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The second COVID wave weighs on sequential recovery; tentative signs of COVID curve peaking offer hope of faster rebound

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- Advanced economies continue to lead global economic recovery amidst better policy space and vaccine availability compared to developing nations.
- In response to the second COVID wave, the majority of Indian states imposed state-wide restrictions in May. These efforts seem to be working with the number of daily cases tentatively peaking by the end of the first week of May.
- Wider use of lockdowns is weighing on economic activity, though there are also some signs of underlying economic resilience, especially for supply-side indicators compared to the demand-side.
- Despite recent improvement in the COVID situation, states may relax lockdowns gradually, considering the need to further ramp up health infrastructure and pace of vaccination.
- Assuming recent improvement in the COVID situation continues, allowing gradual relaxation of lockdowns from June onward, we expect the second COVID wave to weigh on sequential economic recovery mostly in Q1 FY22, followed by a quick rebound in following quarters. Accordingly, we estimate real GDP to grow by around 9.9% YoY in FY22 compared to the earlier projection of 12.4%.
- The second wave is weighing on labour market recovery, leading to a jump in the unemployment rate. It could widen the employment condition divide between rural and urban areas, organized and unorganized sectors, and contact intensive and non-contact intensive segments, noticed last year.
- Targeted policy measures for vulnerable sections and most affected sectors are needed to alleviate pressures on them. This will need the centre's policy intervention, besides ongoing front-loading of expenditure, as states have mixed fiscal flexibility.
- Meanwhile, the RBI continues to be proactive, announcing a slew of measures for small borrowers and the health sector in early May. The RBI's approach is to provide targeted relief in a calibrated manner and to remain open to step up policy support as the situation unfolds.

Pramod Chowdhary
Chief Economist
pramod.chowdhary@dmifinance.in

Ashray Ohri
Economist
ashray.ohri@dmifinance.in

Bhawna Sachdeva
Economist
bhawna.sachdeva@dmifinance.in

www.dmifinance.in

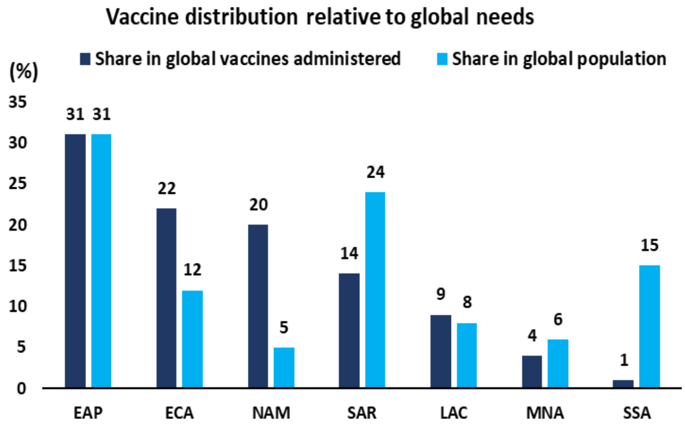
+91 11 4120 4444

DMI Finance Private Limited
Express Building, 9-10, 3rd Floor,
Bahadur Shah Zafar Marg,
Delhi – 110002.

Advanced economies leading global economic recovery amidst better policy space and vaccine availability

The global economy continues to tread on its path of recovery. In April, Global Composite Purchase Managers' Index (PMI) rose to its highest levels in more than a decade, buoyed by both the manufacturing and services sectors as new orders, international trade and employment levels noted a strong increase. In fact, the activity of the services sector outpaced that of manufacturing for the first time since the revival in global activity began in July last year, as more contact intensive sectors treaded towards normalcy.

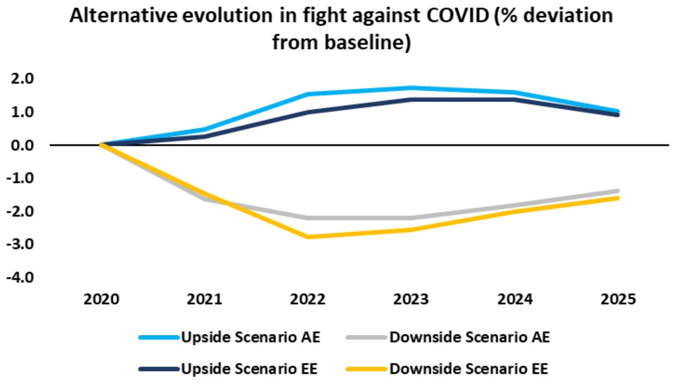
High disparity in vaccines across regions



Source: pandemic-ic.com; data as on May 16, 2021; acronyms: EAP – East Asia & Pacific, ECA – Europe & Central Asia, NAM – North America, SAR – South Asia, LAC – Latin America & Caribbean, MNA – the Middle East & North Africa, SSA – Sub-Saharan Africa

However, the disparity between recoveries of advanced and emerging economies seems to be widening. It was initially led by larger policy space and better health infrastructure of advanced economies. This further widened in 2021 given vaccine inequity - advanced economies have been able to stock up vaccines and inoculate their populations at a much faster pace than many emerging economies. Accordingly, North American countries that comprise only 5% of the world population constitute a 20% share in global vaccination as on May 16, 2021. The East Asia and Pacific region (EAP) look balanced, accounting for 31% of the world population and a similar share of global vaccinations. On the other hand, South Asia, and countries from sub-Saharan Africa that make up 24% and 15% of the world population, only account for 14% and 1% shares respectively when it comes to global vaccination status. Given this inequity, it's not surprising that developing countries like India, Brazil, Malaysia, Thailand, etc. witnessed a sharp surge in cases in 2021 forcing them to impose containment measures. On the other hand, the spread of the infection seems to be coming under control in advanced nations, allowing them to reopen their economies and economic activities to gather steam.

Advanced economies' recovery relatively resilient



Source: IMF; AE - Advanced Economies, EE – Emerging Economies; Upside scenario - assumes that vaccine rollout occurs about 10 percent faster than in the baseline and that vaccines are effective in preventing infections from the growing range of variants as well as containing infectiousness of those vaccinated. Downside scenario – assumes that supply bottlenecks in production and other logistical problems with delivering the vaccines that are most effective against growing variants allow existing variants to become well entrenched, and additional mutations occur.

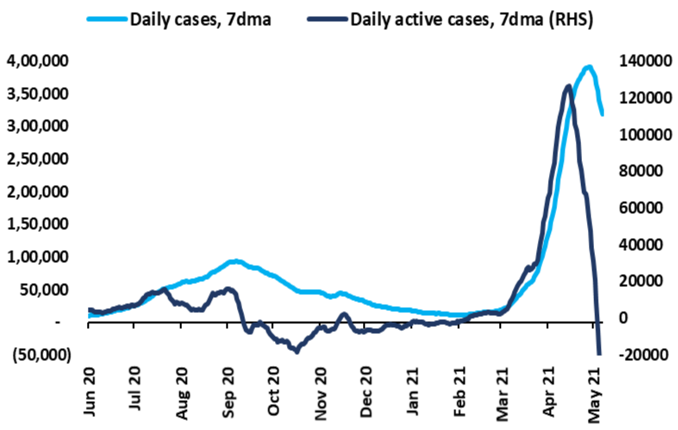
These two factors - of better policy space and access to vaccines - are likely to improve the trajectory of recovery for advanced economies better than emerging economies. According to the IMF, advanced economies are expected to outperform emerging economies across different scenarios of recovery. In an upside scenario, advanced economies are expected to grow by 1.28% annually over 2025, above their baseline, compared to a 0.98% growth above the baseline for emerging economies, over the same period (~0.3% points higher). Meanwhile, in a downside scenario as well, advanced economies are likely to be more resilient as output gets impacted by 1.84% on average annually over 2025, compared to an impact of 2.08% on average annually over 2025 for emerging economies, over their respective baselines (0.23% points lower impact). Given this divergence, global efforts need to be stepped up to assist vaccination in developing countries.

India's second COVID wave seems to be on the mend.

The second COVID wave that has been raging since late March seems to be plateauing in recent days. The number of daily cases has tentatively peaked by the end of the first week of May, with the 7-day moving average (7-dma) of daily cases down to 3.19 lakhs as on May 17 from the peak of 3.92 lakhs on May 8. The positivity rate (7-dma) also tentatively peaked at 22.7% on May 8 and has dropped to below 20% presently. As recoveries improved, outnumbering daily fresh cases over the past week, total active cases also peaked at 37.5 lakhs as on May 10 and have fallen by nearly 4 lakhs since then. The death rate, however, has remained high, though it may improve going forward due to the lag effect.

While the second wave seems to have tentatively peaked at the national level, there are regional differences given the stage of state-wise COVID waves and virus containment actions by local authorities. Over the April-May period, the second wave widened its geographical reach, with nearly all states coming under its grip. Accordingly, over 70% of daily cases in the country are registered by the ten most affected states compared to only four states earlier in March. The second wave seems to be intensifying in southern parts of the country and spreading to eastern parts of India. As such, states like Kerala, Tamil Nadu, Andhra Pradesh, Odisha, West Bengal, and all the northeastern states are reporting a surge in daily cases. On a positive note, states such as Maharashtra, Delhi, Uttar Pradesh, and Gujarat that were leading the daily count initially are reporting a decline or plateauing in daily cases. Overall, around 18 states/UTs are showing tentative signs of peaking.

India's second COVID wave shows signs of abating

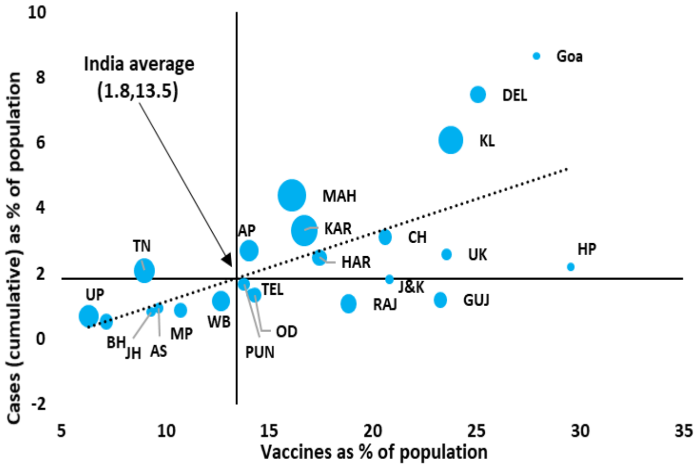


Source: CMIE

On the vaccination front, India has vaccinated ~13.5% of its population so far (single dose) and remains far from its goal of achieving herd immunity. Most of the states that are witnessing a surge in cases are thankfully leading the vaccination drive (except some states like Uttar Pradesh, Madhya Pradesh, Tamil Nadu, etc.) as shown in the chart below, with a strong positive relation between cumulative confirmed cases and a single dose of vaccine being administered, adjusted for population. States such as Delhi, Kerala, and Karnataka that have reported among the highest daily cases in May so far have also vaccinated more than 15-20% of their population and stand above the Indian average.

Over the past three weeks, supply issues have undermined the steady progress of the vaccination drive in India. After inoculating ~3.6 million people (7-dma) per day in early April, the current pace has slowed to ~2 million people (7-dma) per day as on May 16. But the supply constraint of vaccines is expected to ease in the coming months. According to India's health minister, vaccine supply should rise to 51.6 crore doses by July (including 18 crore doses already administered) and increase further to more than 216 crore doses between August and December. This is likely to be enhanced by the Sputnik V vaccine that has already been approved by the government. Moreover, other potential candidates of Zydus Cadila, Biological E, Genova mRNA, and Bharat Biotech's nasal vaccine that are in various stages of clinical trials are likely to boost supply in Q2/Q3 FY22, if approved. India may also expect to receive ~20mn doses of AstraZeneca from the US. Pick-up in vaccination pace should allow faster normalization of economic activity in coming quarters.

States with high COVID cases lead the vaccination drive



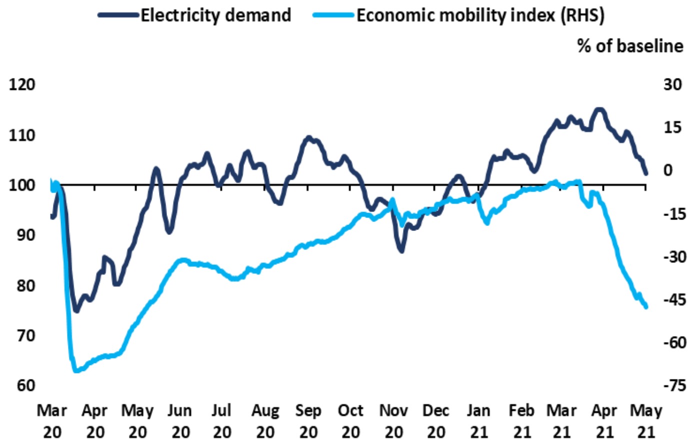
Source: Covid19India.org; data until May 17, 2021; state-wise population-based on 2020 projection of UIDAI; size of the bubble represents a share in daily COVID cases

Economic activity to take a hit, although temporary and less severe than last year's lockdown

In response to the acute hit from the second wave of the virus, varying degrees of localized restrictions have been announced across states. A total of 24 states/UTs that account for around 90% of India's Gross Domestic Product (GDP) have announced state-wide lockdowns, with varying degrees of intensities and exemptions. As a result, the Oxford stringency index shot up to ~82 in May (last available value), up from 58 at the end of March but still lower compared to 100 in April last year. Wider use of local lockdowns is weighing on economic activity. The impact seems relatively more on demand-side indicators than supply-side as per initial data. PMI for manufacturing and services were resilient in April, with the latest values of 55.5 (v/s 54.6) and 54 (v/s 55.4) respectively, close to the previous month's levels and remaining in the expansion zone. GST collections, rail freight traffic, and E-way bills also showed some degree of resilience. Compared to April'19 levels, exports and imports registered solid 17.6% and 7.9% growth respectively in April'21. Auto sales and labour market data, though, show deterioration. The unemployment rate has gone up which will weigh on consumer spending.

Early ultra-high frequency economic indicators show further deterioration in May. Electricity consumption showed resilience in April but registered sequential moderation in the first fortnight of May though relatively less compared to last year. This reflects better adaptability by businesses and exemptions to industries. Google mobility levels are down significantly and now closer to levels of May-June last year. Accordingly, we expect economic indicators to deteriorate sequentially in May, weighing on Q1 FY22 growth; however, the impact is likely to be temporary. In our last monthly report, we noted several important factors which should support a quick economic rebound after a temporary sequential slowdown in Q1 FY22 (For a more detailed take on these factors, please refer to our previous Economic Monitor report). Tentative peaking of daily COVID cases should also allow states/UTs to consider gradual unlocking in the coming weeks.

Mobility levels fall sharply; electricity demand shows some resilience



Source: CMIE, Google mobility reports

Considering these factors, we expect the second COVID wave to weigh on sequential economic recovery, mostly in Q1 FY22. The economy should rebound quickly in the following quarters, assuming that the recent improvement in the COVID situation continues, allowing gradual relaxation of lockdowns from June onward. We also assume that the pace of vaccination will pick up from July onward, and vaccines will continue to remain effective against virus variants. Under these assumptions, we estimate FY22 real GDP growth at around 9.9% YoY compared to the earlier projection of 12.4% YoY. The revision also takes into account a slightly more favourable base as we now estimate real GDP to contract by 7.5% YoY compared to 6.7% YoY earlier. Almost all the adjustments in FY21 numbers are driven by back-ended subsidy outlays, which will also weigh on real GDP numbers in Q4 FY21, estimated to be around +0.9% YoY.

Employment conditions come under stress with an ongoing surge in cases

After completing a full circle since the COVID-induced national lockdown last year, labour markets remain under pressure, marked by an incomplete recovery until March 2021. Besides this, the divide between rural and urban employment/unemployment conditions, organized and unorganized sectors, contact intensive and non-contact intensive sectors widened last year, given multi-speed recoveries among different labour market sub-sections. Moreover, the quality and income earning potential seem to have deteriorated among recovered jobs for certain sections. The onset of the second wave and state-wide lockdowns could worsen some of these trends, which could impact consumption spending of affected segments. In the section below, we highlight some important trends of labour market sub-sections over last year as well as the latest development in response to the second COVID wave.

1. **Incomplete labour market recovery: the second wave adds to pressure in the near term.**

At the height of the nationwide lockdown in April'20, around 120 million jobs were lost. Even after nearly a year since then, 5 million jobs were still left to be recovered by March'21. The onset of the second wave and state-wide lockdowns have dented this incomplete job market recovery further, with an additional 7.4 million jobs lost in April'21 and more losses expected in May'21. With renewed job losses, the pool of unemployed (including ~19 million unemployed persons who are willing to work but not actively looking for work) has gone up to 53 million by the end of April'21 (~88% of these belong to the 15-29 year age group). The broader unemployment rate has also risen from 9.9% in March'21 to 12% in April'21, which is expected to rise further to around 14-16% in May. This compares to 38% in April'20 (national lockdown) and 16.1% in June'20 (around localized lockdowns). Please refer to the table below.

2. Rural and urban divide widens; agriculture acted as the absorber of surplus workers; MNREGA also helped

In the first month of the national lockdown last year, a relatively larger share of urban jobs (33% of those employed in urban areas in the calendar year (CY) 2019) was lost compared to rural jobs (28% of those employed in rural areas in CY19). However, given that the rural region accounts for a larger number of total employed persons in the country, these percentages still implied that more absolute numbers of jobs were lost in rural than urban areas. The absolute numbers of jobs lost in the rural region were 78 million, which is 1.8 times the number of jobs lost in the urban region in April'20. By March'21, the rural region recovered almost all jobs lost last year, with the number of those employed in the rural region rising to 99.9% of pre-COVID levels. By contrast, the urban region managed to recover to 96.2% of its pre-COVID level (Please refer to the table). This shows the important role that agriculture has played as an employer of last resort and the continued intensity of COVID and restrictions in urban centres.

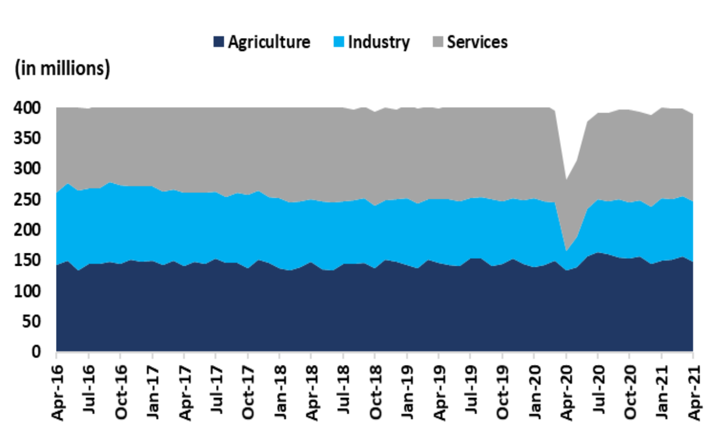
Labour markets undergoing renewed strains with the onset of the second wave

Labour Market Indicators							
Category	Apr-20	May-20	Jun-20	Sep-20	Dec-20	Mar-21	Apr-21
Unemployment Rate	38.3	29.7	16.1	9.2	13.5	9.9	12.0
Rural	36.0	27.3	16.2	8.3	13.3	9.9	11.1
Urban	43.1	34.8	15.9	11.1	14.0	9.9	13.9
Employed persons by region (Compared to 2019 average level; Index = 100)							
Employed Persons	70.0	77.8	93.5	98.7	96.4	98.8	96.9
Rural	71.5	79.5	94.5	100.2	96.7	99.9	97.5
Urban	66.8	74.3	91.3	95.3	95.9	96.2	95.8
Employed persons by Industry type (Compared to 2019 average level; Index = 100)							
Agriculture	92.0	94.9	107.3	105.8	99.2	107.7	101.8
Industry	29.9	47.5	74.8	92.8	89.5	94.2	94.4
Manufacturing	53.6	58.5	68.7	61.4	73.3	75.3	73.8
Real Estate & Construction	12.1	37.5	77.3	112.6	101.8	105.5	110.0
Services	76.2	82.2	93.2	96.0	98.7	93.6	94.2
Hotels & Restaurant	64.5	66.5	108.3	95.3	113.1	90.0	80.9
Travel & Tourism	61.1	64.4	88.2	102.6	112.5	96.3	96.7
Financial & Professional	63.1	84.9	74.6	90.0	94.9	106.8	93.6
Public administrative & defence	115.8	101.3	88.3	84.8	92.5	94.6	87.1

***Source: CMIE. The unemployment rate includes* unemployed persons who are willing to work but not actively looking for work**

The agriculture sector accounted for 36% of India's total number of employed persons and 53% of rural region employment in CY19. As the sector was relatively unaffected by the lockdown last year, the above-noted loss of jobs in the rural region is likely to have occurred in the non-farm rural sector, which comprises a wide range of activities/industries, including Micro, Small, and Medium Enterprises (MSMEs), construction, low-skilled services like repair, retail, transport, etc. There was also reverse migration from urban to rural areas. Most of these have found refuge in MNREGA and the agriculture sector, which provide low-paying jobs. The number of people employed in the agriculture sector rose to 107.7% by March'21 of CY19 average levels, indicating disguised unemployment in the sector.

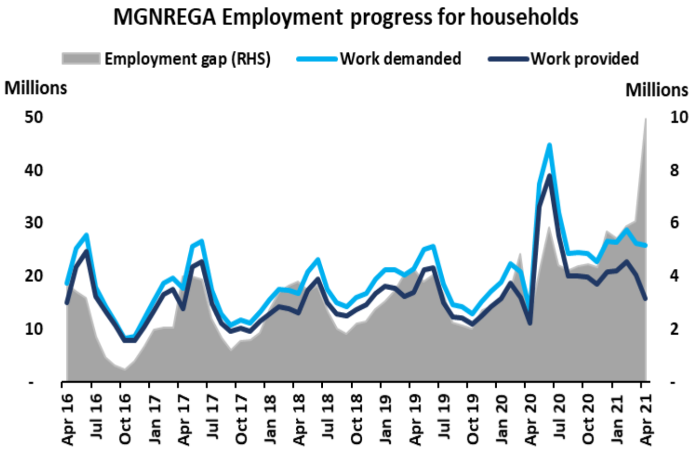
Employment conditions improve but remain below pre-COVID levels with notable disparity among sectors



Source: CMIE

Outside the agricultural sector, the MNREGA scheme offered some support to migrants and unemployed persons, though in low-paying temporary work. Further, demand for work exceeded the work provided throughout FY21, indicating continued high stress in the rural jobs market. In FY21, the number of households that demanded work under MNREGA went up by 23 million to 85 million, a 38% jump compared to FY20, and the gap between the number of households that demanded work and work supplied rose to 9.9 million in FY21, up from 6.8 million in FY20. As the agriculture sector is unlikely to be able to absorb more people, the government will have to increase support through MNREGA, especially as the intensity of the second COVID wave increases in rural areas.

Gap between job demand and jobs provided increase steadily in rural areas



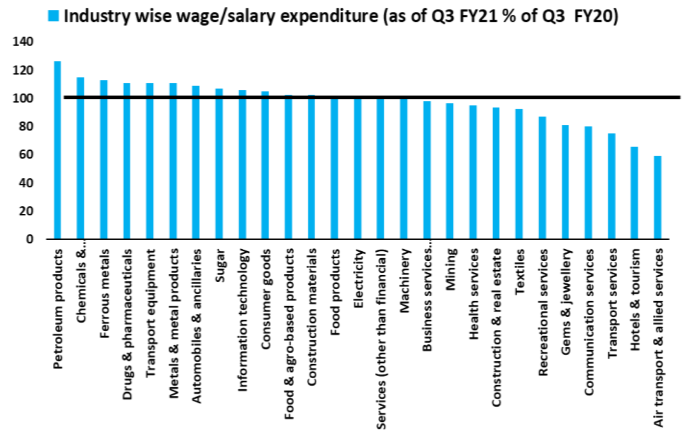
Source: CMIE

3. Organized sector fared well though contact intensive industries bore the brunt of the pandemic

Industry and services sectors suffered steep job losses in April'20 due to strict national lockdown. Recovery of employment in these sectors was relatively slower during FY21. By March'21, the number of people employed in the industry and services sectors rose to 94.2% and 93.6% of their respective pre-COVID levels. Within the industry, the construction sector led recovery while the manufacturing sector remained far below its pre-COVID level. On the other hand, contact intensive industries such as hotel/restaurant and travel/tourism suffered significant initial job losses, and employment levels remained far below their respective pre-COVID levels even after one year.

Given the lack of sub-industries data, we look at wage cost (as a proxy of employment level) as per the reported quarterly financials of companies. Within the corporate sector, out of 27 industries, recovery in wages cost of four sectors (hotels and tourism, airlines, transport, and communication services) stayed below 80% of their respective pre-COVID levels in Q3 FY21. Despite the health sector being an essential service, the employment cost has not seen a full recovery. The employment cost for textiles, mining, and construction is on the path to recovery but is still below their pre-COVID levels. The remaining sectors largely witnessed no change or relatively higher employment costs in Q3 FY21. Overall, the decline in wages is concentrated mainly in more contact intensive/non-essential industries. These industries are likely to face renewed pressure due to the second COVID wave.

Contact intensive sectors remain worst affected



Source: CMIE

4. Quality of jobs and income levels deteriorated

The quality of job revivals has also been sub-optimal. According to the latest Periodic Labour Force Survey (PLFS), the share of self-employed workers rose to 41% of the total workforce in Q1 FY21 compared to a 37.7% share in the same period last year. Data from CMIE suggests a similar trend for self-employed workers has continued during FY21. People employed as small traders & wage labourers, farmers, and home workers noted an increase compared to their pre-COVID levels, indicating a larger share of workers with lower wages and higher job insecurity. This, coupled with increased unemployment, weighed on average household income levels. As per CMIE data, household income levels on average were 6.7% lower by December 2020 compared to FY20 levels.

5. Second wave weighing on labour markets

In April'21, job losses were skewed towards rural areas and the agriculture sector, primarily due to a lean season in the farm sector post-harvest season. Meanwhile, industry and services sectors continued to employ essentially the same number of people. Real Estate & Construction witnessed some increase in employment in April, with construction activities remaining exempt from the lockdown in several states. Within services, Hotels & Restaurant noted a further deterioration to employment in April, along with Public Administration & Defence. However, employment in wholesale and retail trade offset these losses. Within occupation groups – loss of jobs for salaried employees (mainly in rural areas, indicating employees of MSMEs/construction sectors) and small traders & wage labourers show impact on MSMEs and the informal sector. As the scope and regional coverage of the lockdown widened in May, we could see further deterioration in labour market conditions going ahead.

Given the above-noted impact on labour markets, the government should step up support for vulnerable sections and through MNREGA (allocation for the scheme was cut by ~35% to Rs 73,000 crores in FY22 from Rs 1.1 lakh crores in FY21).

Second wave to weigh on states' fiscal position; states vary in terms of fiscal space availability.

The central government's initial policy response to the second wave is to front-load its expenditure. Last year, the COVID shock had a significant impact on the government's fiscal position. The central government revised its FY21 budget estimate to 9.5% of GDP from 3.5% of GDP led by higher-than-budgeted expenditure and a significant drop in revenues. Last year, state governments also faced pressures, registering a steep fall in revenues leading to fiscal slippage despite a squeeze on expenditure. Our analysis of 17 states shows that the combined fiscal slippage of these states was ~42% higher as per the revised estimate (RE) compared to the budget estimate (BE) in FY21. However, this slippage was surprisingly much lower than the fiscal leeway allowed by the center to states, indicating state governments did not fully use the fiscal/borrowing space provided in the wake of the COVID crisis. As part of the Aatmanirbhar package, the central government permitted states to increase their fiscal deficit up to 5% of Gross State Domestic Product (GSDP) in FY21; 1% of GSDP was unconditional, while another 1% of GSDP was conditional on the implementation of reforms by states. Only 5 out of 17 states used this additional space fully, with their registered fiscal deficits of over 5% of GSDP, based on revised estimates.

Pressures on states could be higher this time as state governments take the lead in virus containment efforts compared to a national approach taken early last year. The cost of vaccination will also put pressure on state government finances. In this context, it is worth noting that similar to the central government, state governments also made a push for economic revival in their respective FY22 budgets, with ~15.5% increase in total expenditure for FY22 BE compared to FY21 RE, with capital expenditure budgeted to increase over 23.7% over FY21 RE. Meanwhile, on the revenues side, total receipts for FY22 are estimated to be ~15.6% higher than FY21 RE, which is similar to the central government's revenue projection of 15.0% over FY21 RE. The second wave of COVID-19 imparts uncertainty to these revenue projections while increasing pressures on expenditure. However, there is some scope for states to absorb the pressure from the second wave without having to actively cut expenditure like last year. The majority of the states have pegged their fiscal deficit targets below 4% (of respective GSDP) for FY22 (except Madhya Pradesh, Uttar Pradesh, Himachal Pradesh, and Chhattisgarh) and have the flexibility to carry forward some of the unutilized limits from last year. Beyond this level, fiscal flexibility is mixed among states, given the high debt burden for several states. Looking at the fiscal space available to a given state on two accounts - a cap of 4% budget deficit and a limit of 25% for debt burden (% of GSDP) - states like Maharashtra and Gujarat will have higher fiscal flexibility compared to states like Madhya Pradesh and Uttar Pradesh (refer to below table for more details). This implies that if the second wave were to be protracted, states would be forced to rationalize expenditure which can weigh on economic growth. Recent improvements in the COVID situation, though, provide some reasons to be hopeful that this situation may not arise for most states.

States vary in terms of fiscal space availability

2021-2022 Budget Estimate			
State	Fiscal Deficit (% of GSDP)	Outstanding Debt (% of GSDP)	Fiscal Flexibility
Maharashtra	2.2%	21%	High
Uttar Pradesh	4.2%	28%	Low
Karnataka	3.5%	27%	Medium
Gujarat	1.6%	17%	High
Rajasthan	4.0%	38%	Medium
Telangana	3.9%	25%	High
Madhya Pradesh	4.5%	29%	Low
Kerala	3.5%	37%	Medium
Delhi	1.6%	5.0%	High
Haryana	3.8%	26%	Medium
Bihar	3.0%	32%	Medium
Punjab	4.0%	46%	Medium
Odisha	3.5%	21%	High
Chhattisgarh	4.6%	28%	Low
Jharkhand	2.8%	27%	Medium
Uttarakhand	3.2%	31%	Medium
Himachal Pradesh	4.5%	40%	Low

Source: Budget documents, PRS. Note: States breaching cap of fiscal deficit (4% of GSDP) and debt burden (25% of GSDP) are classified as under Low flexibility; states breaching one of the above two caps are classified under Medium flexibility, and states not breaching any caps are classified under High flexibility. Delhi's numbers are for FY21 RE.

RBI continues to remain proactive

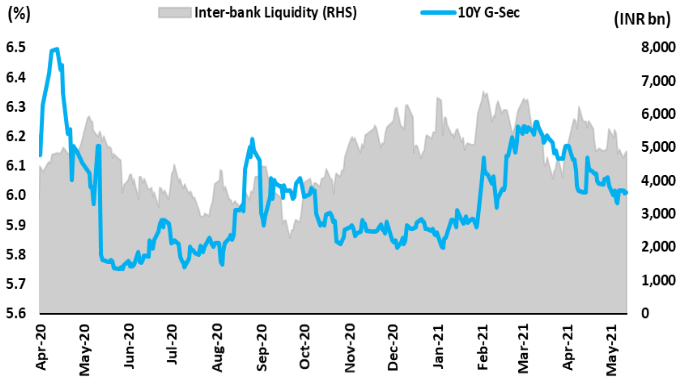
The ongoing wave has further solidified RBI's case to remain accommodative and provide support to the reeling economy. The RBI has remained proactive since the beginning of the pandemic last year. Starting in February 2020, the RBI front-loaded policy rate cuts, maintained an accommodative stance, and took several liquidity measures to reinforce easy financial conditions to support economic recovery. Overall, the central bank has announced Rs 13.6 lakh crore (6.9% of GDP) worth of liquidity measures during February 2020-March 2021. The central bank carried forward the same proactive approach into FY22, as the RBI governor, in an unscheduled presser on May 5, 2021, announced a slew of targeted measures in light of the rampant second COVID wave. The measures were primarily focused on providing relief to individuals, small businesses, and MSMEs by reopening restructuring schemes. Given the strains on the health infrastructure at present, the RBI provided an on-tap liquidity window of Rs 50,000 crores for emergency health services with tenors of up to three years at the repo rate till March 31, 2022. Given the uncertainty associated with the pandemic, we believe the RBI's approach is to provide targeted relief in a calibrated manner at this point and to remain open to step up policy support as the situation unfolds. (Please read our detailed report on the measures announced by the RBI governor). A recent drop in inflation by 122 bps to 4.3% in April from 5.5% in March 2021 provides monetary policy flexibility to provide additional support.

Market Update

Indian bond markets moved into the new fiscal year on a positive note as the RBI doubled down on its accommodative stance and policy support in the light of the second wave of the virus. Bond purchases by the RBI through its G-SAP announcement of Rs 1 lakh crore have been absorbing the incremental supply of government debt – the first tranche announced in the April policy (of Rs 25,000 crores) and the second tranche announced in the unscheduled presser in early May (of Rs 35,000 crores).

The RBI also continued the use of its other tools to keep interest rates lower as it conducted a special open market operation of Rs 10,000 crores on May 6, 2021. Consequently, the benchmark 10-year G-sec yields traded 12 basis points lower on average at 6.07% in April (v/s 6.19% in March) and have further eased in May to currently trade around the 6% threshold. Bond markets also witnessed tailwinds from a benign inflation print in April and a mild reversal in tide from Foreign Portfolio Investors (FPIs) as they injected ~ $238 million in the first 12 days in May v/s over $2 billion outflows between January-April this year.

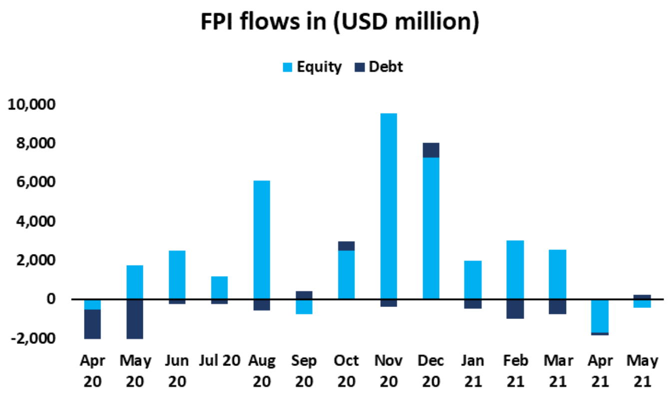
Proactive RBI continues to keep liquidity in surplus and interest rates lower



Source: CMIE, Bloomberg

Indian equity markets partially eroded gains in April as the benchmark NIFTY and SENSEX indices declined by 0.4% and 1.5%, respectively. The second wave of the virus impinged economic recovery and led to capital outflows from foreign investors ($1.7 billion) for the first time since September last year. The outflows continued into May ($442 million until May 12, 2021); however, support from domestic investors curtailed losses as mutual funds ploughed their investments in equity markets for the second month in a row in April (following nine months of capital withdrawal between June 2020 and February 2021). Equity markets are showing some resilience in May given the optimism from nascent signs of COVID cases plateauing, less stringent restrictions, and expectation of a quick economic rebound. However, the outlook is likely to remain uncertain, with downside risks prevalent until the COVID situation comes firmly under control.

Foreign investors withdraw capital with the uncertainty around the second COVID wave



Source: CMIE; data for May'21 is until May 12

The Indian Rupee came under pressure with the onset of the second wave of the virus as the currency depreciated by 2.3% in April (compared to March) to trade at 74.5 levels on average. FPI outflows to the tune of $1.8 billion in April (debt and equity markets) weighed on the domestic currency that breached the threshold of 75 multiple times during the month. The benign trade environment also reversed for India with domestic recovery and reflating commodity prices widening the trade deficit further in April. Meanwhile, RBI continued its intervention by buying Dollars (added further foreign reserves by ~$11 billion in April, taking its total to $588 billion) offering little support to the domestic currency. However, the Rupee has recovered significantly moving into May as the US Federal Reserve maintained its accommodative stance leading to a weaker Dollar index and falling US yields – both supporting the domestic currency. The Rupee has broadly recovered to its March-end levels as it currently trades at ~73.1, however, the uncertainty from the ongoing second COVID wave may keep the Rupee volatile with a downward bias in the near term.

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