20 December 2021

India's economic recovery remains on track, but headwinds rise amidst new COVID variant and global developments.

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- A new COVID variant (Omicron) has been added to the list of several headwinds for the global economy, including the persistence of supply chain disruptions, elevated inflationary pressures, and the recalibration of the pace of policy normalization by major central banks.

- India's COVID situation remains contained though concerns about Omicron spread persist. Compared to the second wave, the progress on vaccination should help the country face the new COVID variant, presuming vaccines remain effective.

- The Indian economy resumed on the path of recovery after a temporary disruption caused by the COVID second wave.

- In Q2 FY22, there was a robust sequential pickup in the real GDP by 10.4% QoQ after registering a 16.9% QoQ decline in Q1 FY22, with real GDP surpassing its pre-COVID level.

- Early data for Q3 show strong economic momentum in October aided by the festival demand, followed by mixed data in November and early December as the festive effect wanes.

- The government's favorable fiscal position in the FY22 (till October) provides it with the flexibility to step up expenditure in the rest of FY22 without jeopardizing the budget deficit target.

- Meanwhile, the RBI continues to prioritize economic growth revival, as indicated by its dovish leaning in the December policy meeting.

- The central bank maintained a status quo on policy rates and the accommodative policy stance amidst rising global uncertainty.

- The RBI focused on liquidity management to strengthen control over the liquidity overhang and announced measures to soak up surplus liquidity.

- CPI inflation remains below the RBI's upper tolerance threshold of 6%. However, elevated core-CPI and WPI inflation highlight underlying price pressures, likely to feed into headline CPI as demand conditions continue to recover.

- We expect the RBI to start the policy normalization process from Feb'22 with a reverse repo rate hike in the range of 10 bps to 25 bps. We do not rule out delays in policy normalization if any new COVID wave weighs on the economy.

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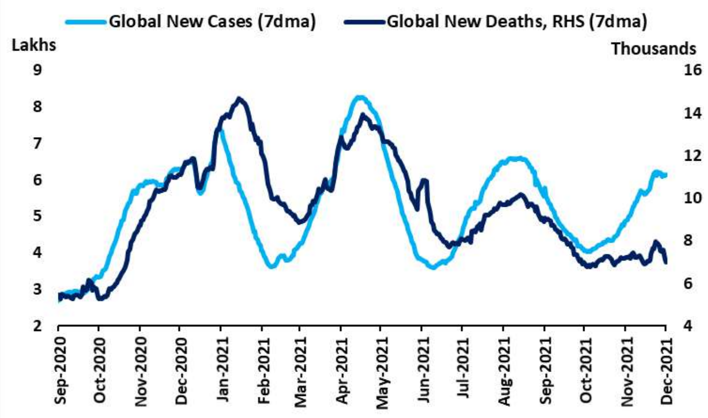
The new COVID variant accentuates uncertainty about the global economic outlook

In our last monthly report, we noted rising uncertainty about the global economic outlook. We noted several headwinds posing downside risks to the global economic recovery, including the persistence of supply chain disruptions longer than previously anticipated, jump in energy prices and inflationary pressures, the repricing of the pace of policy normalization by major central banks, and rising in global COVID cases. Over the past few weeks, most of these headwinds have persisted. An additional risk emanating from a new COVID variant Omicron (first reported in the Southern Africa region in late November) has accentuated the level of uncertainty and potential downside risk to the global economy. Early data from South Africa suggest that the Omicron variant is more contagious than the delta variant but may be less severe. The effectiveness of current vaccines, including the booster dose, against the Omicron variant, is yet to be fully determined. Omicron could still lead to significantly higher COVID cases worldwide, even with the potential of being less severe. COVID cases across the globe have already risen steadily at over 6.1 lakhs per day (as of December 13). Daily deaths have continued to decline, with a case fatality rate of ~1.1% at present.

Global daily cases rise again, although fatality remains contained



Source: Ourworldindata

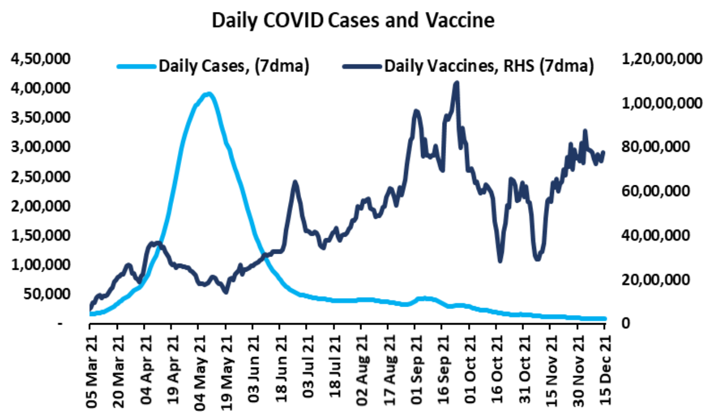
In reaction to Omicron, countries have so far refrained from imposing major domestic restrictions but have leaned on stricter guidelines and controls for the movement and travel of people while incentivizing a larger vaccine and booster coverage of their respective populations. It remains to be seen to what extent this will change as Omicron spreads and the nature/extent of containment measures that countries might have to deploy. The return of wider lockdowns and restrictions could weigh on the global economic recovery, which was showing signs of renewed traction after the delta wave dented the economic momentum in Q3 CY. Before the Omicron news in late November, the global composite PMI signaled an expansion for the 17th consecutive month and jumped to a 4-month high of 54.8 in November, as overall output continued to recover with an increased new business (including new export business) and job creation. The service sector led the growth in business activity and continued to outpace the manufacturing sector in recent months. However, price pressures remain elevated, with average input costs rising to their highest since July 2008, while output cost inflation endured close to its highs of the previous month.

Another key risk facing the global economy is the time and pace of policy normalization, wherein major central banks have to ensure a soft landing while containing inflationary pressures. As price pressures continue to persist, the consensus is shifting away from the transitory nature of ongoing high inflation towards a stickier and enduring one. Persistence of elevated inflation and recent (November) inflation data in the US (at 6.8% YoY, nearly a 40-year high), Euro Area (4.9% YoY, a 30-year high), and the UK (at 5.1% YoY, nearly a decade high) are compelling central banks to recalibrate their policy stance, with a faster than anticipated normalization of the ultra-loose monetary policy. The Bank of England became the first major central bank to hike its policy rate by 15 basis points (bps) to 0.25% in December. In late November, the US Fed's chair Jerome Powell suggested that it is probably time to retire the word 'transitory' when describing inflation and indicated a faster pace of asset purchase program taper than previously anticipated. This policy pivot led to market volatility in late November/early December. In its December meeting, the US Fed doubled the pace of tapering its asset purchase programme (from $15 billion per month to $30 billion), along with the 'dot-plot' indicating the median expectations of 3 rate hikes in 2022 itself. This is a sharp break from the previous expectations in the September meeting, where the median expectations showed no rate hikes in 2022. With the US Fed now scheduled to run down its asset purchase programme by March 2022 (v/s June 2022 as per the previous policy meeting), the Fed could start hiking as early as Q2 CY 2022. As major central banks withdraw policy support, financial market volatility is expected to rise, which could weigh on global economic momentum. As headwinds to global recovery increase, it becomes even more pertinent to tackle the pandemic that continues to sit at the bedrock of the growth-inflation dynamic. While the world has been able to better adapt itself with each passing wave of the virus, risks remain in terms of unequal and low vaccine coverage - with low income and lower-middle-income countries that together constitute more than 50% of the world population having fully inoculated only 3.5% and ~31% of their respective population.

India's COVID situation remains contained, vaccination pace gathers pace

India's COVID situation continues to stay benign as new cases have been falling. The risk of cases resurgence during the festive season did not materialize. Daily cases hover ~8K (7dma) as of December 14 compared to over 11.5K cases as of November 14. With daily new recoveries outpacing the daily new cases, the active caseload has fallen to 87K at present from over 1.3 lakh cases a month ago. The positivity rate has declined to 0.67% (7dma) from roughly 1% during the same period. However, the fatality rate has increased to 4.1% (7dma) as of December 14 from over 3% a month ago, primarily led by the elevated number of deaths in Kerala and restating of backlog data. The concerns surrounding the spread of the new Omicron variant persists as India has reported a total of over 100 cases until December 17. Compared to the COVID second wave, India's vaccination levels are looking much better now. India has managed to inoculate almost 87% of its adult population with at least a single dose, while 56% of the adult population has been given both doses as of December 15. This should help the country face the Omicron variant, presuming vaccines remain effective.

Daily cases continue to decline; vaccination pace gathers pace

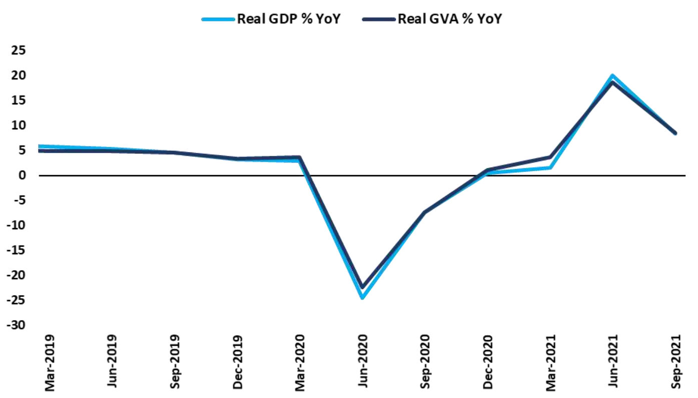


Source: CMIE; Ourworldindata

The economy stages a robust sequential recovery in Q2 FY22

India's economic recovery remains on track despite mixed data post the festival season. In Q2 FY22, the economy staged a quick recovery from the impact of the COVID second wave, facilitated by the easing of localized restrictions, the sustained decline in cases, and accelerated vaccination coverage. There was a robust sequential pickup in the real GDP by 10.4% QoQ after registering a 16.9% QoQ decline in Q1 FY22. However, on an annualized basis, growth numbers were mostly lower than the previous quarter, but that reflects the waning of the base effect. Real GDP registered a growth of 8.4% YoY in Q2 FY22, slowing from 20.1% YoY in Q1 FY22, though it managed to surpass its pre-COVID levels. On the demand side, the growth was broad-based, with all major sub-components noting expansion. The economic growth was primarily led by the investments on the back of the government's CAPEX and the exports buoyed by strong external demand. On the other hand, private final consumption expenditure noted recovery but continued to fare below its pre-pandemic levels. On the supply side, the real GVA rebounded, noting a sequential pickup of 7.9% QoQ (compared to a 13.3% QoQ decline in Q1 FY22) on the back of broad-based expansion. Among the major sectors, agriculture continued to post robust performance, while industry and services noted a sequential pickup in Q2 FY22 after putting behind the impact of the second COVID wave. However, the services sector continued to fare below its pre-pandemic levels.

India's economic recovery rebounded sequentially in Q2 FY22; annualized growth moderated weighed by the base effect

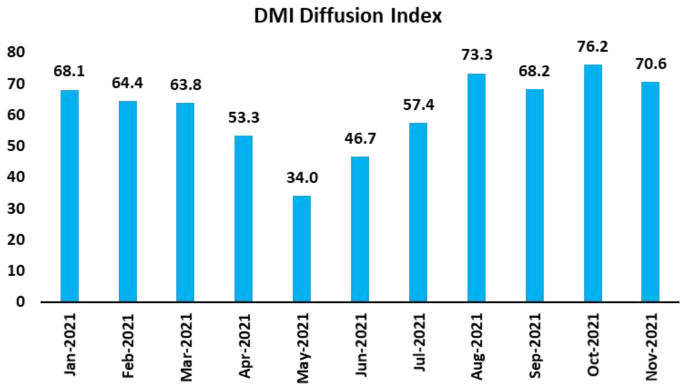


Source: CMIE

High-frequency data show mixed trends with a strong start in October followed by moderation in some indicators post-festival season

Early data for Q3 show strong economic momentum in October aided by the festival demand, followed by mixed data in November and in early December as the festive effect wanes. We see some sequential moderation pointed by early indicators based on our diffusion index. Compared to over 76% of the available indicators above their pre-pandemic levels in October, the diffusion index in November showed 71% of the available indicators crossing their pre-pandemic levels. This might reflect the effect of supply-side constraints and the waning of festival demand. The new COVID variant could temper growth impulse in the coming months, especially in contact intensive industries. We need to monitor how the risks from the new COVID variant pan out in coming months. Combination of persistent supply-side issues and headwinds related to the Omicron variant (directly and indirectly through impact on global trade growth) could pose downside risks to our FY22 real GDP growth projection of 10.5% YoY.

Diffusion index indicates a sequential moderation

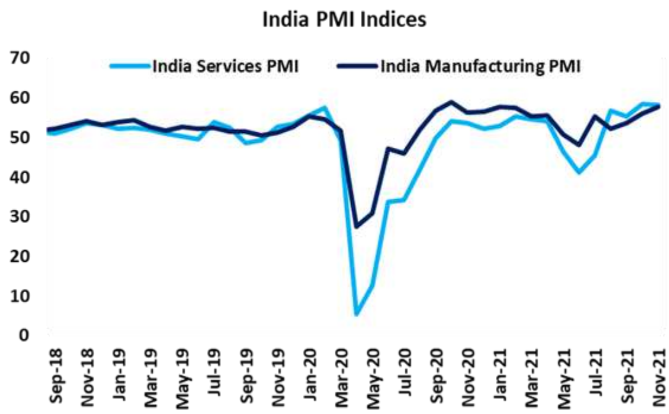


Source: DMI Finance; Our Diffusion Index shows the % of indicators showing above/equal growth to pre-COVID levels (taken as Jan-Dec 2019); the Growth rate in the above months is calculated over the base of 2019 to avoid the unusual base of 2020; November 2021 data is based on around 1/3rd of the indicators

On the agricultural front, the sector stays resilient, buoyed by ongoing rabi sowing and good reservoir conditions. As of December 10, the sowing of Rabi crops was 1.9% higher than the previous year, primarily driven by the oilseeds, which stood 22.7% higher than last year. The total live storage in 130 important reservoirs of ~77.6% of the full reservoir level was 11% higher than the decadal average (data as of December 9), which continues to bode well for the sowing season. Further, the pickup in fertilizer sales in November (post the announcement of subsidy for DAP (Di-ammonium Phosphate) also indicates a positive outlook for the agriculture output.

On the industrial activity, incoming data is somewhat mixed. The Index of Industrial Production (IIP) eased to 3.2% YoY compared to 3.3% YoY in September, reflecting waning of the favorable base effect, and continued supply-side issues (shortage of semiconductors faced by auto and electronics sectors). However, the effect of festival season was visible in a sharp 4.3% MoM jump in the index in October after registering two consecutive months of contraction, with manufacturing noting the growth of 3.4%. With the normalization of coal production, the mining output grew by 15.4% MoM, which should help reverse the contraction in electricity in the coming months. With some gain in momentum, the IIP managed to recover to 102.5% of its pre-pandemic levels after sliding below its pre-pandemic levels in the preceding month. However, early indications from other lead high-frequency indicators for November paint a somewhat mixed picture for the industrial sector. In November, the electricity generation declined sequentially by ~13% MoM (v/s 2.6% MoM growth in October). E-way bills declined sequentially by ~17% MoM in November (v/s 8.2% MoM increase in October), whereas the GST collection grew marginally by 1% MoM in November (v/s 11.2% MoM increase in October). However, both E-way bills and GST remained above their pre-pandemic levels. In contrast, the PMI for the manufacturing sector suggests a further uptick in the momentum as it rose to a ten-month high of 57.6 in November compared to 55.9 in October as companies report increased sales and production amidst improving demand conditions. Overall, we believe that industrial activity is likely to remain on the path of recovery with its pace tempered by supply-side constraints, including semiconductor shortages.

PMI indices suggest a sustained recovery in manufacturing and services



Source: IHS

Regarding the services sector, the broadening of the recovery in October continued in November as the PMI services index noted its second-highest print in a decade at 58.1, only marginally lower than 58.4 in October. The companies reported a substantial upturn in the new order, and the business confidence rose to its three months high but remained below its long-term average. Other high-frequency data pertaining to services point to a mixed picture with railway freight, port traffic, toll collections, etc., noting sequential moderation but remaining above the pre-pandemic levels. Going ahead, the international travel restrictions on account of Omicron (government rolled back the decision for resumption of international flights from December 15) and the inflationary pressures could weigh on the recovery of the services sector.

On the demand side, the incoming data for high-frequency indicators suggest continued demand recovery, but some indicators show moderation from highs of the festival season. As per IIP data, consumer durables noted marginal moderation, whereas consumer non-durables noted a sequential pick-up in October amidst the festive season.

Retail credit increased sequentially by 1.3% MoM in October v/s 0.9% MoM in September. Moving into November, as pent-up and festival demand tapers off, select indicators showed sequential moderation. As such, the indicators for rural demand like tractor sales, two-wheeler sales, etc. noted sequential moderation. On the other hand, passenger car sales noted a marginal pick up. As global chip shortages continued to weigh on the automobile sector, the combined wholesale dispatches for Passenger Vehicles, Two-Wheelers, and Three-Wheelers combined noted sequential decline as it moderated by 28% MoM in November. Notwithstanding the supply-side disruptions, the registrations, on the other hand, picked up by 33% MoM during the same month. Meanwhile, the petrol consumption for November noted a sequential decline, but it remained above its pre-pandemic levels. Google mobility continued to increase with rising domestic footfall amidst the festive season and easing of restrictions. Accordingly, the google mobility for groceries and pharmacies reached an average of 47% above baseline levels in November, while google mobility for retail and recreation inched closer to its baseline levels as it averaged to 0.4% below baseline in November and further to 1.0% above baseline in December (data till December 12). Moreover, the recent consumer confidence survey of RBI also suggests improved sentiment, with the current situation index increasing from 57.7 in September to 62.3 in November, while the future expectations index inched higher from 107 in September to 109.6 (value above 100 indicated optimism and below indicated pessimism).

Early data for November suggest sequential moderation from highs during the festival period

Consumption Indicators, Index Averaged to 2019	Apr-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Oct-21	Nov-21
Google Mobility - Grocery & Pharmacy	-52.0	-2.5	-4.9	9.5	18.5	3.2	32.7	42.8	47.4
Google Mobility - Retail & Recreation	-81.5	-59.8	-41.9	-27.5	-22.1	-40.4	-13.0	-4.9	-0.4
Petrol Consumption	38.8	91.1	97.8	108.0	109.4	96.2	103.7	109.8	105.6
Personal Loans	108.3	108.1	113.0	115.6	123.5	120.9	126.7	128.3	
Passenger Car Sales	1.4	38.3	97.1	95.5	95.5	81.6	52.1	68.1	68.3
Two Wheeler sales	2.5	66.0	119.2	81.5	101.0	76.4	102.8	104.4	76.7
Tractor Sales	18.6	147.2	173.4	107.1	142.1	179.8	156.9	190.8	111.3
Domestic air passenger traffic	0.0	16.5	32.9	61.0	65.0	25.3	57.5	59.0	
IIP: Consumer Durables	4.4	63.0	104.0	100.7	107.2	80.7	102.0	101.3	
IIP: Non-Consumer Durables	49.0	99.5	99.4	108.6	106.0	95.6	99.6	100.8	

Source: CMIE, Google mobility reports; CY 2019 refers to Jan' 19-Dec'19

As the festival season effect wanes, robust revival in employment becomes a prerequisite for a sustained pickup in demand. Encouragingly the employment data for November showed an improvement as the greater unemployment rate declined from 11.1% in October to 10.6% in November on the back of a recovery in the rural labor market supported by a strong rabi sowing season. Meanwhile, the urban unemployment rate noted an uptick, which could be a cause of concern. One comforting news for the urban labor market could be a marginal rise in greater labor force participation rate (38.4% v/s 38.3% in Oct). Having said that, the improvement in the unemployment rate is coupled with deterioration in job quality as salaried class noted a decline of 69 lakh jobs while the small traders and wage laborers noted a jump of 113 lakh jobs. The Naukri jobs opening data gives some hope for improvement in job quality as the organized sector's hiring activity continued to show strong momentum. The Naukri Jobs Index grew by 26% YoY in November, on the back of a robust pick up in hiring activity for retail, hotels/restaurants/airline/travels, education/teaching/training, banking/financial, IT/Software and telecom sector compared to last year levels. The employment-related sub-indices of PMI Manufacturing and services also indicated marginal expansion in jobs in November. Tentative signs of revival in private sector investment activity, if sustained, should also contribute to jobs growth.

With respect to the external sector, the exports continued their stellar growth trajectory as they grew by 27% YoY in November; however, the growth moderated on a sequential basis as the exports declined by 16% MoM from their peak of October. Nonetheless, exports remained above the $30 billion mark for the eighth consecutive month in this fiscal year, led by a strong performance of petroleum products, engineering goods, chemicals, and electronics. The sequential contraction possibly reflects a moderation in global trade activity due to the ongoing resurgence of cases globally and supply-side bottlenecks. Meanwhile, the imports continue to remain elevated as they noted robust growth of 56% YoY in November, potentially reflecting the impact of higher international commodity prices and strong domestic demand. Any new COVID wave is likely to weigh on the external trade growth and may also perpetuate supply issues.

Government fiscal position continues to stay benign on the back of robust tax collections

The government's favorable fiscal position in the FY22 (till October) provides it with the flexibility to step up expenditure without jeopardizing the budget deficit target of 6.8% of GDP. In the first seven months of FY22 (Apr-Oct), the central government's fiscal position remained contained as the fiscal deficit stood at 36% of its budgeted estimates which is much lower than the previous year trends when it had reached 91% of its budgeted estimates (5-year average FY16-FY20). This better-than-expected performance is primarily due to robust revenue collections. As such, the overall revenue receipts of the centre increased by 81% YoY during April-Oct, led by an uptick in both tax and non-tax revenues. While the net tax revenues noted an increase of 83% YoY buoyed by both direct and indirect taxes, indicating a continuing recovery in the economy, the non-tax revenues rose by 78% YoY, driven by an increase in dividends & profits. Accordingly, the government reached 65% of its budgeted receipts by October, higher than the previous year's trends (5-year average FY16-FY20), where the government met 48% of its budgeted revenues target in the same period, despite disappointment on the divestment program.

Regarding the expenditure, the central government expenditure picked up in the second quarter of FY22, broadly aligning with the opening of the economy post-ebbing of the second wave. The government expenditure increased by 10% YoY until October of FY22, led by capital expenditure (rising by 28% YoY), while revenue expenditure noted a modest growth of 7% YoY. As a result, the government expenditure has reached 52% of its budgeted estimates which appears to be a tad bit lower than previous year trends (59% of budget estimates in FY16-FY20). This coupled with continued strong revenue growth, should allow higher expenditure in the rest of FY22.

Cash outgo proposed under the second Supplementary Demand for Grants

Purpose	Expenditure (in crores)		
	Revenue	Capital	Total
Fertilizer Subsidy	58,430		58,430
Food Subsidy	49,805		49,805
Equity infusion in Air India etc.	2,135	64,685	66,820
Export Incentives/Remissions	53,123		53,123
Pradhan Mantri Awas Yojna - Urban	14,102		14,102
Mahatma Gandhi National Rural Employment Guarantee Scheme	22,039		22,039
Others	33,774	1,150	34,924
Total Cash Outgo	2,33,408	65,835	2,99,243

Source: RBI

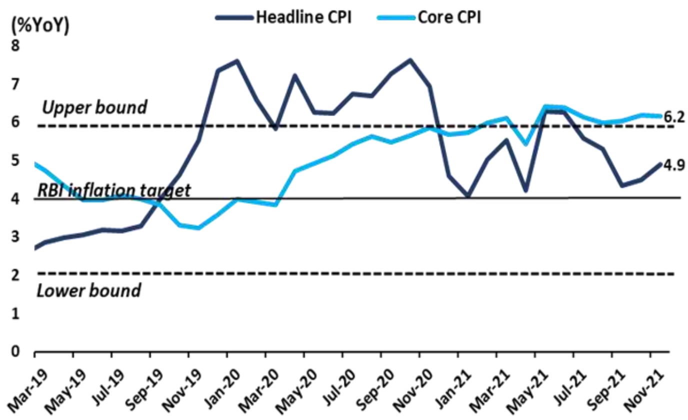
The central government has sought parliamentary approval for the second batch of supplementary demands for grants worth Rs 3.7 lakh crores involving a net cash outgo of roughly Rs 3.0 lakh crores. This additional spending mainly caters to food and fertilizer subsidies, exports incentives, MNREGA funds, and repayment of Air Asia's past dues. As per the RBI's estimates, the revenue expenditure of the centre and the state government (18 states) is expected to increase by 27% YoY in the remainder of the fiscal year (Nov-Mar), while capital expenditure is expected to increase by 54% YoY after accounting for the above additional expenditure proposals and assuming states meet their respective expenditure targets. This should help bolster economic recovery even if some momentum in private sector activity is lost due to uncertainty related to the new COVID variant

RBI continues to remain dovish; defers policy normalization on rising global uncertainty

The RBI continues to prioritize economic growth revival, as indicated by its dovish leaning in the December policy meeting. While acknowledging the improving economic conditions, the RBI noted increased downside risks to growth mainly emanating from global developments, including the Omicron variant, potential volatility in global financial markets due to a faster normalization of monetary policy in advanced economies, and prolonged global supply bottlenecks. Accordingly, the central bank decided to be cautious and maintained a status quo on policy rates and the stance. The RBI governor also recognized that the continuing slack in the economy, despite the strong recovery, warranted policy support to ensure a durable and broad-based recovery. Accordingly, the central bank deferred the policy normalization and kept the reverse repo rate unchanged at 3.35% against our expectation of a small hike in the range of 10 bps to 20 bps. It kept the focus on liquidity management to strengthen the RBI's control over the liquidity overhang. The central bank enhanced the size of the 14-day variable rate reverse repo (VRRR) auctions, decided to return to normal dispensation under the MSF, and provided banks with an option to prepay outstanding funds availed through TLTRO 1.0 & 2.0 schemes. We see these liquidity adjustment steps as continued work towards the start of policy normalization, which we now expect to begin from Feb '22 with a reverse repo rate hike in the range of 10 bps to 25 bps, assuming no major disruption to the economic outlook from the new COVID variant. We don't rule out further delays in policy normalization if a new COVID wave strikes, weighing on the economic recovery. Please refer to our report for more details on the RBI December policy meeting.

In November, the headline CPI inflation print, which came below the market expectations, provided some comfort to the RBI's current policy stance. Although it inched up to 4.9% YoY in November compared to 4.5% YoY in the previous month, the CPI headline inflation remained well below the RBI upper tolerance threshold of 6%. The headline inflation averaged 4.7% YoY in the last two months, sitting below the RBI forecast of 5.1% for Q3 FY22. The marginal rise in headline inflation is primarily led by a pickup in food prices and elevated levels of core CPI. Food inflation increased by 1.9% YoY against 0.8% YoY in October, led by an increase in prices of vegetables, cereals, pulses, milk, etc. The core CPI is a cause of concern, which remained sticky at 6.2% YoY, driven by a surge in prices of clothes and footwear, housing, recreation, and amusement services, and personal care. On the other hand, fuel & light inflation, albeit growing by 13.3% YoY, noted a sequential contraction of 0.2% MoM, potentially reflecting the impact of recent cuts in excise duty on petrol and diesel. With the continued surge in input price pressures, the WPI noted its highest print of FY22 at 14.2% YoY, led by an uptick in food articles, minerals, and crude petroleum & natural gas and fuel prices. With WPI print highlighting underlying inflationary pressures, we expect the retail inflation to pick up as demand revival continues and also due to hikes in telecom tariffs and GST on certain clothing and footwear. These pressures are likely to be offset partly by the moderation in food prices and the recent excise cuts on petrol and diesel. Overall, we believe that inflation could potentially surprise the upside in the coming months, which could lead to RBI having to recalibrate its present dovish policy stance.

Headline inflation remained comfortably lower than RBI upper tolerance threshold

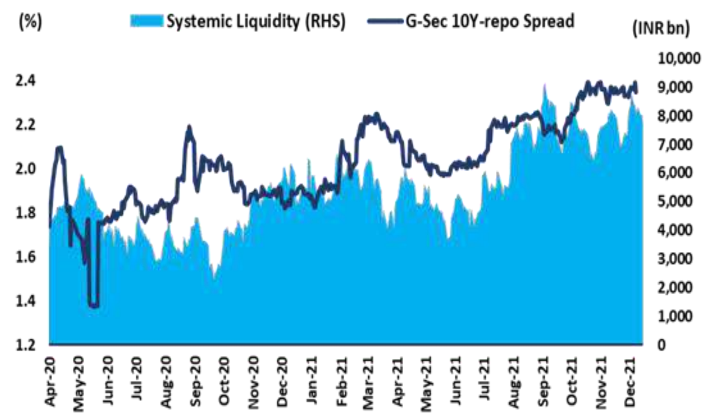


Source: CMIE

Market Section

Indian bond markets remained under pressure in November as major central banks moved closer or started the withdrawal of ultra-loose monetary policy conditions. The yields on the Indian 10Y G-sec rose to 6.35% on average in November (vs 6.18% and 6.33% on average in September and October, respectively). Accordingly, its spread over the repo rate stood at ~235 basis points, which is more than double the long-term average of ~100 basis points (FY10-FY20), indicating market expectations of higher interest rates going ahead. The cut-offs on the VRRR auctions have also increased steadily in recent months and stood at 3.99% on average in October and November vs 3.75% in September. Yields on other short-tenor instruments such as the 1-year and 2-year G-sec have also increased by ~8 bps and ~16 bps respectively in November, which has been much higher than the increase in 10Y yields, resulting in a flattening of the curve. Moving into December, the yield curve has further flattened with the 10Y-1Y spread narrowing by ~9 basis points to 2.03% from 2.12% in November (as of December 13) as the RBI continued focus on liquidity management even as it maintained a status-quo on policy rates. The shorter end of the curve saw a sharper increase in yields as the RBI continued to embark on its liquidity normalization path, enhancing the 14-day VRRR auction amounts to Rs 7.5 lakh crore by December 31 (from Rs 6 crore on December 3 auction), essentially absorbing the entire systemic liquidity through this window (systemic liquidity stood at Rs 7.6 lakh crore on average in November 2021). Easing oil prices due to the risk-off sentiment from the Omicron variant scare eased India 10Y yields relative to the shorter term. Going ahead, we expect the curve to remain flat as the RBI embarks on its policy normalization path.

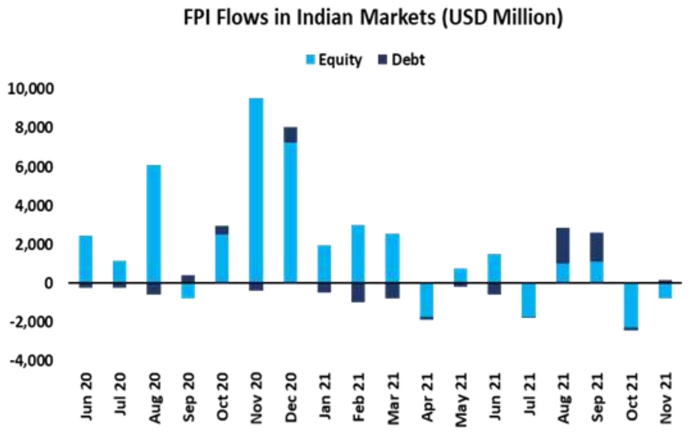
Bond markets remain under pressure with a flattening bias as the RBI moves towards policy normalization



Source: CMIE, Bloomberg

Indian equity markets came under pressure in November for the first time this fiscal year (after a very modest correction noted during April 2021). Indian benchmark indices - NIFTY and SENSEX contracted by 3.9% and 3.8% respectively in November, easing from their record highs in October as the risk-off sentiment from the Omicron variant, along with scare of a faster than anticipated normalization of the US Fed policy, led to a reversal in foreign portfolio investment. FPIs withdrew another $756 million from Indian equity markets in November (after a $2.3 billion outflow in October), resulting in a net outflow of more than $2 billion since the start of the fiscal year (after record inflows of more than $37 billion in FY21). Meanwhile, domestic investors continued to plough money in the equity markets, with Mutual Funds investing ~$2.4 billion in November, its ninth straight month of net inflow. Based on early data for December (as of December 13), Indian equities have again rallied, with the NIFTY and SENSEX increasing by 2.3% and 2.1%, respectively, on the back of a strong macro-economic outlook along with a benign COVID and vaccine situation. Moreover, a relatively more accommodative RBI in its December policy also boosted sentiments. However, market volatility with bouts of correction can be ruled in the coming months especially given a relatively more hawkish US Fed could lead to larger capital outflows from emerging markets, including India.

Foreign investors continue to pull out capital from Indian equity markets amidst rising headwinds



Source: CMIE

The Indian Rupee remained steady in November as it appreciated marginally by 0.7% against the dollar and traded at an average of 74.5 vs 74.98 in October. The domestic currency held its ground despite a 1.5% appreciation of the dollar index (thanks to a more hawkish US central bank and risk-off sentiment due to the Omicron variant) and capital outflows with FPIs inflows in Indian bond markets (~$153 million) in November offset by the outflows from the equity markets. The positive domestic economic outlook along with a controlled COVID situation and rising vaccine coverage kept sentiments intact. Some positive tailwinds from falling oil prices also boosted the rupee. However, moving into December, the rupee came under pressure as it depreciated by 1.2% (as of December 13) to trade ~75.4 levels on average. A further widening of India's trade deficit to record highs in November as domestic demand strengthened weighed on the rupee. Moreover, the RBI delivered a relatively dovish policy during December, which along with expectations of a faster taper by the US, could widen the interest rate differentials and result in larger capital outflows. Going ahead, we do not rule out volatility with the changing global macro-economic landscape and global inflationary pressures. Although, we expect the RBI to curb any sharp volatility in the currency given its well-equipped stock of FX reserves.

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