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INDIAN MARKETS ARE STILL BETTER POISED ACROSS EMERGING ECONOMIES: DOMESTIC BOND YIELDS ARE RETREATING AMIDST ROUT IN GLOBAL YIELDS, RUPEE MIGHT FIND NATURAL BALANCE SOON

The relentless pounding of global financial markets in recent weeks has bought into sharp focus the dilemma that central banks are facing across economies in terms of stabilizing the currency and the bond rates against a rate cycle of Fed that now is likely to go beyond the earlier estimates. **The rout in bonds markets globally has been exacerbated by long road to contain run away inflation, as Central Banks tighten the seatbelt to continue rate hikes spree, though Indian bond yields have been remarkably contained with even the latest SDL auctions of Rs 27,000 crores going off smoothly.** Investors are looking at elevated rates through 2023, dampening their appetite across asset classes. One of the possible reasons for the sharp increase in US bond yields that is having a material impact on emerging markets could be the sell off in US securities by economies along-with USD to protect domestic currencies. Till now countries are protecting their currencies with the depletion of FX reserves. FX reserves of China and Singapore declined by more than $100 billion in a period of merely six months. Even in the case of India, FX reserves has declined by $86 billion to $546 billion (from their highs last year).

Foreign investors—both official (governments, central banks, and sovereign wealth funds) and private-sector investors—owning approximately a third of total US treasury securities (~$23 Tn) contribute significantly to the selloff in U.S. Treasury securities in times of duress, with only exception noted during peak of GFC'2008 when net buying was seen. **We understand the selling by foreign investor class would have accelerated in recent times of extreme uncertainty as investors shun asset classes en masse, preferring the relative security of cash.**

The Indian markets have however performed much better. Specifically, rupee has been holding remarkably well with RBI intervention supporting in the market. This is in sharp contrast to the 2013 taper tantrum crisis when the rupee was witness to significant volatility for a prolonged stretch of time. **We believe that it might be better for RBI to allow the rupee to depreciate a bit, finding its natural balance**. For example, NDF market for three-month tenure shows that three months forward rate for USD/INR pair is now over ₹82 per dollar. Interestingly, the NDF market had factored a breach of ₹80 barriers from August. The implied yield on INR in the NDF is currently in the range of 4.25%. The yield is steadily rising from mid-August implying depreciation pressure on the rupee going forward. We believe a limited period of rupee depreciation might be a better way to wade through the current period of turbulence. **It must be mentioned, that even as the Dollar Index has surged by 17.1%, since the war broke out, the rupee has only depreciated by 7.8%, indicating the RBI has been leaning against the wind in terms of managing the currency and it may pay off now with a little bit of leaning with the wind, though only to an extent.**

Separately, there is no simple rule also to augment capital flows by the RBI in the current scenario. One possibility in the context of recent efforts by RBI to settle trade transactions in non dollar currency like Rouble is that if Central Banks come together and agree to peg the currency pair RUB/INR (make it agnostic to exchange fluctuation). In principle, exchange rate fluctuation has to be accounted for by the RBI to make the scheme successful.

As far as equity markets are concerned, while the foreign equity markets YTD decline in 2022 is in the range of 20-30%, in the case of India the decline is merely 3.5%. Not only Indian markets are lowest loss generators, they are stable also. Hence, in 2022 so far, Indian equities have shown resilience relative to most of advanced and EME peers. On market capitalisation front also, India's performance has been remarkable. Market cap in USD terms in case of India has increased maximum compared to other major economies (1.37 times in 2022). Notably, retail participation continues to increase. Retail investors turned net buyers of Indian equities in 2020 after a 11-year hiatus, and significantly so over the subsequent 18 months. **Since 2020, they have invested a total of Rs 2.9trn on a net basis (Calculated as the difference of total buy traded value and sell traded value) in NSE's capital market segment (Secondary market only) of which Rs 2.3trn has been invested over 2021 and the first half this year.**

Finally, credit growth continues to be buoyant indicating growth has still been robust in India. Good part is that, as per the latest number available as of 9th Sept 2022, we are witnessing double digit ASCB credit growth of 16.2%. It seems that the working capital utilisation is still maintaining a healthy pace and is contributing to the double digit credit growth. However, the prevailing uncertainties in the global business and economic environment and the domestic rate hikes could have an impact. For example, the number of Industrial Entrepreneur Memoranda (IEM) filed in July'22 declined to 114 from 143 in June'22, with an investment intention of Rs 16,540 crore as compared to Rs 82384 crore in June'2022.

BOND MARKET: THE SELL OFF IN US TREASURY

- The rout in bonds markets globally has been exacerbated by long road to contain run away inflation, as Central Banks tighten the seatbelt to continue rate hikes spree with soft recessionary echoes gaining currency globally. Investors are looking at elevated rates through 2023, dampening their appetite across asset classes.
- One of the possible reasons for the sharp increase in US bond yields may be the sell off in US securities by other economies along-with USD to protect domestic currencies. Till now countries are protecting their currencies with the depletion of FX reserves. Now the reserves are touching their multi-year low levels. FX reserves of China and Singapore declined by more than $100 billion in a period of merely six months. Even in the case of India, FX reserves declined by $86 billion to $546 billion.
- Foreign investors—both official (governments, central banks, and sovereign wealth funds) and private-sector investors—owning approximately a third of total US treasury securities (~$23 Bn) contribute significantly to the selloff in U.S. Treasury securities in times of duress, with only exception noted during peak of GFC'2008 when net buying was seen. We understand the selling by foreign investor class would have accelerated in recent times.

RISING MTM LOSSES

- As per the quarterly financial report, the US Fed is holding $8.7 trillion in assets as on Jun'22 , however it is carrying $720 billion in unrealized losses on its holdings of U.S. Treasury and mortgage-backed securities. By Dec'21, there was MTM profit of $128 billion, however, it turned into loss of $330bn in Mar'22, which further increased in Jun'22. As interest rate continue to rise after June, the market value of the Fed's massive investment portfolio is expected to have shrunk more. It is likely to have increased the losses to $995 bn. This in turn might make it difficult for the Fed to sell securities and continue its QT.

NDF MARKET TRENDS

- NDF market for three-month tenure shows that three months forward rate for USD/INR pair is now over ₹82 per dollar. The NDF market has factored a breach of ₹80 barriers from August. The current market expectation over three-month horizon for USD/INR pair is ₹82.35 per dollar.
- The implied yield on INR in the NDF is currently in the range of 4.25%. The yield is steadily rising from mid-August implying depreciation pressure on the rupee going forward.

US Treasury Security Holding by Countries (USD Bn)

Country	Jul-22	Jun-22	May-22	Apr-22	Mar-22	Feb-22	Jan-22
Japan	1234.3	1236.3	1223.7	1218.5	1232.4	1306.3	1303.1
China, Mainland	970	967.8	980.8	1003.4	1039.6	1054.8	1060.1
United Kingdom	634.6	615.4	630.4	612.7	634.9	625.2	608.8
Luxembourg	304.2	306.8	294.3	294	300.8	314	310.8
Cayman	291.9	300.4	294.2	291.4	292.7	274.7	271
Switzerland	287.3	295.3	291.1	271.6	274.1	281.7	299
Belgium	285.5	273.6	268.4	255.7	264.6	258.4	243
Ireland	277.2	285.1	288.7	309.6	315.9	314.8	308.3
Taiwan	239.9	233.9	230.7	228.4	238.4	248.5	248.6
Brazil	237.6	230.5	232.7	233.3	237.2	241.2	239.7
France	232.8	236.9	243.6	243.8	247	239.6	233.9
Canada	214.1	193.6	210.6	220.4	221.8	208.1	200.7
India	212	208.8	203.7	199	199.8	199.8	198.6

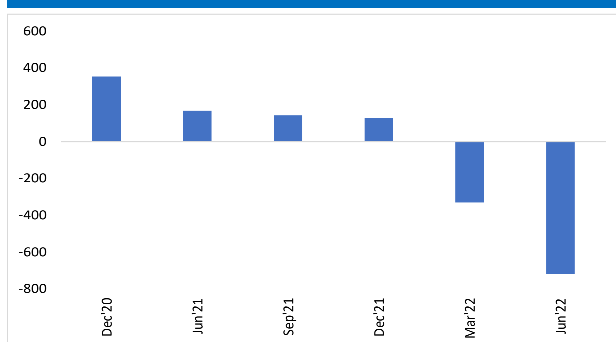
Source: US DoT, SBI Research

Foreign Exchange Reserves in $ Billion

Country	Feb-22	Aug-22	Change	% Change
China	3214	3055	-159	-4.9%
Singapore	417	280	-137	-32.8%
India	**632**	**546**	**-86**	**-13.6%**
Japan	1259	1177	-82	-6.5%
Thailand	223	195	-28	-12.6%
South Korea	437	413	-24	-5.5%
United Kingdom	133	118	-16	-11.7%

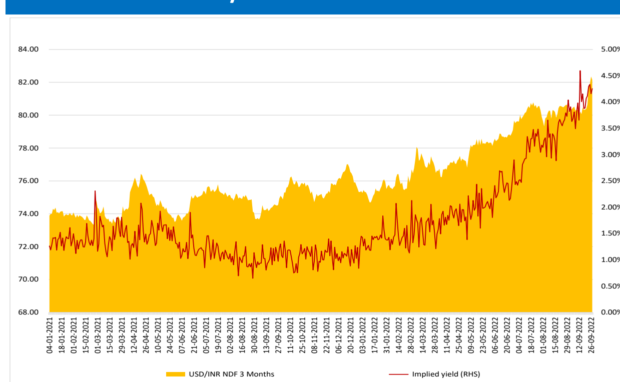
Source: SBI Research

Cumulative unrealised gains/losses (Net) of US Fed Portfolio securities holdings ($ bn)



Source: SBI Research

USD/INR Pair in 3M-NDF



Source: SBI Research

EQUITY MARKET

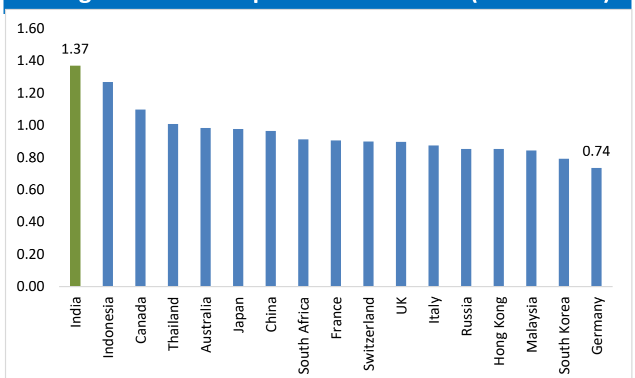
- With worries over high inflation, the continuation of the Russia-Ukraine war and rising interest rates, the equity markets around the world are on a roller-coaster ride for the past few months. India is also not an exception. However, Indian markets are getting their groove back as foreign portfolio flows are coming back, with the trickle of July turning into a flood in August and September so far (since 01 August India received FII inflows of $8.5 billion).
- We have already mentioned earlier also that fear of recession in India is unfounded. Amongst so many indicators the performance of equity markets also substantiate this fact. While the foreign equity markets YTD decline in 2022 is in the range of 20-30%, in the case of India the decline is merely 3.5%. Not even Indian markets are lowest loss generators they are stable also. Hence, in 2022 so far, Indian equities have shown resilience relative to most of advanced and EME peers.
- On market capitalisation front also, India's performance has been remarkable. Market cap in USD terms in case of India has increased maximum compared to other major economies (1.37 times in 2022).
- Notably, retail participation continues to increase. Retail investors turned net buyers of Indian equities in 2020 after a 11-year hiatus, and significantly so over the subsequent 18 months. Since 2020, they have invested a total of Rs 2.9trn on a net basis (Calculated as the difference of total buy traded value and sell traded value) in NSE's capital market segment (Secondary market only) of which Rs 2.3trn has been invested over 2021 and the first half this year.
- Moreover, their share in total capital market turnover at NSE rose from 33% in FY16 to 45% in FY21, only to fall marginally to ~41% in FY22, and then to 37% this fiscal, partly attributed to the market correction that has kept investors on the sidelines.

Global Equity Market Returns and Volatility

Country/Region	Index	YTD Change^	Volatility*
Russia	RTS	-49.8	75%
US	S&P 500	-23.8	27%
Germany	MDAX	-23.7	29%
Hong Kong	Hang sang	-23.3	33%
Euro	Euro Stoxx	-22.8	28%
Switzerland	Swiss MKT	-22.2	25%
France	CAC40	-20.1	25%
US	Dow Jones	-20.0	23%
China	Shanghai Composite	-16.0	23%
Japan	Japan	-9.8	17%
Great Britain	FTSE-100	-6.5	10%
India	Nifty 50	-3.5	17%
	SENSEX Index	-3.4	17%
Indonesia	JCI	6.9	11%

Source: SBI Research; ^since 01 Jan; * (Max-Min)/Average

Change in Market Capitalisation in 2022 (no of times)



Source: SBI Research

FRESH CAPEX LOSES STEAM IN Q1FY23. HARDENING INTEREST RATE SLOWED DOWN THE PACE OF GROWTH?

- The decline in the growth rate (4.1 percent) of the Indian economy in the last quarter of FY22, the recent slowdown in the Manufacturing sector, hardening interest rate had an effect on the quantum of fresh investment committed by project promoters in the first quarter of the fiscal 2023 (Q1/FY23). As a result, the growth momentum observed in the last four quarters of FY22 in the announcement of fresh investment lost steam in Q1/FY23. The prevailing uncertainties in the global business and economic environment slowed down the pace of new capex.
- As per Projects Today, the announcement of the new projects declined by around 27% to Rs 4.35 lakh crore as compared to Rs 5.99 lakh crore in Q1FY22 and Rs 5.75 lakh crore in Q4FY22.
- Further, number of Industrial Entrepreneur Memoranda (IEM) filed in July'22 declined to 114 from 143 in June'22, with an investment intention of Rs 16540 crore only as compared to Rs 82384 crore in June'2022.
- Good part is that, as per the latest number available as of 9th Sept 2022, we are witnessing double digit ASCB credit growth of 16.2%. It seems even though the capex is slower, the working capital utilisation is contributing to the double digit credit growth.

Industrial Entrepreneur Memoranda (IEM) filed in FY23

Month	Number	Amount Rs crore
April	69	13223
May	117	81206
June	143	82384
July	114	16540

Source: SBI Research; ; Ministry of Commerce & Industry

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