had gained appreciably in the first week of Apr'23 but gave up on gains to retrace the 82 handle. However, the BoP situation remains well anchored primarily owing to record inward remittances as well as higher exports and weaker import numbers. Even FPI flows for the month till 18<sup>th</sup> Apr'23 were up nearly USD 1 Billion which augurs well for INR holding its ground against the USD. We do not anticipate the USDINR pair to weaken significantly from current levels.

**Indian Equity Update :**

Nifty snapped three months of consecutive decline to end March 0.32% higher, closing the month at 17,359 as concerns of further banking turmoil receded.

In Mar'23, Foreign institutional investors (FIIs) turned out buyers with net purchases of INR 1,997 crs in March. Domestic institutional investors (DIIs) continued their buying streak with net purchases of INR 30,548 crs in March (Source – Money control).

With respect to sectoral indices, except for Nifty Auto, Nifty IT & Nifty Realty, all other sectoral indices ended the month of Mar'23 on a positive note. The largest gain was seen in the Nifty Metals index which was up 4.33% followed by the Nifty Pharma index which was up 2.30%.

With Nifty falling 4.12% in Q4FY23, Nifty 50 12-month trailing PE has come down to ~20.44 times (Source – Bloomberg), but is still above the long-term averages. Thus, we would continue to recommend a staggered or tactical deployment approach.

**India Fixed Income Update :**

Indian fixed-income markets cheered the unexpected pause from RBI's MPC committee meeting with yields across the entire curve falling sharply. 10-year yields declined by 13 bps to 7.18 levels while 5-year and 2-year yields declined by 16 and 19 bps respectively to currently trade around 7.03 and 6.93 handle. The yield curve also displayed some tenor steepening which is akin to a normal curve with tenor premia widening between the 2, 5, and 10-year handle which was almost on the verge of inversion a month back.

The latest RBI borrowing calendar for H1FY'24 has kept borrowings at 5 years and below at minimal levels while stacking the majority of supplies in the greater than 10-year maturities. With CPI on a declining trajectory (sharp decline in WPI inflation hints at further easing of supply side) we believe RBI may not revisit the path of rate hikes any further and we may have reached the terminal policy rate which should aid lower benchmark yields.

The spreads between 2 and 5-year benchmark yields are currently around 10 bps while the same between 5-year and 10-year benchmark yields are around 16 bps. We anticipate the spreads between 5 and 10 year to widen further with 5-year yields sliding sharply as compared to the 10-year yields. The 1-2 year segment will continue to witness volatility primarily owing to liquidity drain as RBI continues to focus on the withdrawal of surplus liquidity to interest rate transmission into the broader economy even as it may not tweak the benchmark rates any further.

**INVESTMENT OUTLOOK :**

Taking the cue from our previous publications, we would like to reiterate that investors are encouraged to adhere to 'Asset Allocation' and calibrate investment decisions by carefully monitoring the ever-evolving economic and geopolitical data points. Marrying our in-house Asset Allocation framework (comprising 4 quadrants –Asset Growth, Return Stability, Inflation Hedge, and Volatility Hedge) with our current stance on markets (as explained above), we build an investment outlook as follows –

- Volatility surged over the past week underlying our theme for the year. In this current backdrop, we continue to be bullish on the volatility hedge allocations played through long short and market-neutral strategies.
- On return stability quadrants, we continue to prefer allocations to funds running maturities in the 3 – 5 year bucket as the current yields continue to be attractive, especially for Investors with an investment horizon of 3 years. Investors could also look to invest in well-managed credit funds (on the AIF platform) where the focus is on capital preservation and current income.
- We continue to avoid lumpsum deployments in equities – part of the asset growth quadrant and we prefer a staggered approach with deployments over the next 3 – 6 months.
- Funds that benefit from domestic growth led by government spending and policies and selective consumption and export opportunities could be considered as an investment opportunity. Allocation to the asset growth quadrant should be consistent with the risk profile of an investor.
- Our view on maintaining a steady allocation to Gold has reaped steady returns for investment portfolios over the past year and we continue to be bullish on the commodity as a vital asset allocation tool

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