HDFC Bank – Research Presentation

June 2024

Risk profile-based asset allocation

Asset Class	Overall View	Asset Allocation		
		Aggressive	Moderate	Conservative
Equity Funds	◆	75%	55%	25%
Debt Funds	▲	20%	40%	70%
Gold	▲	5%	5%	5%

Note:	Optimistic	▲
	Cautiously Optimistic	◆
	Cautious	▼

Category-wise view

MF Categories	View
Equity Oriented Funds	
Largecap Funds	▲
Large Cap Index Funds	▲
Multi/Flexicap Funds	▲
Large and Mid Cap Funds	◆
Mid cap	▼
Small cap	▼
ELSS	◆
Value / Contra / Dividend Yield Funds	◆
Focused Funds	◆
Aggressive Hybrid Funds / Dynamic Asset Allocation / Balanced Advantage Funds	▲
Equity Savings Funds	▲
Business Cycle Funds	▲
Sector/Thematic Funds	◆
Multi Asset Allocation Funds	▲

MF Categories	View
Debt Oriented Funds	
Short Duration Funds/Medium Duration Funds	▲
Banking & PSU Funds	◆
Corporate Bond Funds	▲
Target Maturity Index Funds	◆
Medium to Long / Long Duration Funds	◆
Dynamic Bond Funds	◆
Gilt Funds	◆
Ultra Short Duration/Low Duration/Money Market Funds	▲
Arbitrage Funds	▲
Liquid/Overnight Funds	▲
Conservative Hybrid Funds	◆
Credit Risk Funds	◆

Equity MF Strategy – June 2024

- The global economic growth projections have continued to witness regular upgrades on the back of ample liquidity due to fiscal support by the governments, focus on improving manufacturing and infrastructure in key economies and gradual revival in the Chinese economy.
- The US economy has seen some hiccups in growth indicators in the very near term. Weakening PMI numbers, rising unemployment rate, lower consumer confidence were some of the recent data points that suggest a sense of gradual cooling off of the economy from the strong momentum that it has been exhibiting. These numbers along with low inflation print has given hope to the market participants of couple of rate cuts by the US Federal reserve in CY24. While expectation of the rate cuts has also led key US indices to record highs, the trend in these datapoints needs to be monitored to assess the policy response by the US authorities. With the US Fed curtailing its Quantitative tapering by USD 35 bn, further improvement in financial conditions could be seen going forward. Going forward, **a very important element that all risk assets will have to pay attention to is how the focus of both the US Fed and the US Government move towards managing liquidity, rates and growth dynamics.**
- Eurozone is showing early signs of stability due to easing of financial conditions, the continuation of which would be important. The ECB seems to be clearly hinting on cutting the interest rates as the inflationary pressure in the EU abates. Nevertheless, key high frequency data points in the EU still suggests a long way for growth to revive meaningfully.
- While the GDP growth in China remains below expectations led by the issues in their Real Estate sector, some key data points are showing gradual recovery. The Chinese economy is also witnessing fiscal and monetary support being provided by the Government to tide over the Real estate crisis. With the valuations in the Chinese markets at multi-year lows, positivity due to the measures taken by the government has led to healthy equity market performance.
- With stable economic performance of the US and green shoots being witnessed in China, commodity prices have witnessed a strong uptick from their recent lows; while the food price inflation globally remains weak. With the conflict in the Middle- East not escalating, the crude prices have also come off their highs. The trouble in the Red Sea has led to the rise in logistics costs for businesses across the world. Rising industrial commodity prices and logistics costs seems to be beginning to have a negative impact on margins of the consuming companies. While Gold prices have cooled from their recent highs, the buying by various Central Banks, continues to provide it support.
- The overall economic indicators in India continued to remain strong. The GDP growth for Q4FY24 was above market estimates at 7.8% YoY, while the full year GDP Estimates for FY24 is now estimated at 8.2% YoY. This was far above most expectations. The GDP growth has been predominantly led by improving Gross Fixed Capital Formation growth and strong export performance. Manufacturing growth has emerged as the key element of the growth uptrend.
- Many of the key indicators like the strength in the real estate and construction activities bode well for rural economy, where green shoots are getting visible. Two-wheeler sales have continued to do well suggesting a return of discretionary spending power. With monsoons likely to be normal in FY25, the rural consumption can spring a positive surprise.
- Urban demand trends have remained stable where the premiumisation trend continues. Indicators like personal loan growth, services export growth, and air passenger traffic have been stable to strong. Passenger vehicle sales growth, led by SUV's, too has held strong.
- Corporate and Banking sector balance sheets in India have shown strong improvement. The Corporate debt to equity remains low and as the current capacity utilisation peaks in various sectors, it is supporting to fund incremental private capex demand. With policies like PLI, preference by global corporations to diversify out of China into economies like India and others, need to create more energy assets and focus on import substitution by Indian government, the capex cycle is expected to last long. The current cycle in the equity market seems to be largely driven by the capex upcycle and policy reforms by the Government and the fund managers playing this cycle have been able to create strong alpha. However, valuations in the capex related sectors/companies have become quite rich and some derating of multiples seem to be on the card if the lofty expectations from these companies are not achieved.
- The liquidity conditions in India have been tight due to the focus of RBI on withdrawal of accommodation. As the liquidity conditions ease, the growth trajectory of the economy could see a further bump up.
- At an aggregate level, the valuations of both Midcap and Smallcaps are markedly higher than Largecap indices.
- **The Q4FY24 results have seen weak performance in many key sectors, ex Banking. Weakness in the Revenue growth and the Profit growth in key sectors may not be good news for investors. The differential of earnings performance between companies may see a gradual narrowing in the number of outperforming stocks in the equity market.**
- With the election results showing formation of a coalition government of NDA, with no single party getting a majority, the equity markets have seen sharp volatility as some questions have appeared on the pace of further reform push. In the long term, improving domestic macro conditions, favourable demographics and higher capex investments could keep driving the Indian corporate earnings higher and support the equity markets, thus sharp dips in the markets could be used as fresh investment opportunity.
- **With Valuations still quite high, investment deployment strategy could be at 40% lumpsum and rest 60% to be staggered over the next 5-6 months. Investors can look to focus on categories like Largecap, Flexicap, Multicap, Equity Hybrid and Multi-asset funds. All allocations should be done in line with the risk profile and product suitability of the investor.**

Debt Mutual Fund Strategy

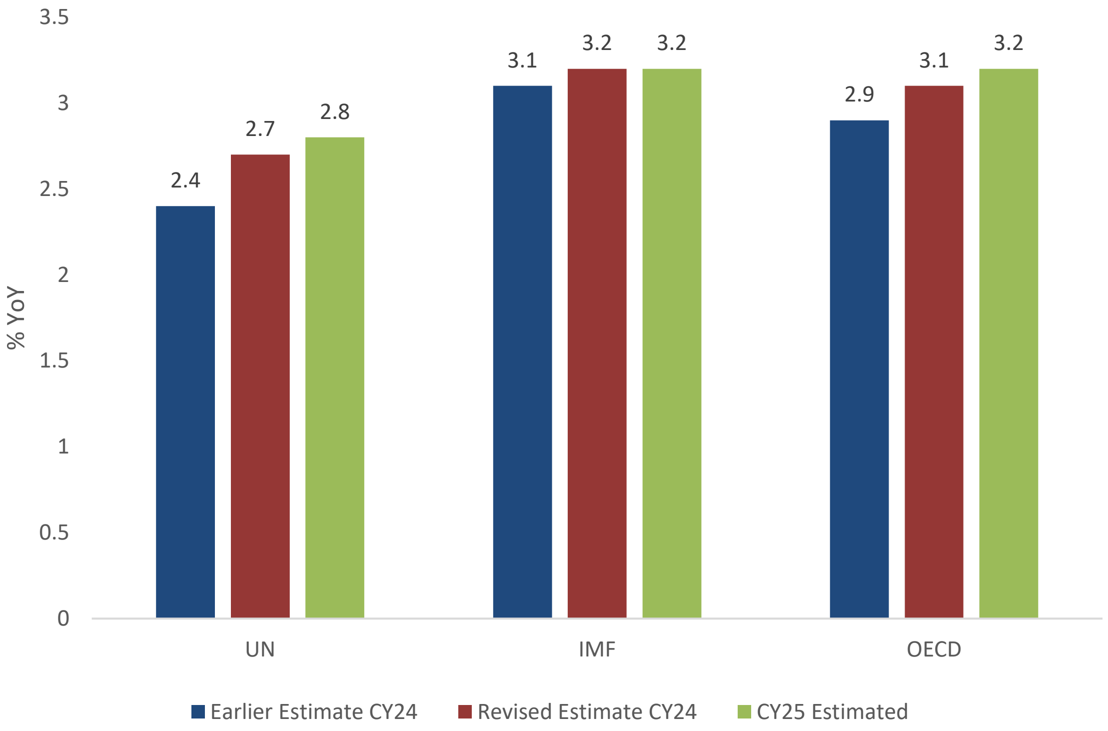
- Accrual opportunities at the 2-4-years segment of the curve remains attractive for incremental investment, from risk-reward perspective until fresh triggers appear to suggest further decline in yields at the longer end.
- As corporate bonds are available at reasonable spreads of similar tenor G-Secs, Corporate Bond Funds continue to look like a safe bet at the current juncture for investors looking to invest in shorter-tenure funds.
- Hence, investors can look at Corporate Bond Funds and Short duration funds for a horizon of 15 months and above.
- For a horizon of 3 months and above, investors can consider Arbitrage Funds.
- Whereas for a horizon of up to 3 months, investors can consider Overnight Funds and Liquid Funds.
- Investors can also look at Multi-asset allocation funds for a horizon of 36 months and above.
- Investors should invest in line with their risk profile and product suitability.

Research presentation – Content

Global growth on a strong wicket

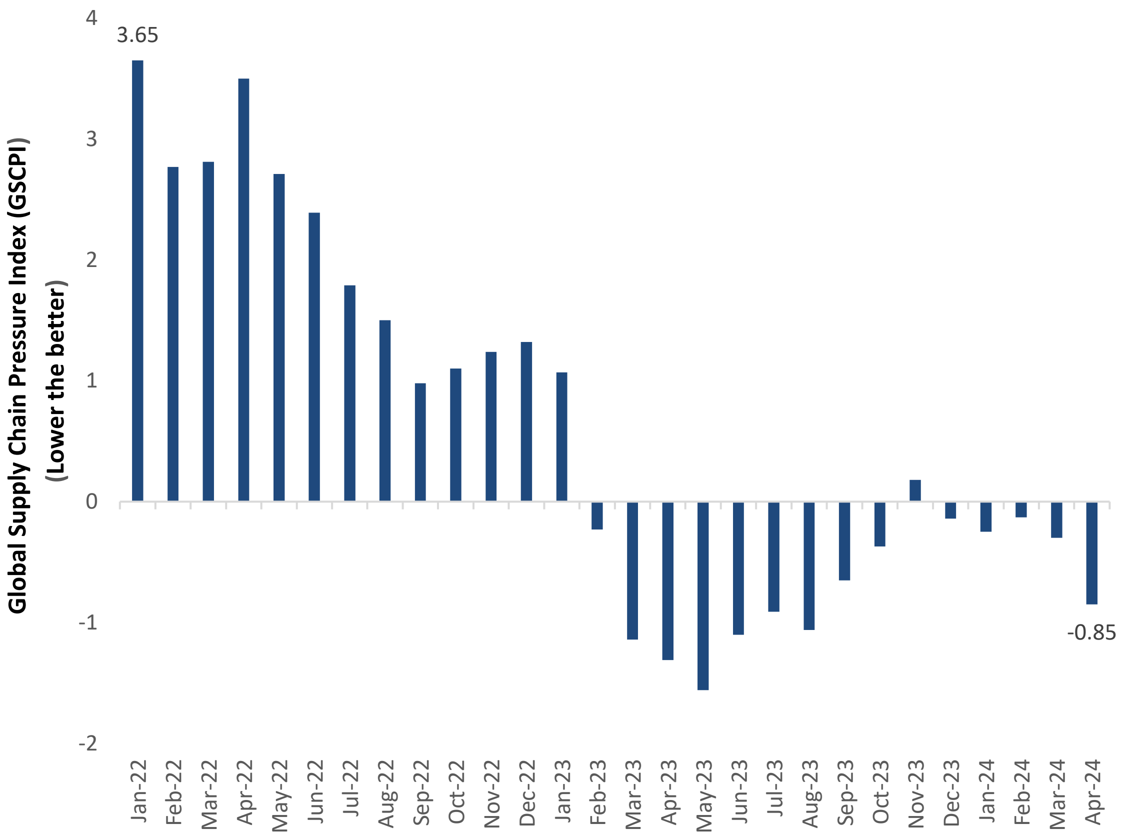
Global Growth Projections of Multilateral agencies

The outlook highlights the robustness of the emerging global economic landscape



Source: IMF , OECD, UN, Media reports

Supply Chain pressures also easing

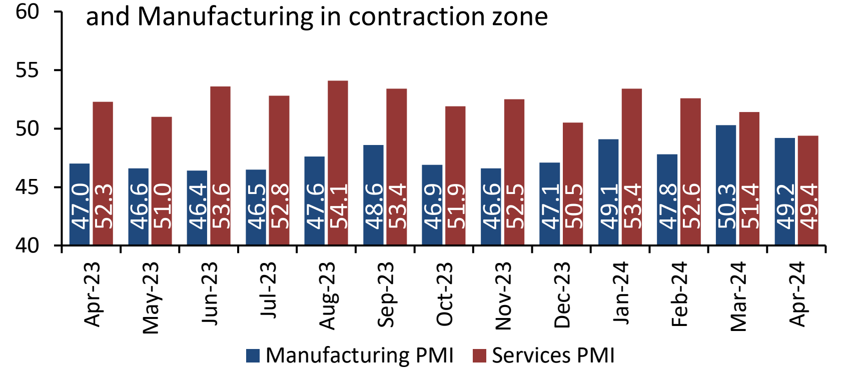


Source: Bloomberg

US economy - Cooling off a bit … Rate cuts on the horizon

US Manufacturing & Services PMI

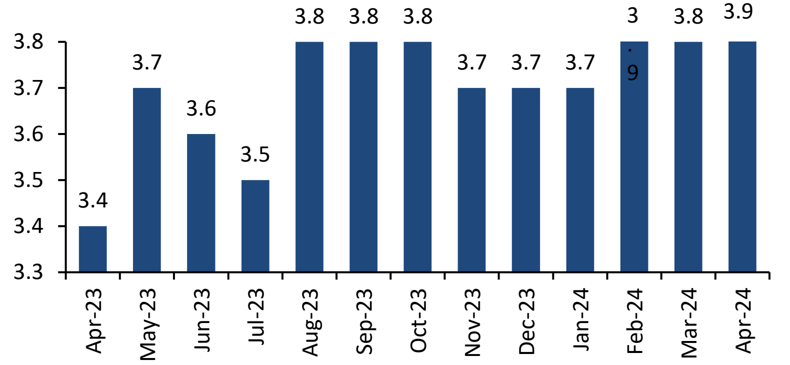
Slowdown can be seen in PMI activities as both Services and Manufacturing in contraction zone



Source: Bloomberg

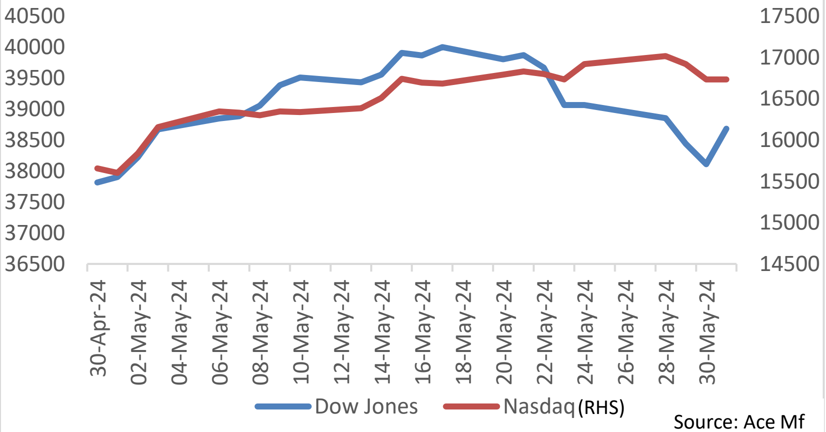
US Unemployment Rate (%)

Though tight, unemployment rate has moved up



Source: Bloomberg

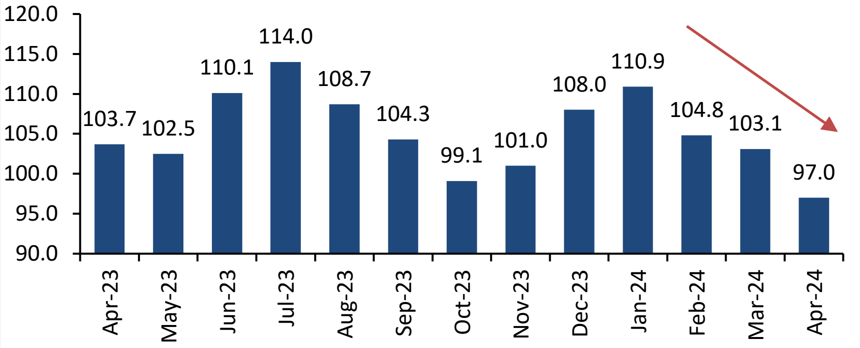
Expectation of rate cuts have kept US markets buoyant



Source: Ace Mf

US Consumer Confidence Index

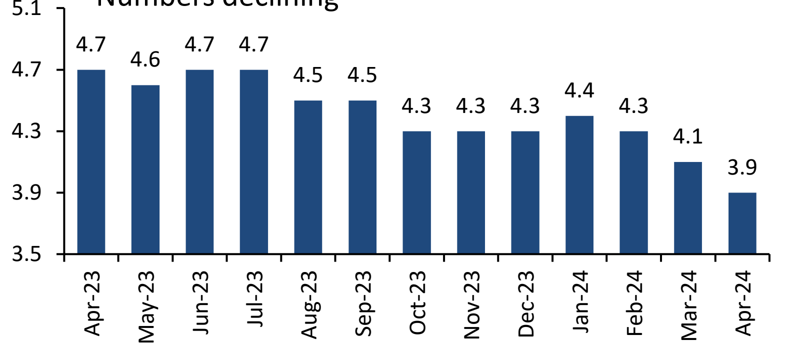
Weakness in consumer confidence visible



Source: Bloomberg

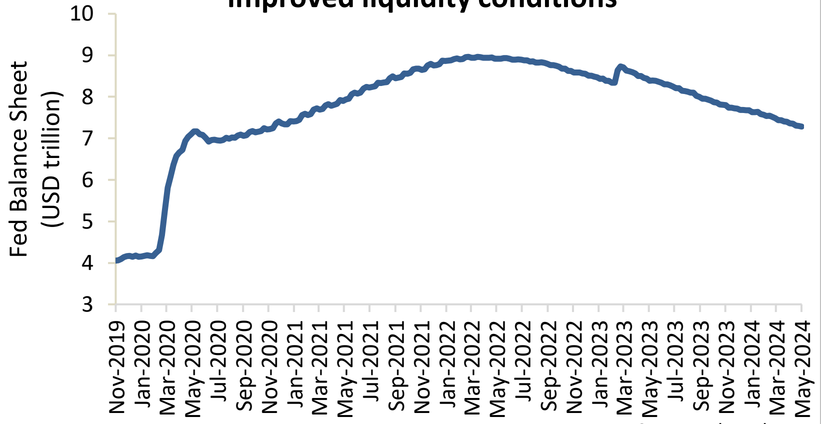
US Average Hourly Earnings - YoY Change (%)

Numbers declining



Source: Bloomberg

Fed curtailment of quantitative tapering has improved liquidity conditions

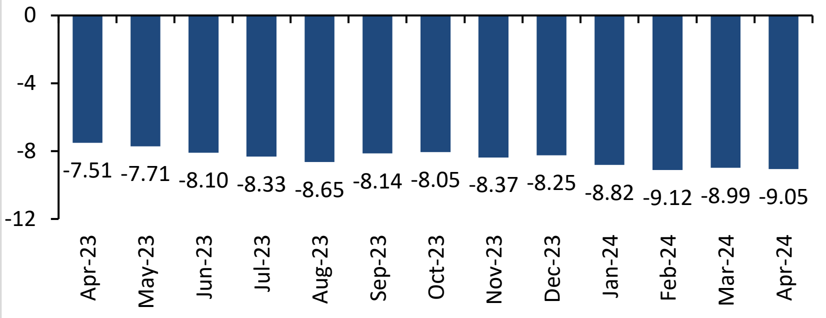


Source: Bloomberg

Eurozone – Looking for a turnaround

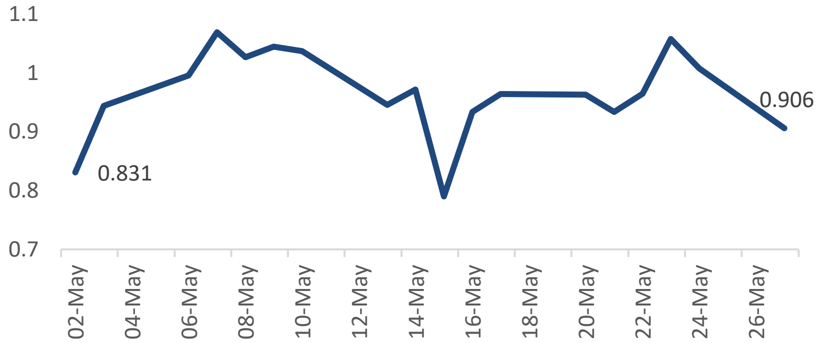
Eurozone Leading Economic Index YoY (%)

Headwinds to growth continue to persist



Source: Bloomberg

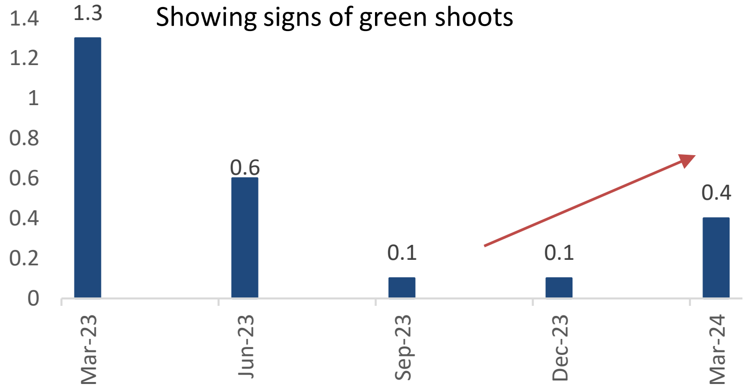
Euro Area Financial Conditions Index has seen improvement



Source: Bloomberg

Eurozone GDP YoY (%)

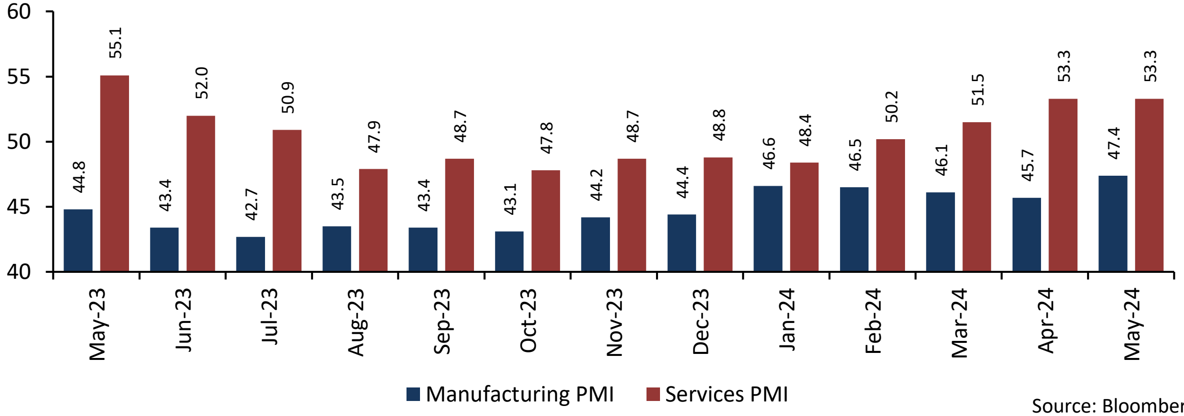
Showing signs of green shoots



Source: Bloomberg

S&P Global Eurozone PMI

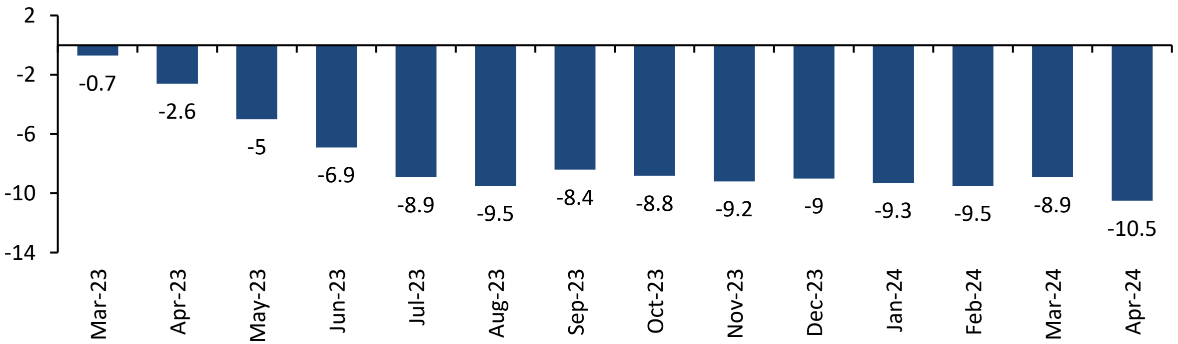
While Manufacturing PMI is weak, Services PMI uptick visible



Source: Bloomberg

Eurozone Industrial Confidence Indicator

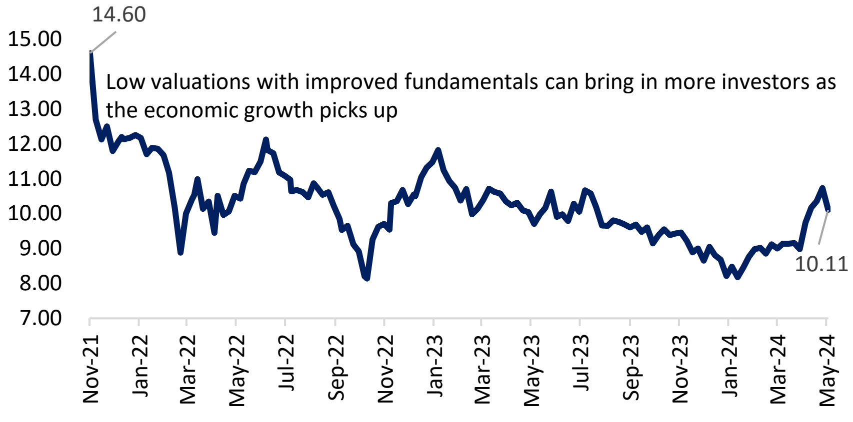
Though business conditions have improved, it remains in negative territory



Source: Bloomberg

China: Economic revival visible…government support to aid further recovery

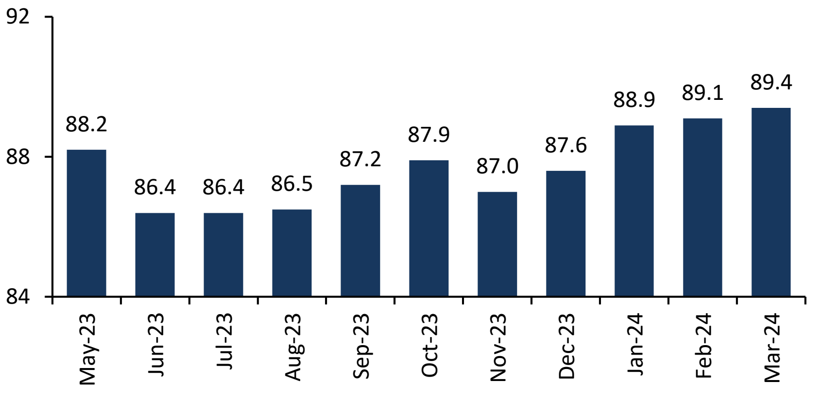
Rolling 1 year Forward P/E for Chinese Market



Source: Bloomberg

China Consumer Confidence Index

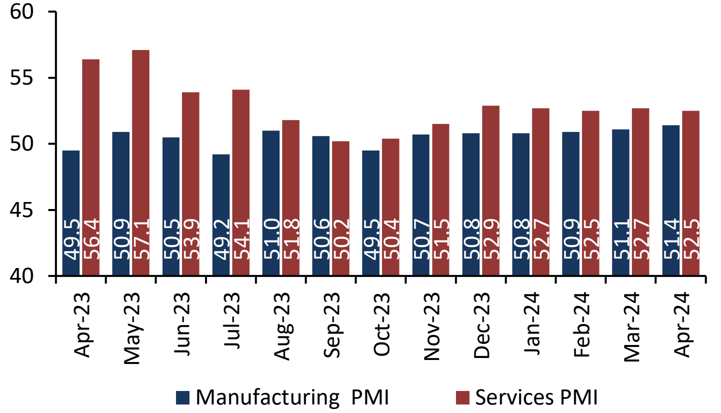
Consumption trends improving



Source: Bloomberg

China Manufacturing & Services PMI

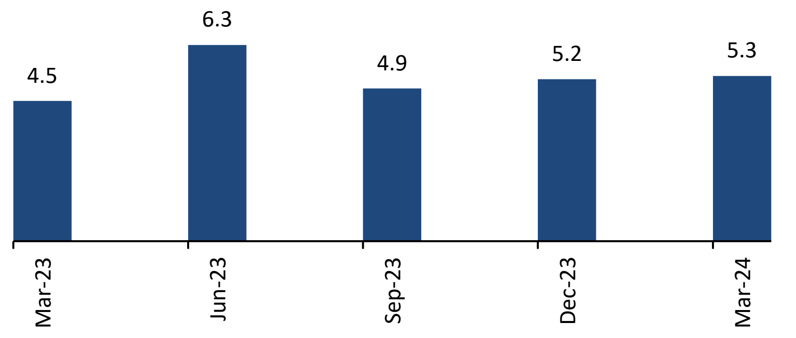
PMI on strong wicket



Source: Bloomberg

China Quarterly GDP - YoY Change (%)

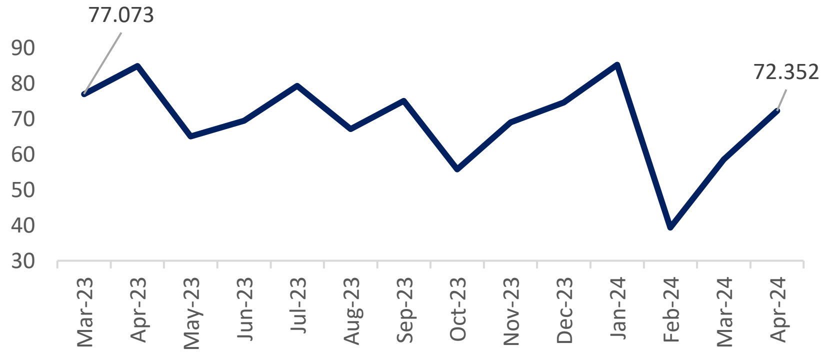
Growth expected to improve



Source: Bloomberg

China Trade balance (USD Bn)

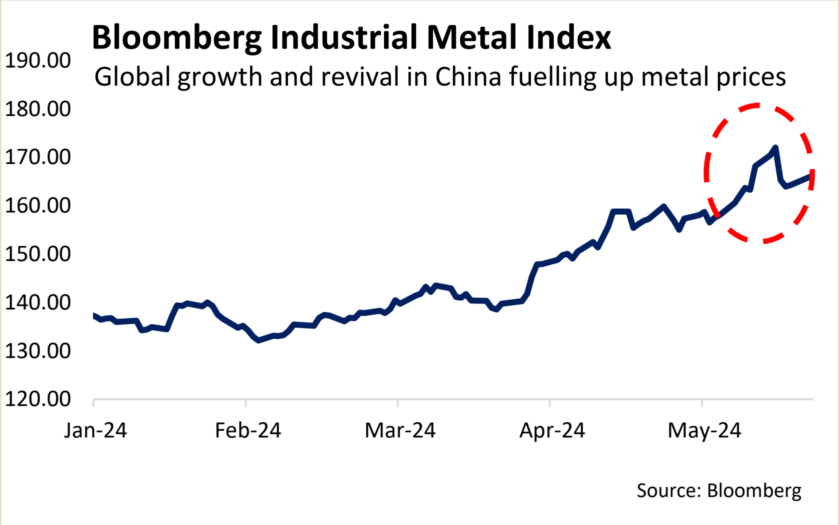
Steady performance continues

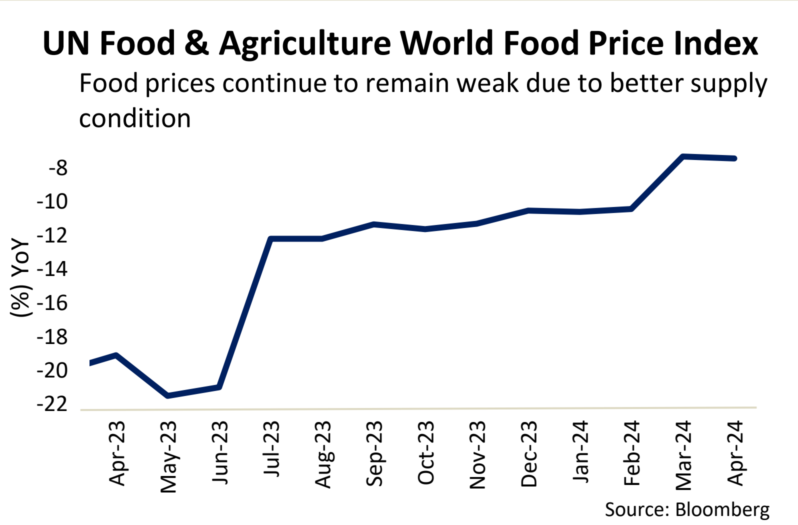


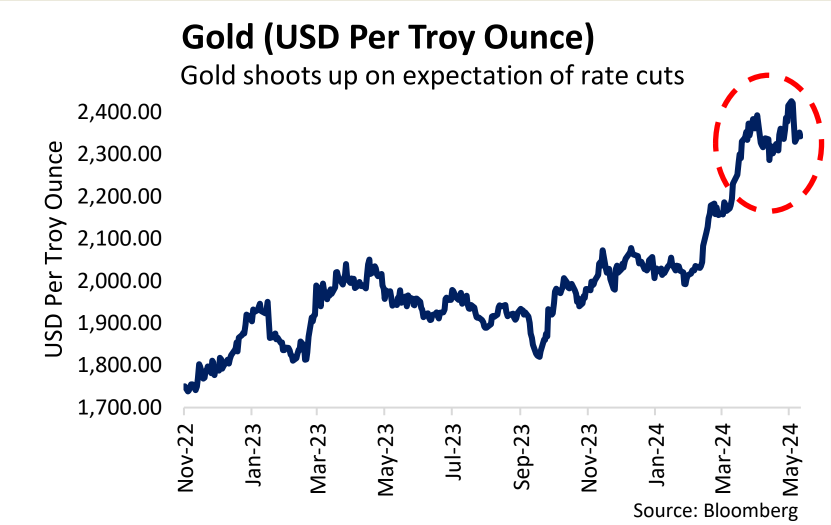
Source: Bloomberg

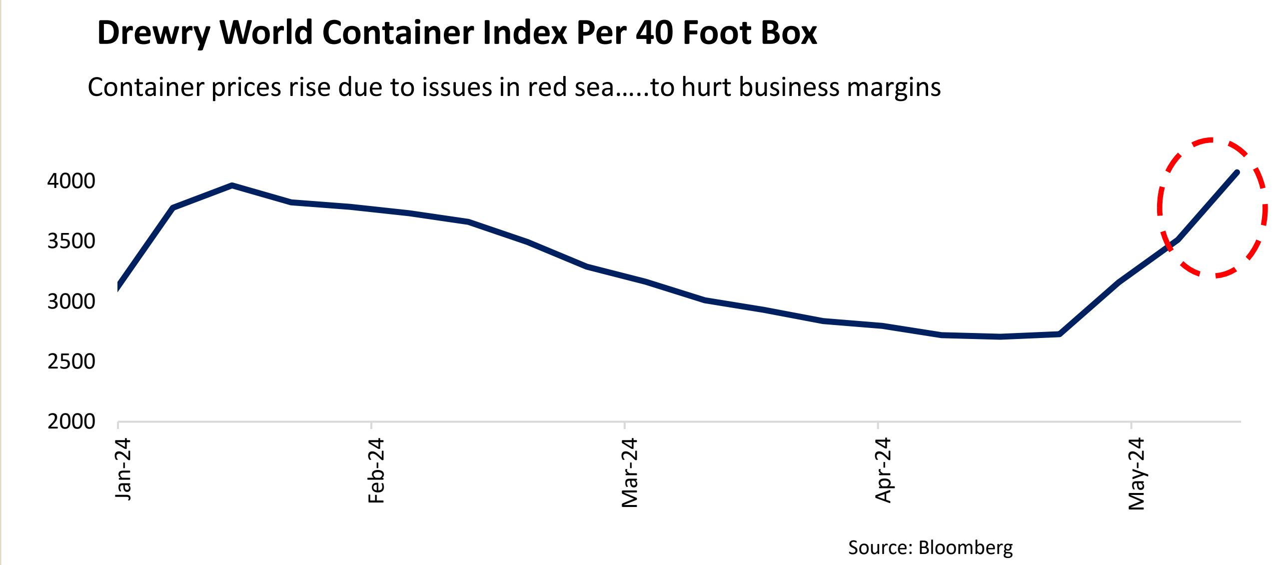
- **The People's Bank Of China (PBOC) announced that it will set up a nationwide program to provide 300 billion yuan ($41.5 billion) in loans to fund state purchases of unsold homes.**
- **Municipal governments should buy unsold homes and convert them into affordable social housing, in a plan that has been trailed as a major solution for the country's crisis-ridden property sector.**

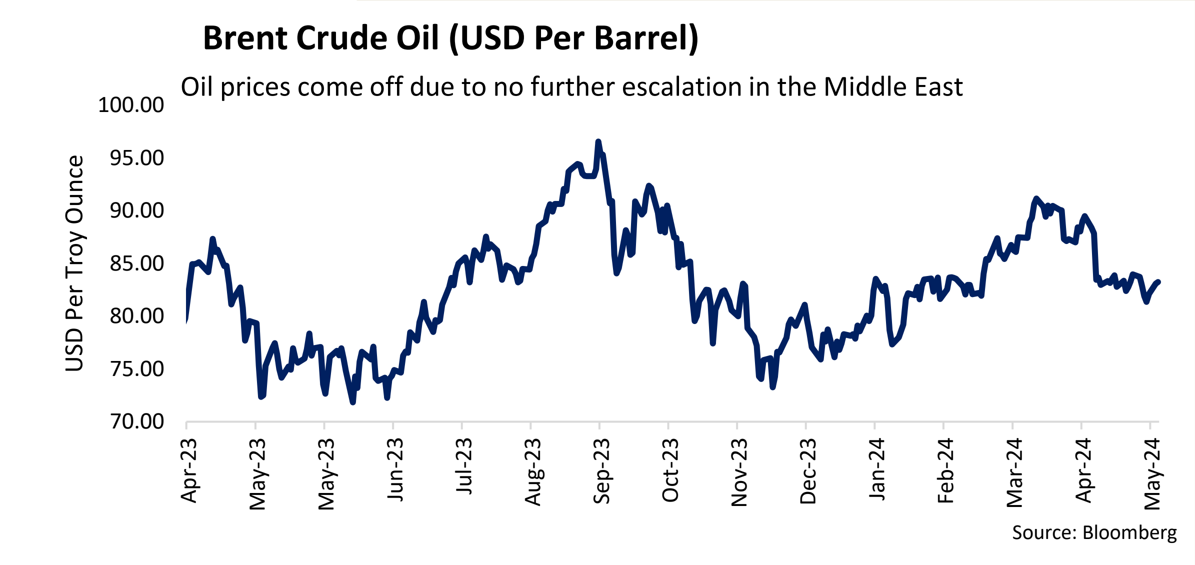
Commodities: Metals rise… transportation costs up… while food inflation under control











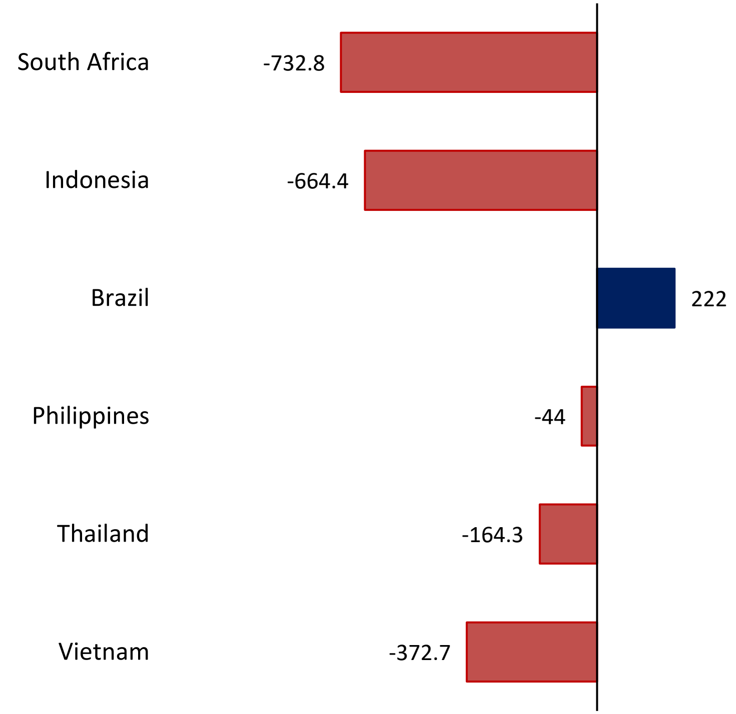
Uptick in the US dollar index impacting foreign flows into the emerging economies

US Dollar Index

USD moderating on softer landing of US economy, fed rate cuts awaited

Source: Bloomberg

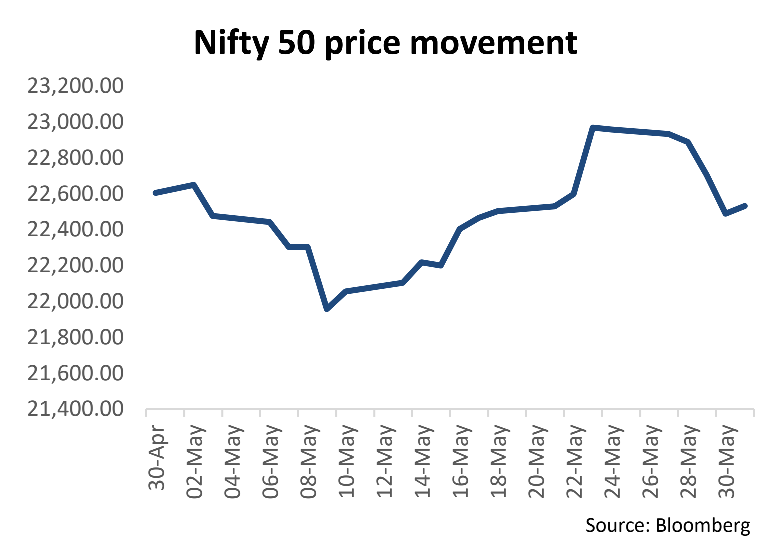
Emerging Markets – saw net outflows In May 2024 (USD Million)

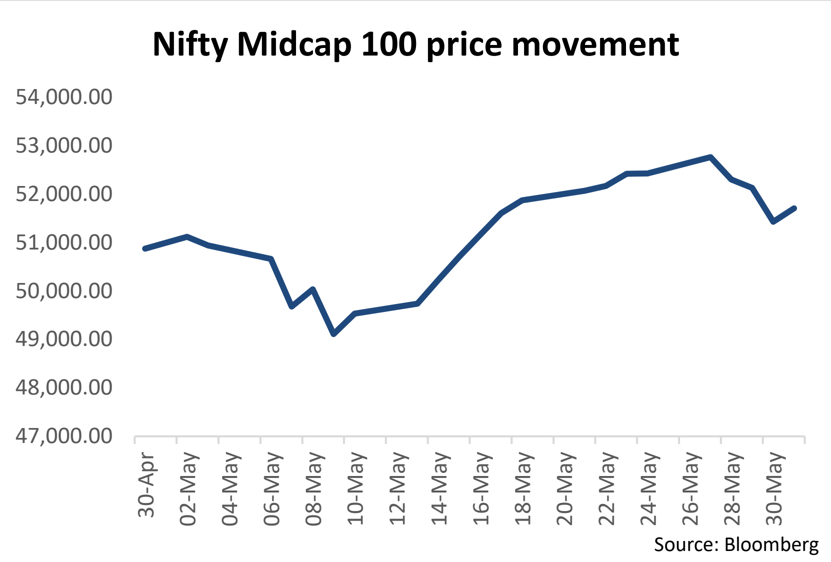


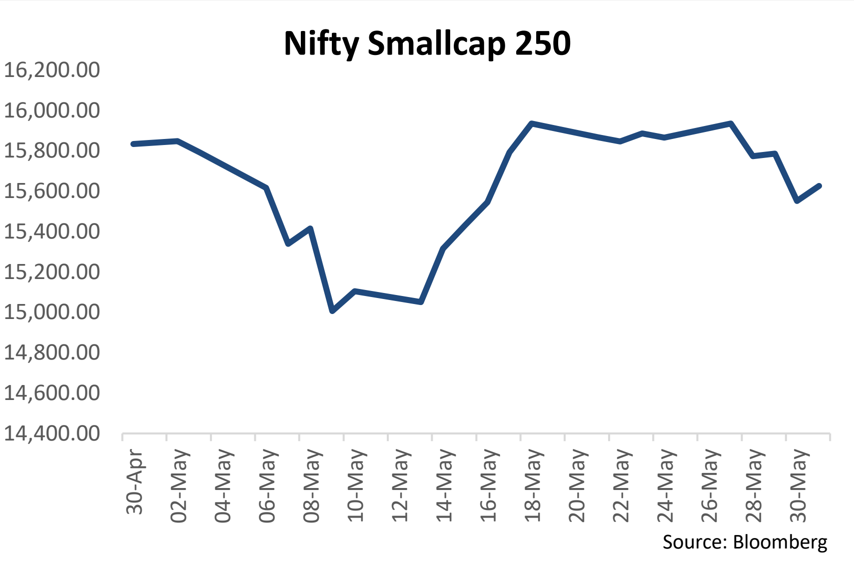
Source: Bloomberg

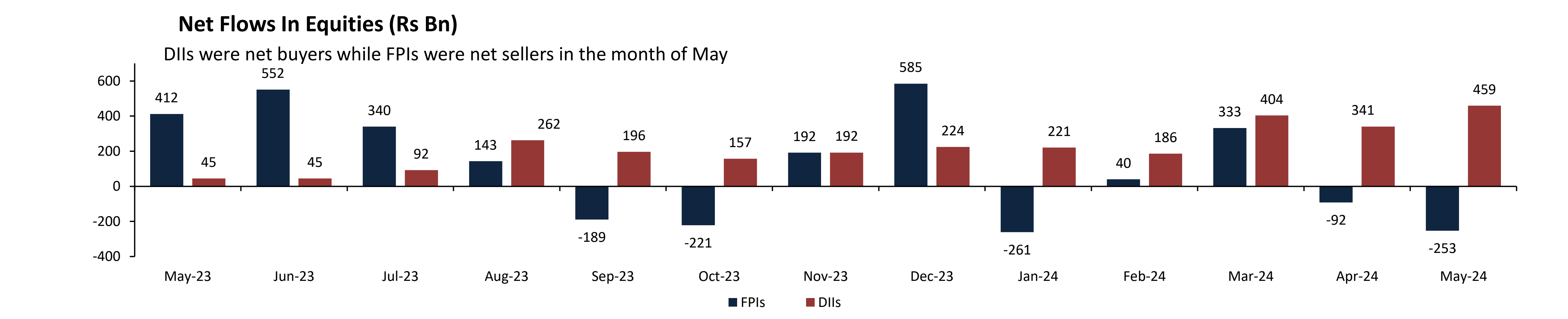
Source: Bloomberg

Indian market turned volatile ahead of general election results









*For 2024, FPI and DII data is up to 31st and 30th May, 2024, respectively

Source: SEBI, CDSL

Quarterly earnings – Showing mixed performance

Sector	Net Sales - YoY Growth (%)			EBITDA - YoY Growth (%)			PAT - YoY Growth (%)		
	Q4 FY24	Q3 FY24	Q4 FY23	Q4 FY24	Q3 FY24	Q4 FY23	Q4 FY24	Q3 FY24	Q4 FY23
Auto & Auto Anc	14.28	20.54	27.20	41.23	53.65	67.63	86.77	57.30	125.75
BFSI	16.55	15.99	19.35	-15.12	23.93	78.64	25.52	11.11	36.97
Capital Goods	17.69	18.01	9.75	28.31	15.79	6.40	27.43	19.20	5.09
Cement & Products	9.61	8.27	14.58	34.50	81.39	-6.38	48.11	100.16	-16.93
Chem & Fert	-14.03	-20.88	11.92	-41.29	-73.77	-6.52	-83.67	-100.54	-9.59
Ecomm	28.57	40.53	50.48	61.86	78.01	64.93	85.39	126.31	-45.00
FMCG & Retail	7.22	5.25	10.95	8.44	8.74	9.91	-5.77	8.73	13.19
Healthcare	12.15	12.47	14.24	27.85	25.17	30.13	50.54	38.38	420.70
Infrastructure	18.97	44.59	39.99	25.82	82.47	87.53	76.88	65.22	2.47
IT	2.14	2.51	18.43	1.88	0.72	14.53	8.64	-1.97	9.37
Media & Ent	6.05	-0.89	-7.12	12.62	-19.99	-49.29	38.90	5.25	-51.10
Metal & Mine	-3.43	-0.31	-2.11	0.09	42.85	-37.31	-6.09	70.18	-42.47
Oil & Gas	3.11	-0.51	9.25	-5.81	33.57	11.49	-1.25	37.64	6.55
Others	2.25	-3.11	15.96	-8.38	80.12	162.41	-31.69	100.40	94.45
Power	9.95	0.95	19.64	6.99	-11.08	17.73	16.98	-20.46	-0.64
Realty	5.14	-16.61	9.73	41.60	-26.45	21.68	23.64	-20.87	3.89
Telecom	5.61	6.39	8.87	4.30	41.01	10.58	-397.26	52.55	19.32
Textiles	12.75	11.62	16.14	33.31	50.85	16.86	15.54	-41.56	-35.57
Transport	21.97	26.91	49.28	52.91	97.29	309.43	83.62	105.31	198.36
Grand Total	8.05	6.86	13.22	3.92	22.95	13.37	17.46	20.07	14.58
Ex-Financials	5.30	4.07	11.37	7.33	22.79	6.41	12.64	26.33	4.38

Data as on May 31, 2024 and pertains to 199 companies within the Nifty 200 universe

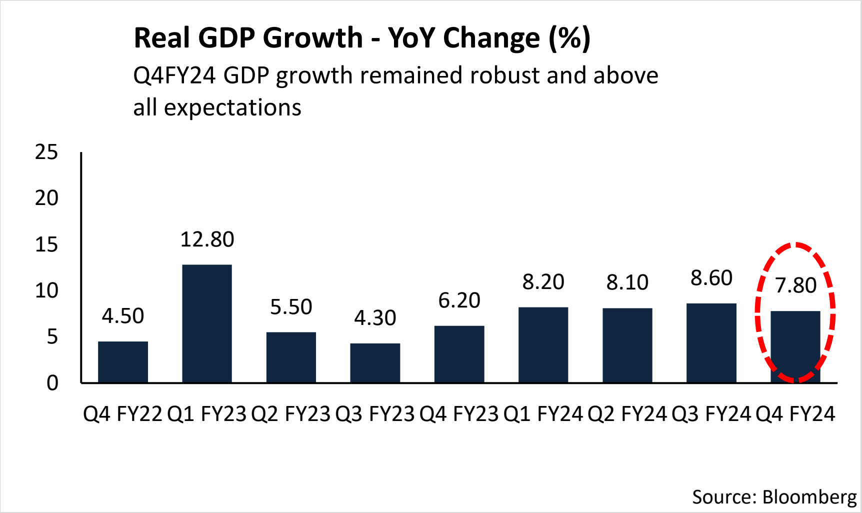
Source: Capitaline, HDFC Bank Research

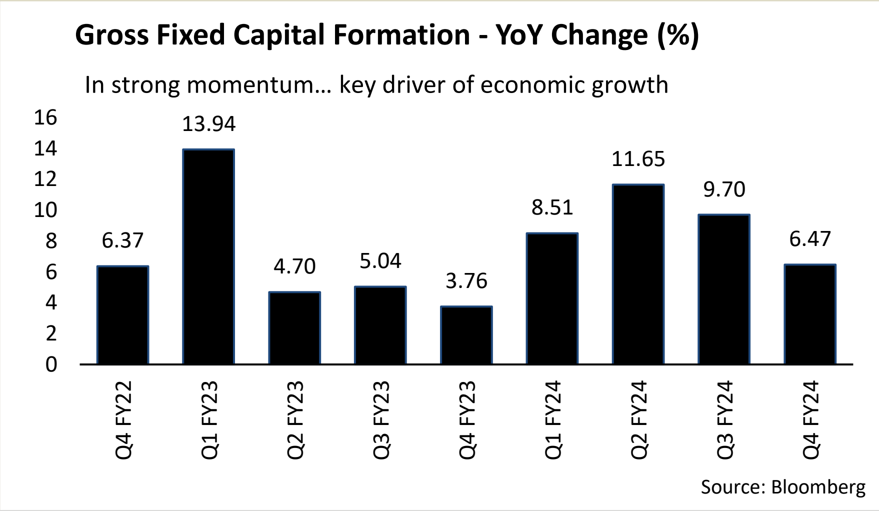
Sector	No of Companies	Net Profit Margin (%)		
		Q4 FY24	Q3 FY24	Q4 FY23
IT	59	17.7	18.9	20
Manufacturing	369	11.8	10.8	9.1
Services (non IT)	119	7.8	8.6	10
Aggregate	596	12.6	11.8	11

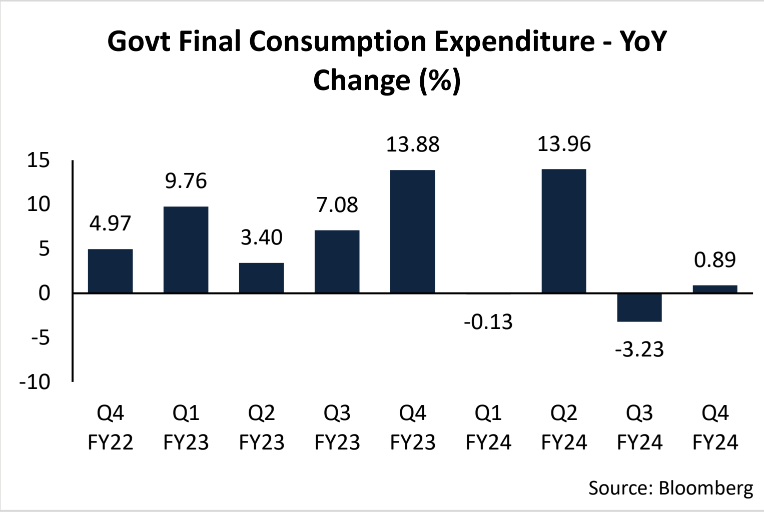
Sources: Capitaline and RBI staff estimates.

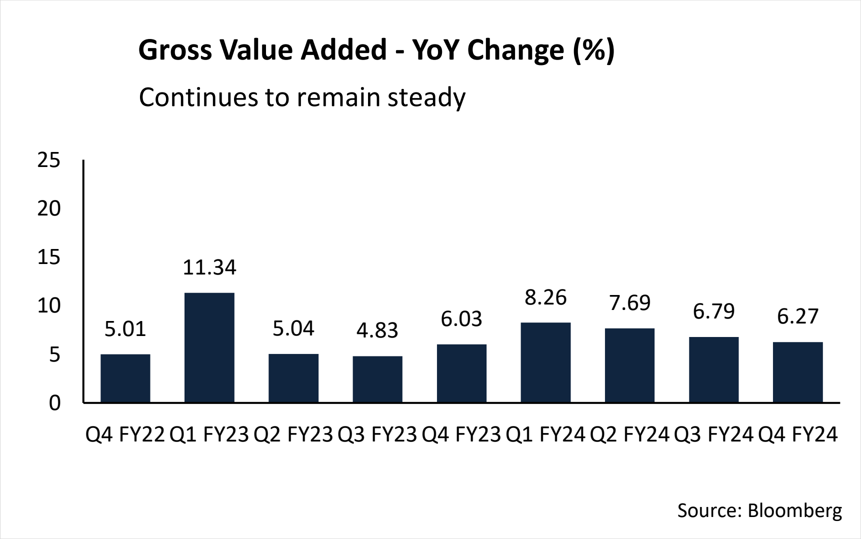
- Margins of Manufacturing companies have seen steady performance
- Q4FY24 results have remained muted where the Largecap companies have outperformed the Mid and Smallcap companies at an aggregate.
- Infra, Pharma, Capital Goods, Banking, Healthcare & Auto sector have outperformed most in terms of PAT growth.

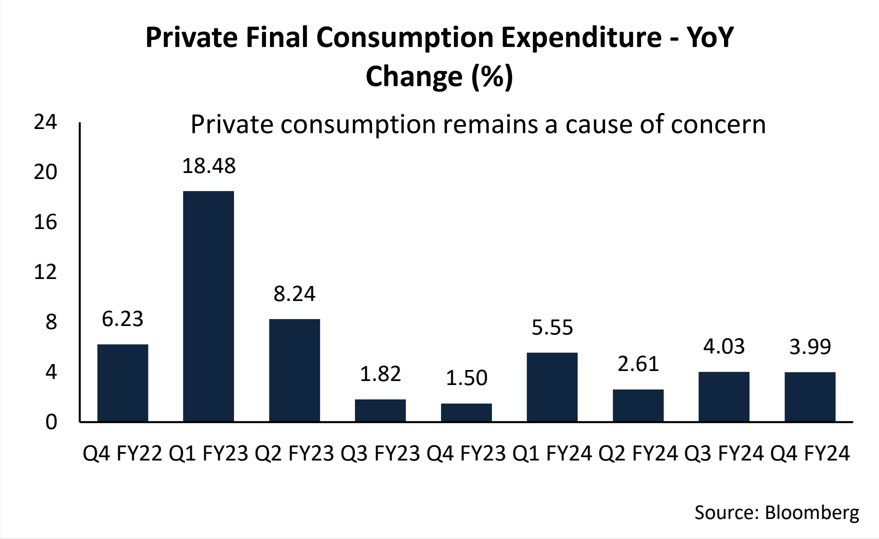
GDP growth surprises on the upside… Yet Again!!!

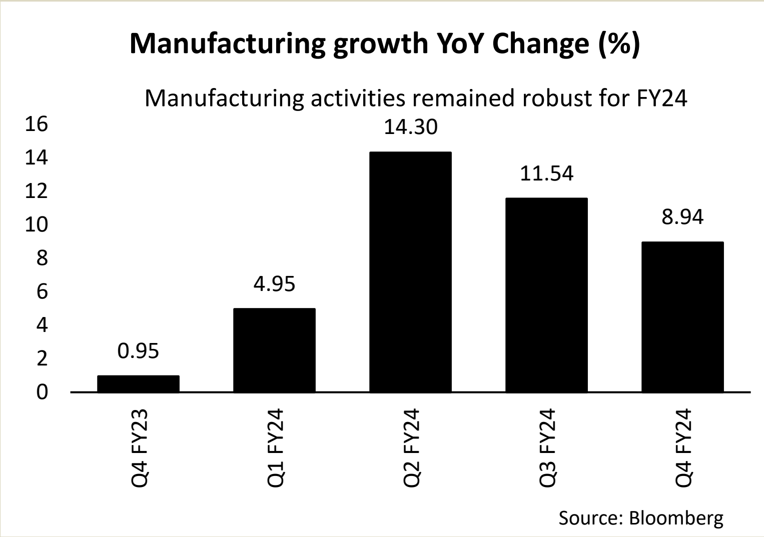




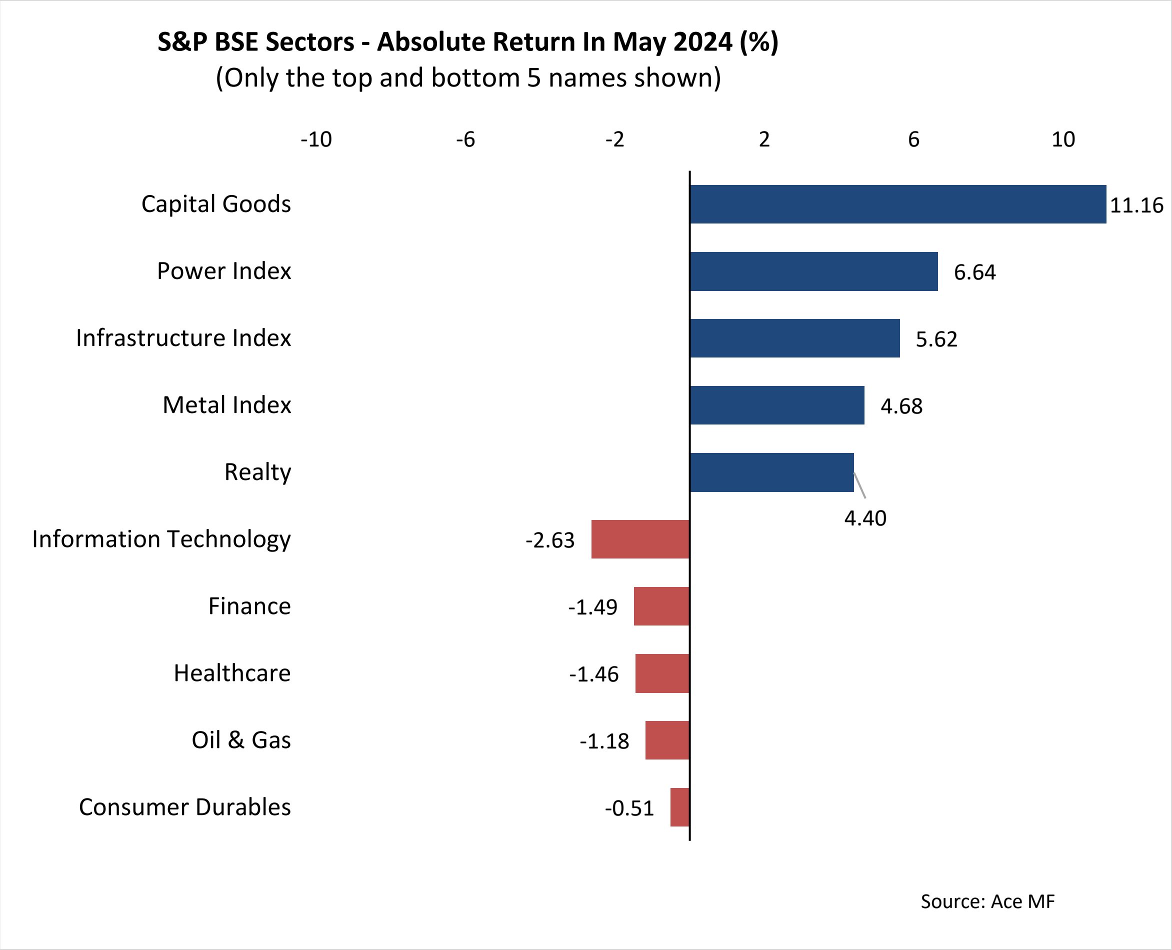


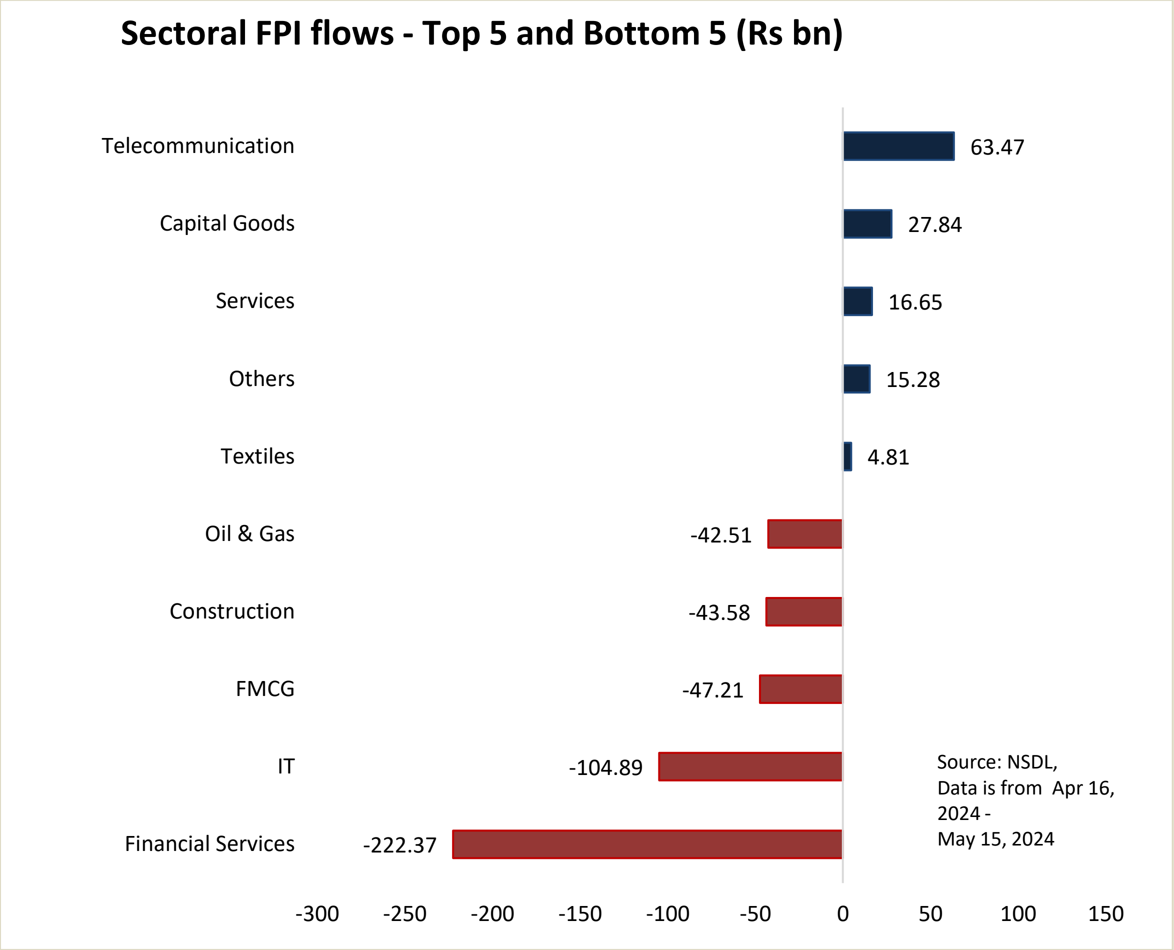






Sectoral performance and FPI flows in May 2024

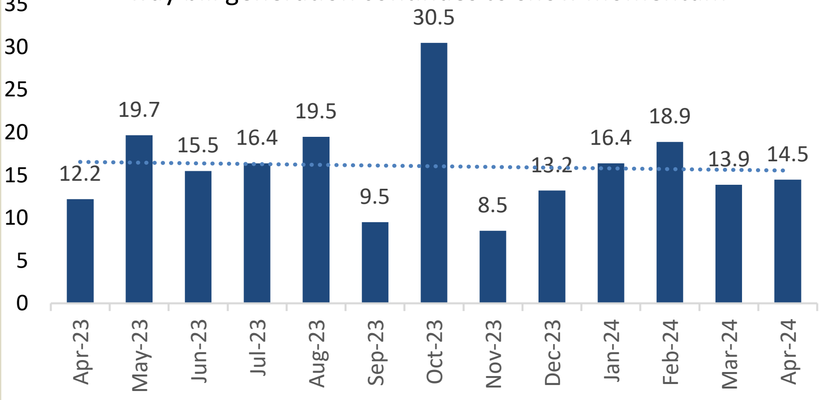




India – Macro high frequency data trend remains stable…

E-way bill (%YoY)

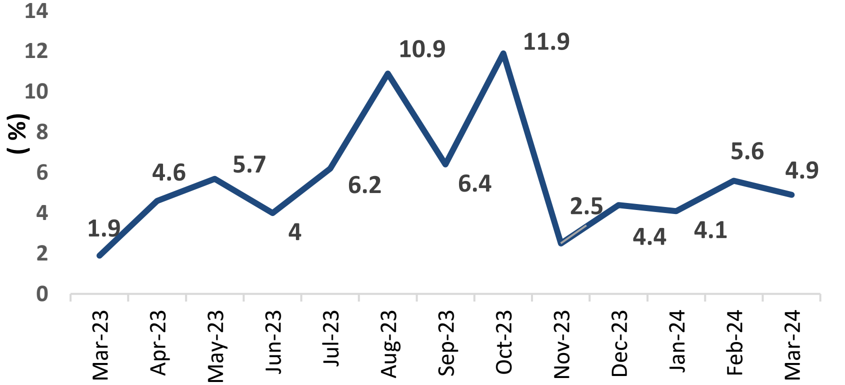
E-way bill generation continues to show momentum



Source: Bloomberg

Index of Industrial Production (% YoY)

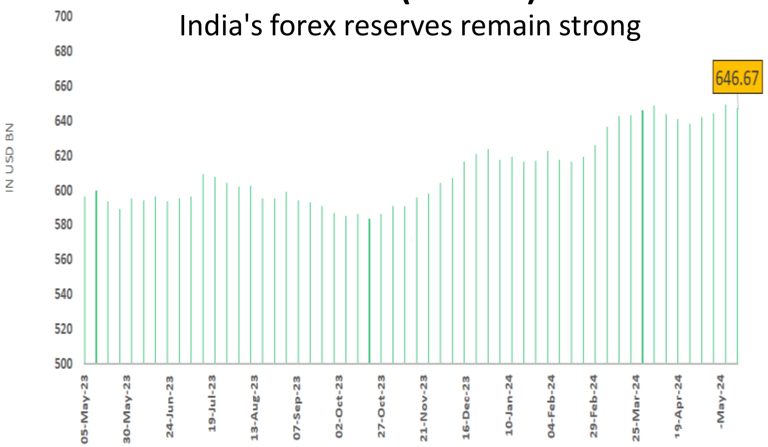
IIP growth remains steady



Source: Mospi

Forex Reserve (USD Bn)

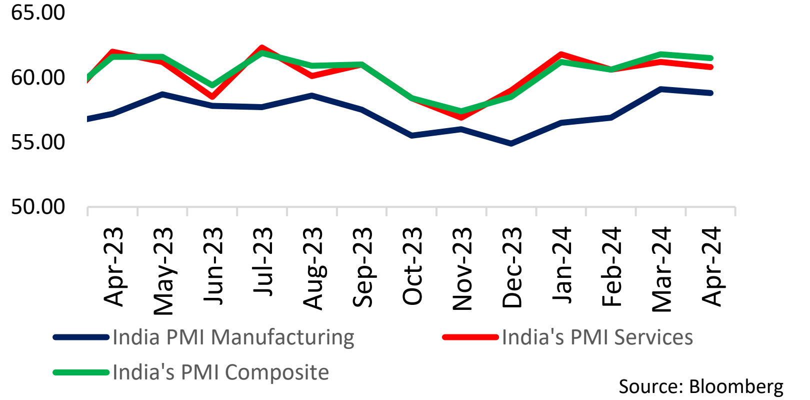
India's forex reserves remain strong



Source: Bloomberg

HSBC India PMI

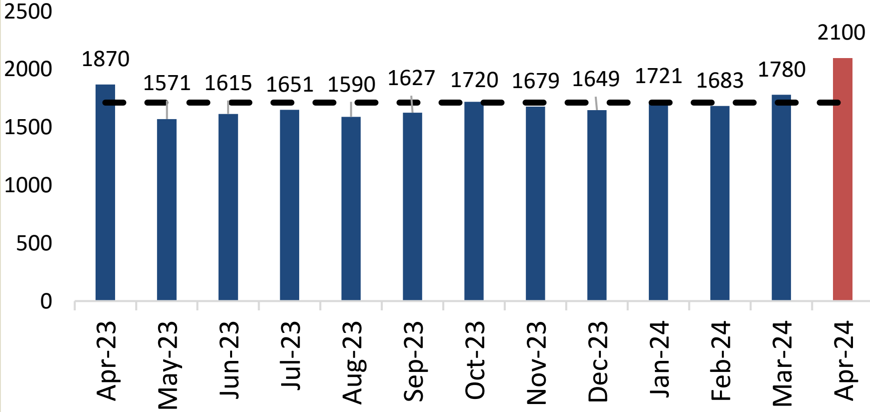
Strong PMI activity, signalling a substantial rate of expansion across the private sectors



Source: Bloomberg

GST Collection (Rs Bn)

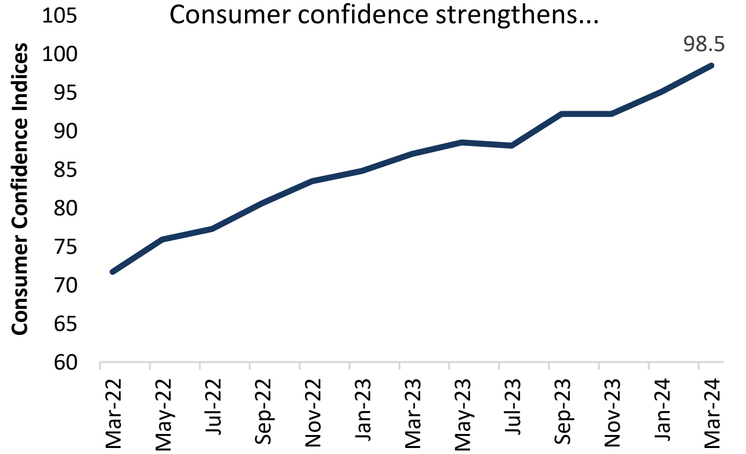
GST collections hit a record high



Source: Ministry of Finance

Consumer Confidence Index

Consumer confidence strengthens...

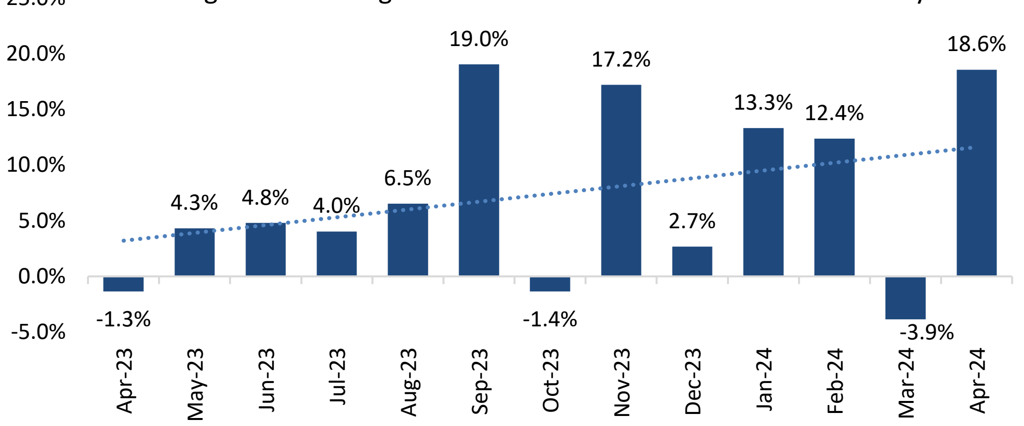


Source: Bloomberg

Urban India also remains steady

India Passenger Vehicle Registrations (% YoY)

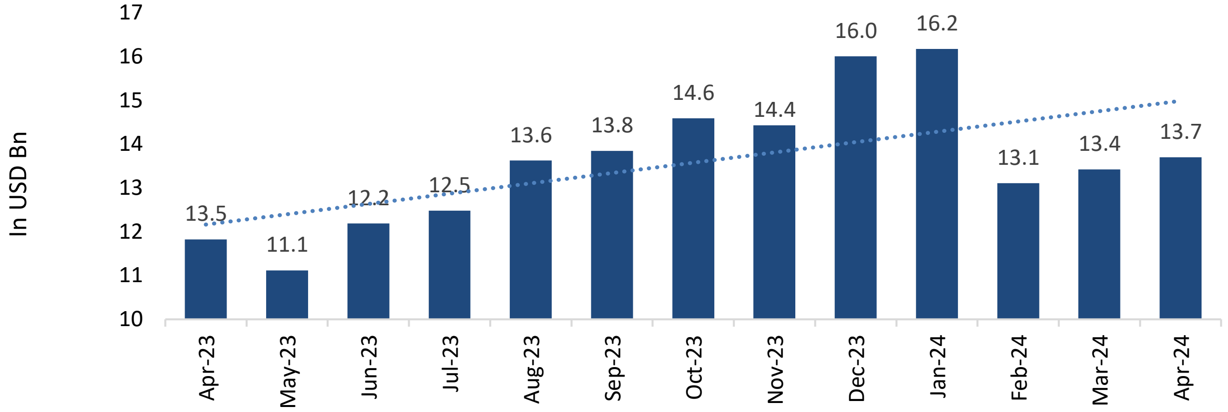
Passenger Vehicles registration rises even after election uncertainty



Source: Bloomberg, FADA

Net Services Exports (USD Bn)

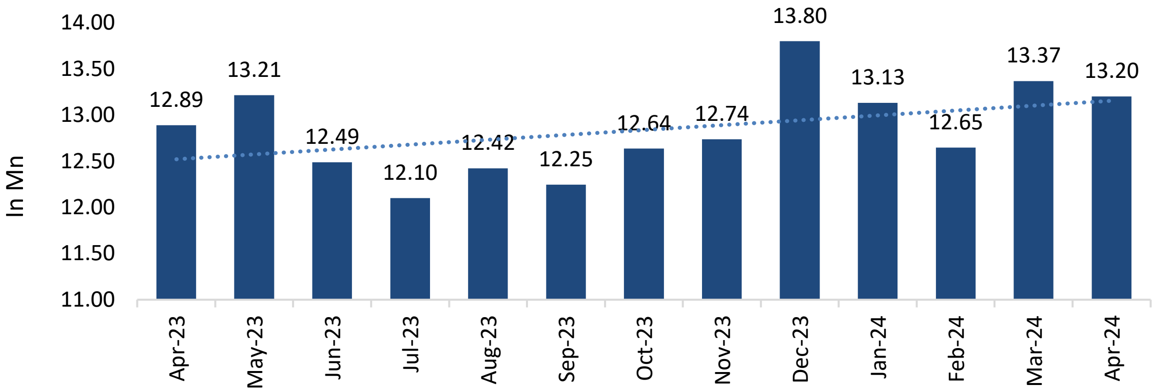
Improving services exports is benefiting urban economy



Source: Bloomberg

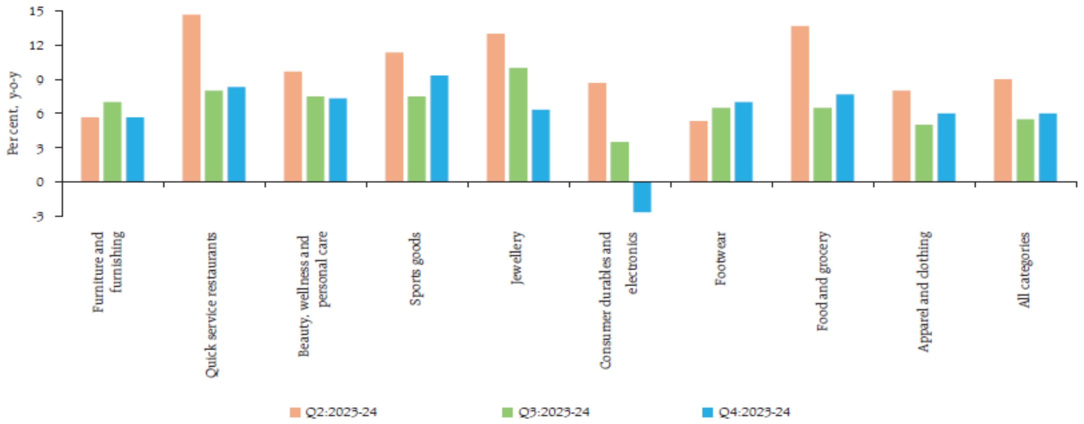
Domestic - Number of Passengers Carried by airlines

Domestic Air Passenger Traffic remains strong...



Source: DGCA

Retail sales growth gains momentum (%YoY)

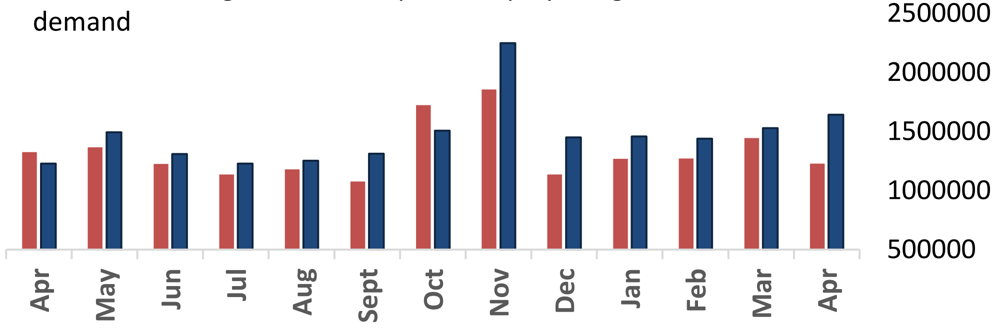


Source: Retailers Association of India; RBI Bulletin

Rural India: Revival to pick up

Two Wheeler Registrations

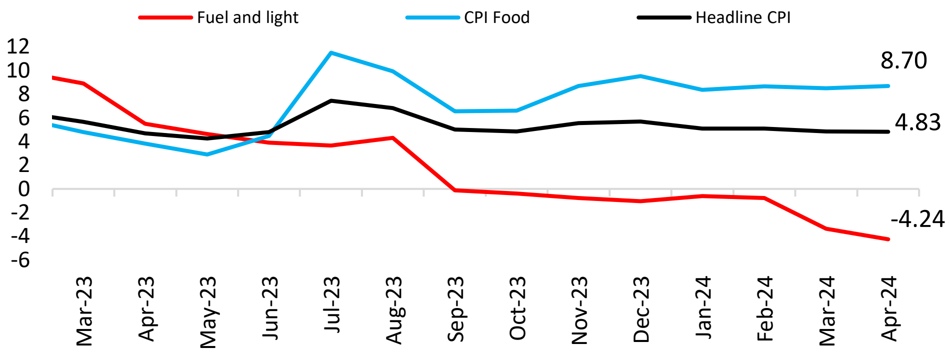
Two-wheeler registrations are pushed up by the green shoots of rural demand



Source: Bloomberg, FADA

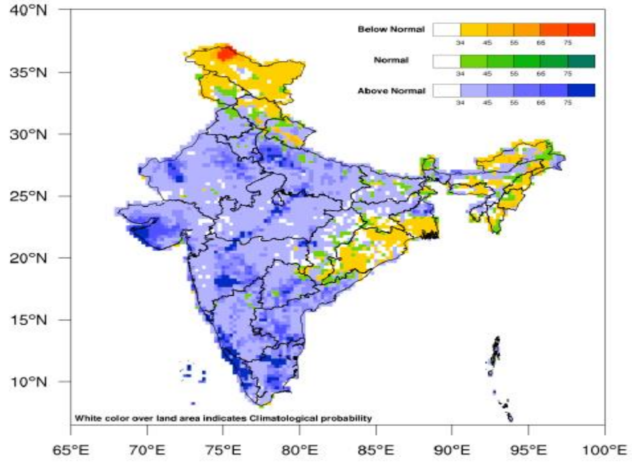
CPI Inflation (% YoY)

Lower inflation to help affordability



Source:-Ministry of Statistics and Program Implementation

Above normal monsoon to drive agricultural growth & lead to improved consumption demand from rural economy

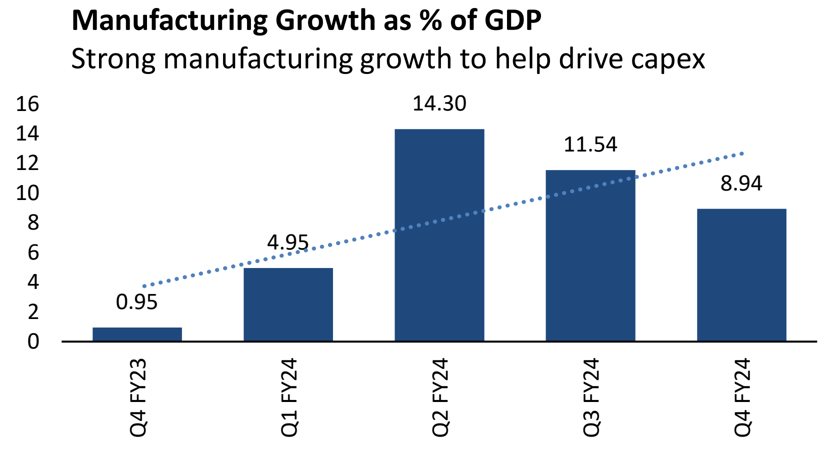


Probabilistic rainfall forecast for monsoon season (June – September), 2024

Category	Rainfall Range (% of LPA)	Forecast Probability (%)	Climatological Probability (%)
Deficient	< 90	**2**	16
Below Normal	> 90 - 95	**8**	17
Normal	96 -104	**31**	33
Above Normal	> 105 -110	**32**	16
Excess	> 110	**29**	17

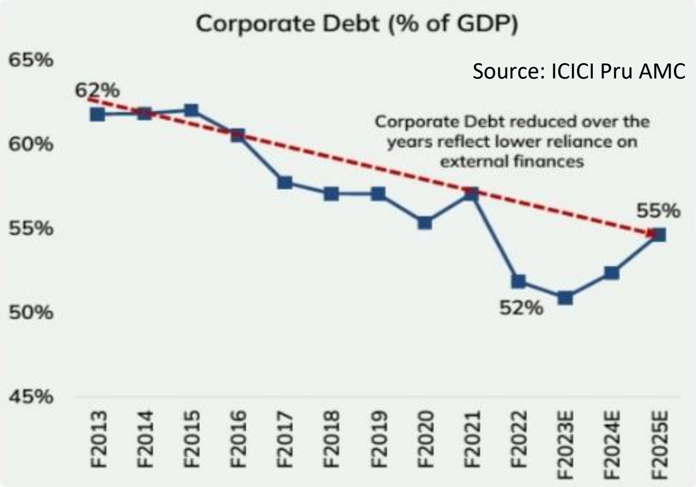
Source: IMD

Capex driving India's growth

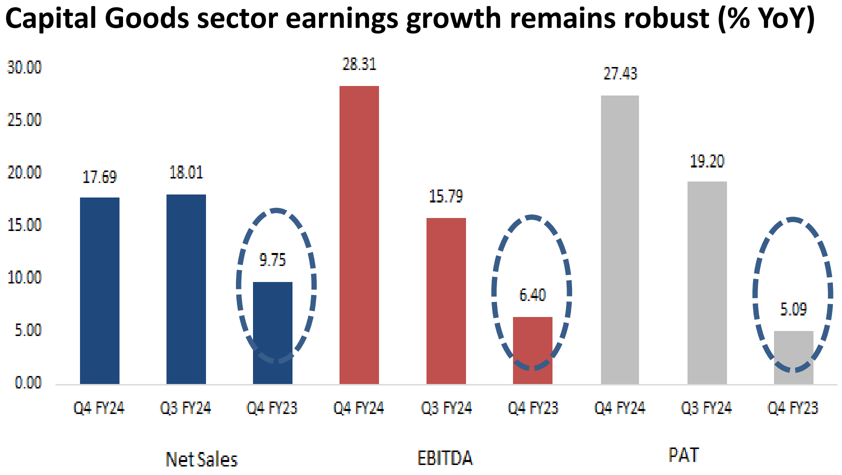


Source: Bloomberg

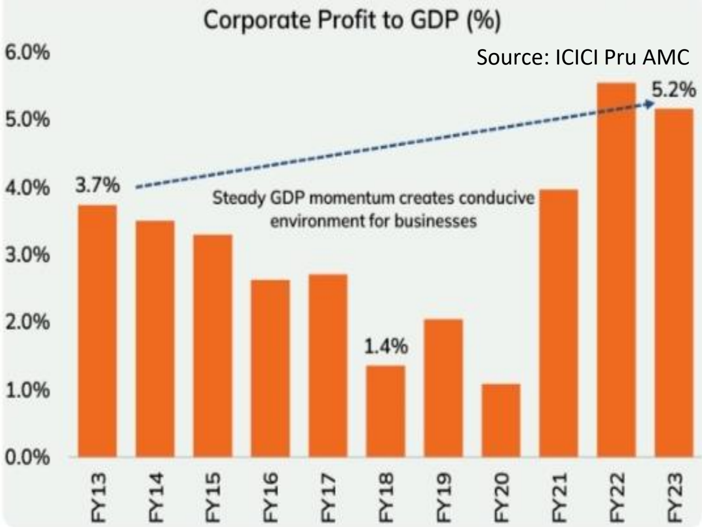
Source: Sundaram AMC



Source: ICICI Pru AMC



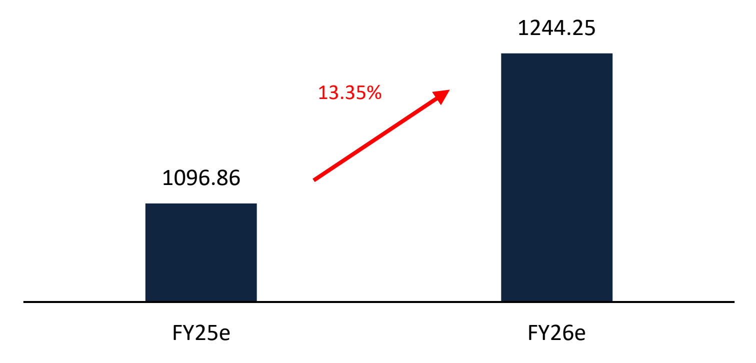
Source: Capital line, HDFC Bank Research



Source: ICICI Pru AMC

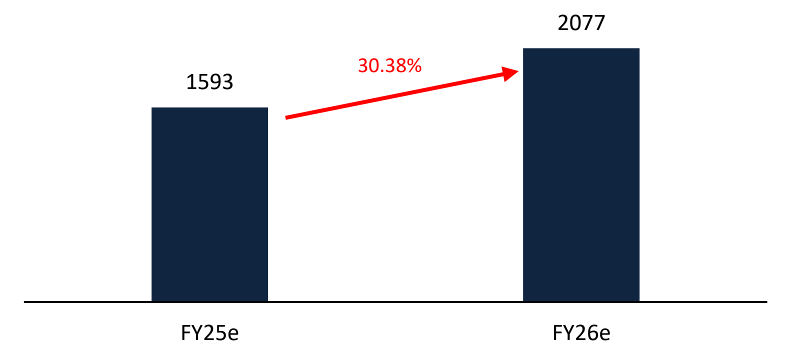
India valuations – Remain rich…Elections related volatility may bring the valuations lower… leading to better investment opportunities

Expected Nifty 50 EPS (Rs)



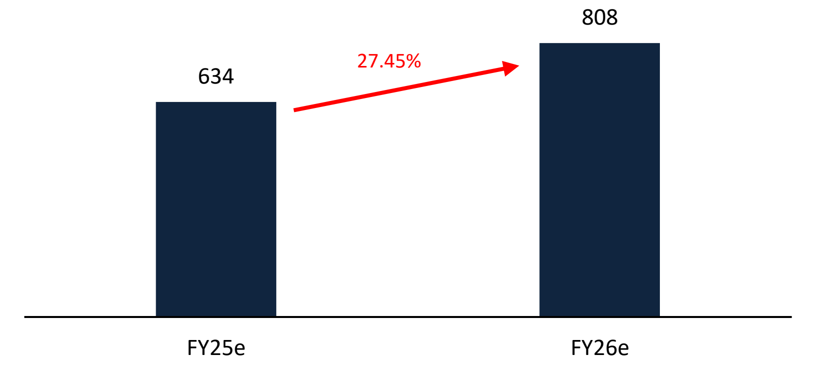
Source: Bloomberg

Expected Nifty Midcap 100 EPS (Rs)



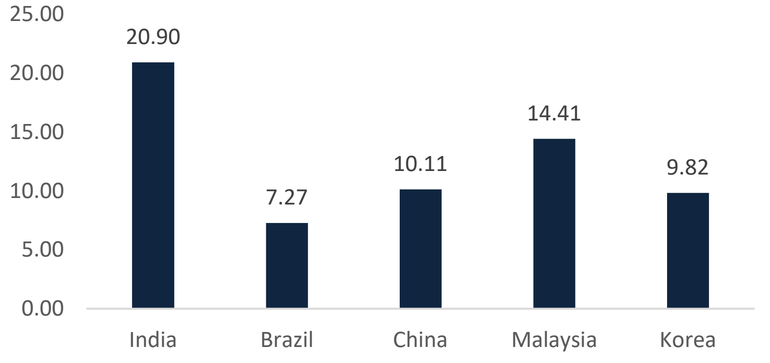
Source: Bloomberg

Expected Nifty Smallcap 250 EPS (Rs)



Source: Bloomberg

12M Expected Fwd PE of India vs. Emerging markets peers



12M expected Fwd P/E (x) Comparison By Market Cap

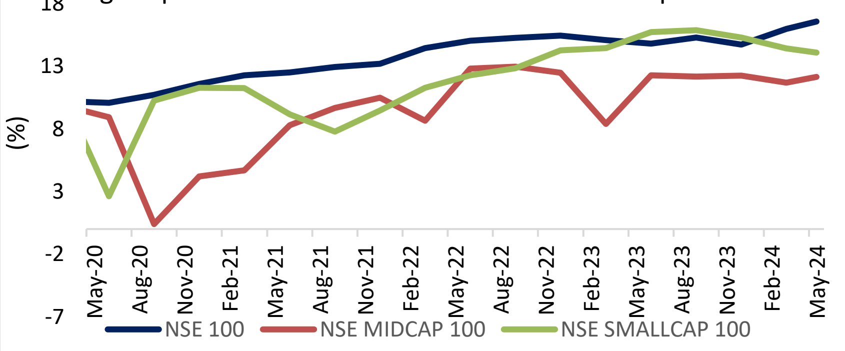
Index	FY25 (Est)	FY26 (Est)
Nifty 50	20.90	18.42
Nifty Midcap 100	32.83	25.18
Nifty Smallcap 250	24.91	19.56

Source: Bloomberg

Source: Bloomberg

Indices – Return on Equity (ROE)

Large cap ROE's look better than Mid and Small cap

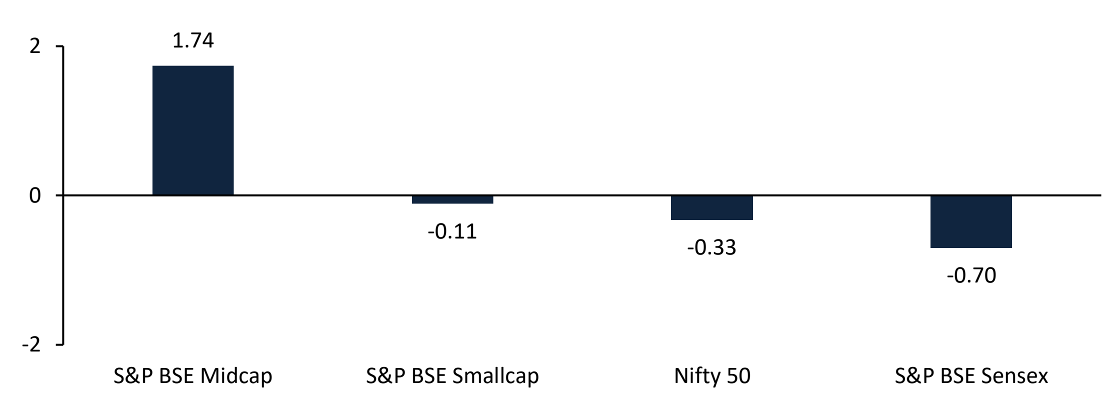


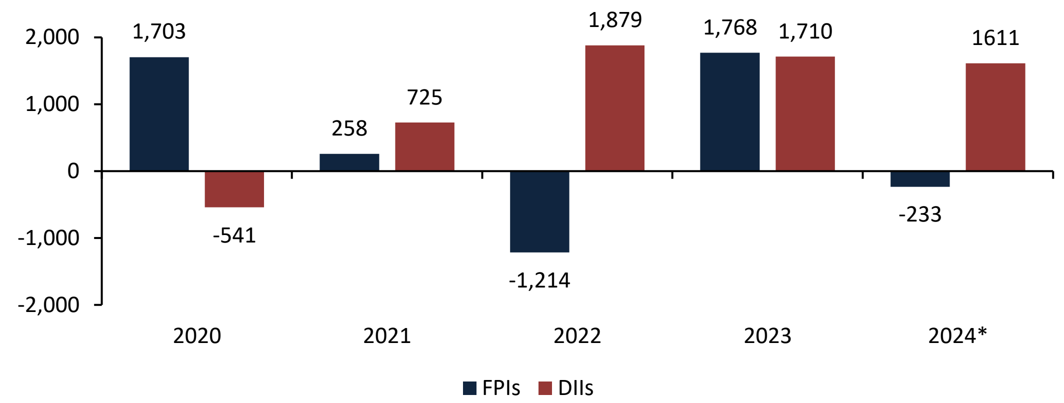
Source: Bloomberg

Note: Data as on 28th May 2024

Market Roundup – May 2024

- Indian equities ended the month on a mixed note. Large cap-oriented S&P BSE Sensex and Nifty 50 ended lower to the tune of 0.70% & 0.33% (MoM) respectively.
- While the S&P BSE Midcap index ended higher by 1.74% (MoM), S&P BSE Small cap index ended lower by 0.11% (MoM).
- In terms of BSE sectoral indices, Capital Goods was the top performer. In contrast, IT, Healthcare and Oil & Gas underperformed the most.
- Indian equities ended the month on a mixed note due to nervousness with regard to the outcome of the general elections.





*For 2024, FPI and DII data is up to 31st and 30th May, 2024, respectively

Source: SEBI, CDSL

Sectoral outlook by fund managers – Part 1

Sector	Particulars
Financials	**View –Neutral to Positive** • Valuations in most of the Banks are reasonable, especially the Largecap Private sector banks. • NIM concerns have resurfaced as the cost of funds have risen due to tight liquidity scenario and with policy rates likely to be cut, further pressure to NIM possible. This has ensured that overall underweight in Banking exposure for funds. • Credit cost (provisioning) are holding up, Unsecured loans are under scrutiny by the RBI. • Most managers are taking exposures in spaces like Capital Market plays, Insurance and Wealth management.
IT	**View – Negative to Neutral** • Q4FY24 results have been weak. Large global bellwethers have suggested caution for growth going forward. • Order book growth holding up, margins need to sustain, execution cycle seem to be pushed back by customers. • Stocks are expected to consolidate going forward as valuations have run up. • Funds are taking tactical positions, but mostly running underweight.
Pharma	**View – Positive** • Reasonable valuations, domestic demand holding up well. • US is seeing abatement of price erosion in the generic space and some shortage of drugs has built up, which should be positive for Indian pharma stocks. • Decline in the raw material prices to drive margins and earnings. • Fund Managers expect the sector to outperform on the back of improved earnings given lower base and relative under ownership.
Auto/ Auto Ancillaries	**View – Neutral to Positive** • Passenger vehicle demand to sustain, but on a high base the volume growth likely at low single digits. Earnings momentum expected to gradually. wane in this segment in FY25. Stock specific action may continue • 2-Wheeler stocks are seeing renewed traction and driving alpha. Once the base is high, the volume growth can taper. • SUV oriented companies expected to still hold on to earnings growth, as improved product mix in the sales would help drive earnings. • Initial signs of weakness seen globally in the EV theme. Indian policymakers still supportive of this segment. • Commercial vehicle sales getting sluggish, fund managers underweight. • Auto ancillaries gaining due to China+1, Europe+1, PLI and EV initiatives.

Sectoral outlook by fund managers – Part 2

Sector	Particulars
Construction & real estate	**View – Positive** • Favourable demand scenario for housing in terms of volume growth. Strong presales growth from key players has improved visibility • Government's focus on infrastructure and investment cycle. • Real estate stocks are also finding space in the Fund Portfolios, as growth in the sector quite strong. **Approach followed by most AMCs -** Prefer investing in this space through proxy sectors such as housing finance companies, cement, steel, pipes, and building materials, among others. Though some are gradually building exposure into direct Real Estate stocks.
Consumption	**View – consumer services -Positive, consumer durables and FMCG- Neutral** • Staples – Low volume growth, pricing power weak, Valuations high. Funds cutting underweight as rural recovery on the horizon. • Hotels/Travel – Valuations rich, funds holding on to their overweight. Earnings visibility is strong. • Consumer Durables – Funds are looking to bottom fish, as they expect turnaround of demand. • Retail and Quick Service Restaurant: Retail demand expected to improve, while QSR's near term performance expected to be weak, finding favour in portfolios due to expectations of change in consumer behaviour in long term. **Long-term positives** • Rising per capita income. • Premiumization across categories.
Capital goods, industrials, utilities	**View – Neutral** • Capex cycle uptick implies that domestic capital goods are gaining traction. • Export prospects appear promising, albeit on a bottom-up basis. • Order books are robust, and earnings remain stable. • New ideas also emerging and some old themes getting churned. • Power, Automation, Electronics continues to be the dominant theme for capex. • **Valuations are steep, while earnings momentum holding up. Funds with high exposure not keen on raising further weights, trimming/churning at margin.**
Metals	**View – Positive** • With outlook of Chinese economy improving, US economy continuing to see growth, metal stocks are finding favour with the Fund managers. • Fund manager have reduced their underweight positions and are gradually getting upbeat as they expect metal prices to rise further due to underinvestment in the sector and improved demand conditions.

Monthly Sectoral Movement

Absolute Monthly Return By Sector (%)

Index	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24
S&P BSE 500	**0.33**	**7.08**	**3.51**	**3.86**	**3.80**	**-0.81**	**2.04**	**-2.93**	**6.75**	**8.01**	**1.90**	**1.93**	**0.84**	**3.43**	**0.61**
Auto	-3.35	10.29	7.94	6.76	3.14	-1.40	3.65	-1.25	10.08	5.43	4.18	8.12	4.96	3.92	3.84
Bankex	0.93	9.18	2.11	0.12	1.85	-4.01	0.35	-3.44	3.47	8.12	-4.38	1.92	2.02	4.64	-0.40
Basic Material	2.54	7.83	1.70	2.39	3.19	1.06	1.70	-3.70	7.25	11.39	0.33	-0.42	1.06	7.86	0.73
Capital Goods	1.50	9.71	1.31	9.79	8.15	2.66	6.20	-4.07	8.88	11.31	1.88	-1.21	6.15	3.42	11.16
Consumer Discretionary	-1.74	9.25	7.18	5.94	4.46	2.10	2.40	-1.38	9.36	5.91	2.35	4.89	1.69	5.05	0.77
Consumer Durables	0.45	2.91	6.47	5.67	-0.25	4.24	3.18	-2.32	7.42	6.11	0.70	0.00	2.05	5.59	-0.51
Energy	1.95	7.19	-0.07	-0.24	6.89	-4.38	3.20	-2.17	9.17	11.06	12.18	6.18	-0.19	3.33	-0.78
FMCG	2.01	6.81	5.89	2.47	1.58	-2.75	0.97	-0.86	3.58	6.84	-2.81	-2.33	-0.67	1.52	-0.42
Finance	-0.08	9.05	2.13	1.97	3.16	-2.64	1.08	-3.09	4.82	6.92	-2.40	0.47	1.35	4.93	-1.49
Healthcare	1.31	6.33	2.81	9.71	7.45	0.57	2.45	-4.30	10.92	3.87	7.18	5.94	-0.08	1.01	-1.46
IT	-3.15	-0.13	6.70	2.16	1.34	4.13	2.62	-3.13	6.77	8.38	3.74	3.38	-7.20	-4.35	-2.63
Infra	4.24	6.06	0.89	4.51	10.73	1.64	8.45	-3.38	10.40	14.88	18.15	1.23	0.48	7.03	5.62
Metal	1.04	7.21	-2.94	3.99	7.88	-1.64	7.45	-4.17	8.74	11.35	-0.85	1.15	4.95	10.83	4.68
Oil & Gas	2.77	6.39	-1.64	0.27	6.67	-5.03	1.23	-4.17	12.51	12.02	12.57	6.86	-0.07	4.83	-1.18
Power	9.39	5.37	2.01	4.33	9.20	-0.63	5.96	-4.90	11.16	18.24	8.57	4.33	1.70	7.73	6.64
Realty	-1.60	19.64	7.67	9.35	9.01	-1.50	5.21	3.70	19.99	9.37	9.37	9.16	-1.21	7.52	4.40
Telecom	-3.65	8.44	4.12	9.08	5.61	3.20	10.55	-5.69	7.21	6.15	6.94	1.44	1.81	8.36	3.29
Utilities	10.02	6.22	-0.59	5.02	10.36	-0.64	7.20	-3.98	11.85	20.00	9.71	3.61	0.25	8.84	2.80

The abovementioned sectoral indices pertain to the S&P BSE universe

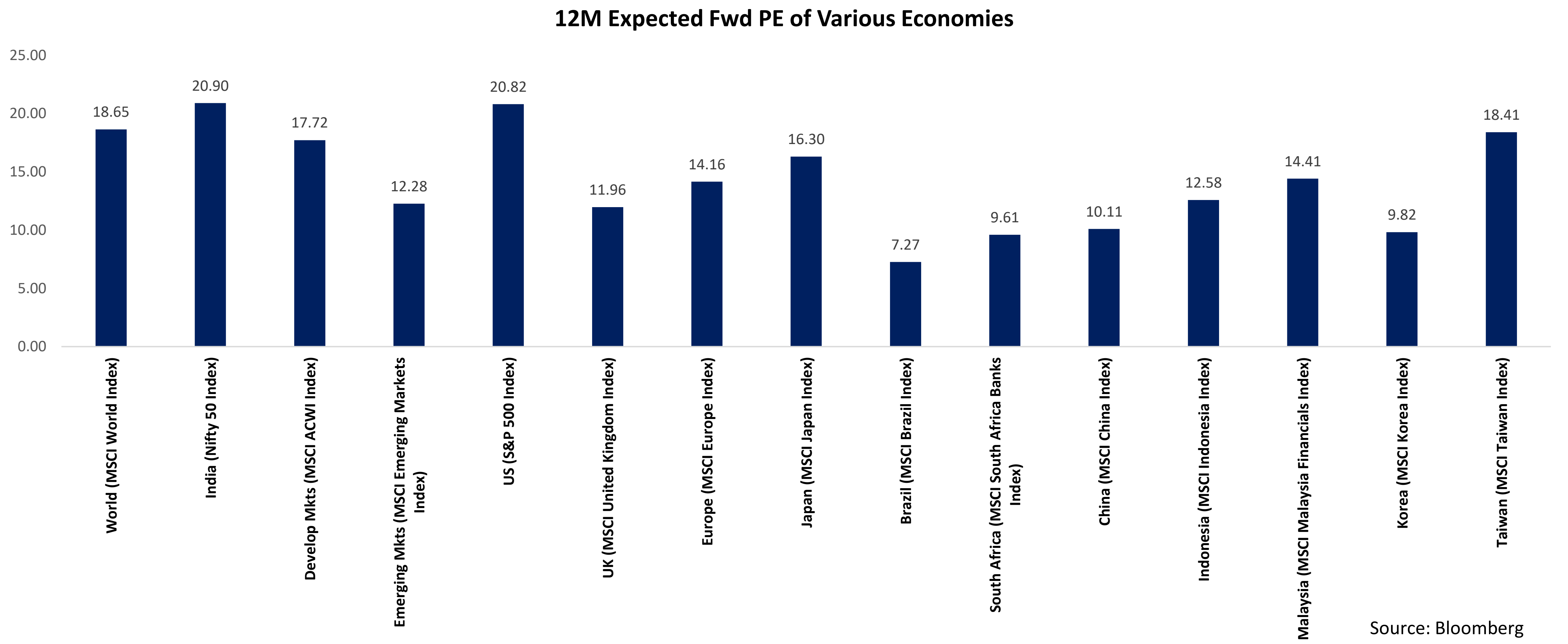
Colour scales assigned vertically

Source: Ace MF, HDFC Bank Research

Key concerns for Indian equities

- Low growth in consumer demand
- Expectation of weakening margin profile for corporates
- Delay in rate cuts by Global Central Banks
- Upward pressure on food inflation (El Nino, export restrictions by some nations)
- Rising tensions in Middle East
- Movement of global liquidity
- The impact of Dollar Index and US Bond Yields on FPI flows in emerging markets

Annexure



Source: Bloomberg

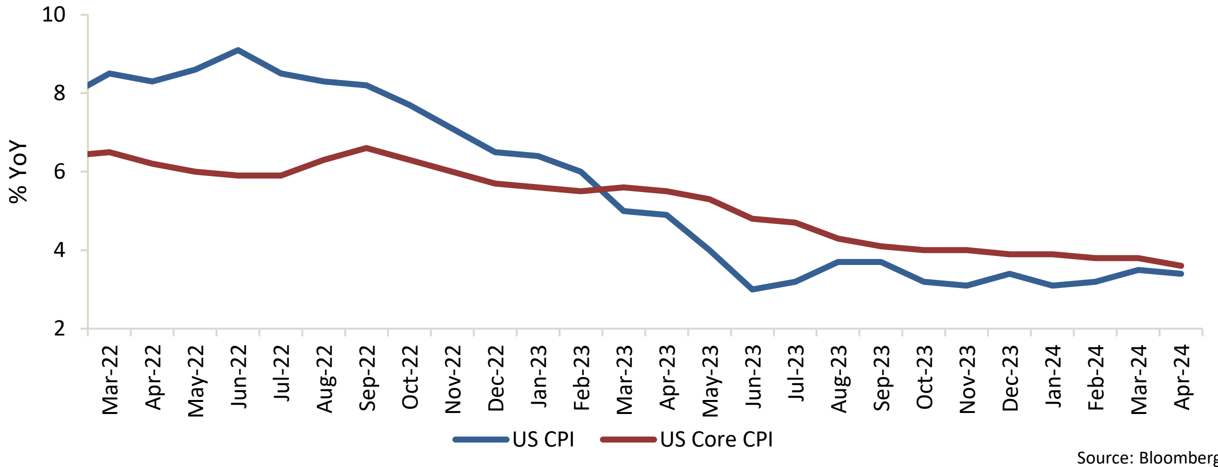
Fixed Income Market

Fixed Income Outlook

- The banking system liquidity remains in deficit for the RBI to keep the overnight rate around the repo rate. The RBI will likely remain nimble in liquidity management and continue using tools like VRRR or VRR to manage liquidity. The market expects the RBI to move towards “neutral” stance from “withdrawal of Accommodation” stance. The buyback of G-secs and reduction in T-Bills issuances are likely to ease system liquidity. Furthermore, the record surplus transfer by the RBI and the return of government spending post the elections, may ease banking system liquidity over the near to medium term. Going forward, the inclusion of G-secs in JPMorgan’s Government Bond Index-Emerging Markets is likely to improve liquidity.
- Headline inflation remained almost steady as food inflation continued to remain elevated. However, the fuel and light category contraction relieved some of the inflationary pressure. As food price shocks exhibit significant volatility on inflation, they can keep headline CPI elevated. The commodity prices remain susceptible to the escalation of geopolitical tensions or a rise in demand on the back of improvement in China’s economic activity. Nonetheless, as the monsoon season is likely to be better in FY25, there could be some disinflationary pressure on food prices in the medium term.
- India’s merchandise trade deficit widened to a four-month high in April 2024 primarily due to a surge in gold and oil imports. The exports faced headwinds due to geopolitical tensions and lower demand. The services exports remain resilient, provided a cushion against the wider merchandise trade deficit. The trend of services exports will likely continue and strengthen the external sector.
- India’s growth momentum was sustained in FY24 and exceeded expectations, with the GDP growing 8.2% YoY in FY24. In the upcoming meeting, the market is looking forward to the RBI’s guidance on liquidity as flows regarding JPMorgan index inclusion start moving into the system. The RBI may remain apprehensive about cutting rates early as the economy remains robust even with higher rates. The RBI is also likely to take cues from the monetary policies of the major global central banks, as early cutting of rates may have repercussions on currency.
- The government's fiscal deficit came in at 5.6% of GDP, better than the revised estimate of 5.8% on the back of robust tax collection. The narrowing of fiscal deficit remains positive for the bond market as this would lead to lesser market borrowing by the government, thus limiting the supply of bonds and pulling the yields down.
- In the US, while the inflation reversed its trajectory and trended downwards, the minutes of the Fed’s latest FOMC meeting revealed that participants expect the disinflation process to take longer than previously expected and, hence, have reduced the expectations of a Fed rate cut in September 2024. Thus, while the current rate cycle has peaked, there is uncertainty regarding the timing and quantum of rate cuts. On the other hand, the slowdown of quantitative tapering from USD 95 bn to USD 60 bn is likely to improve liquidity conditions.
- In contrast to the Fed, the ECB is widely expected to cut rates in June 2024. However, the upside surprise on inflation for May 2024 could result in hawkish commentary by the ECB and fewer rate cuts after June 2024. In Japan, the falling Yen may boost inflation, and hence, it may warrant a rate hike. Furthermore, the Bank of Japan (BoJ) may intervene in the currency market to support the Yen. If BoJ raises rates rapidly, the reversal of carry trade may put upward pressure on US Treasury yields as Japan is one of the largest holders of US Treasuries. The weakening of the Yen seems to also have a rub-off effect on currencies of other emerging market (EM) economies. The revival of the Chinese economy needs to be monitored for the resurgence in commodity demand, as it may bring back global inflationary impulses. With divergence in growth and inflation dynamics across economies, the central banks' monetary policy actions may depend on each country's macroeconomic factors.
- Domestically, the lower-than-expected fiscal deficit and higher-than-expected dividend transfer by the RBI may further accentuate the favourable supply-demand dynamics of G-secs, which has been factored in by the market in terms of declining yields at the longer end of the curve. However, with the new election mandate and formation of a coalition government at the centre, market expects possible deceleration in the speed of fiscal consolidation. This may keep the long end of the yield curve volatile. In the medium term, the market is likely to take cues from the US market, the flows related to the JP Morgan bond index inclusion, and the liquidity measures of the RBI.
- Accrual opportunities at the 2-4-years segment of the curve remains attractive for incremental investment, from risk-reward perspective until fresh triggers appear to suggest further decline in yields at the longer end. As corporate bonds are available at reasonable spreads of similar tenor G-Secs, Corporate Bond Funds continue to look like a safe bet at the current juncture for investors looking to invest in shorter-tenure funds. Hence, investors can look at Corporate Bond Funds and Short duration funds for a horizon of 15 months and above.
- For a horizon of 3 months and above, investors can consider Arbitrage Funds. Whereas for a horizon of up to 3 months, investors can consider Overnight Funds and Liquid Funds. Investors can also look at Multi-asset allocation funds for a horizon of 36 months and above. Investors should invest in line with their risk profile and product suitability.

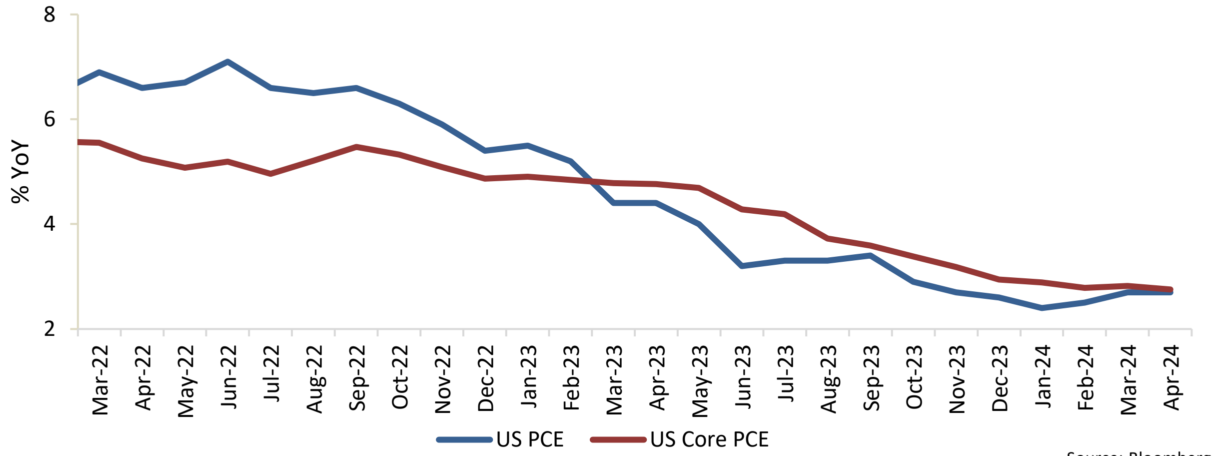
Despite positive inflation data, Fed remains reluctant to cut… QT relaxed

Headline inflation reversed its trend and moved downwards



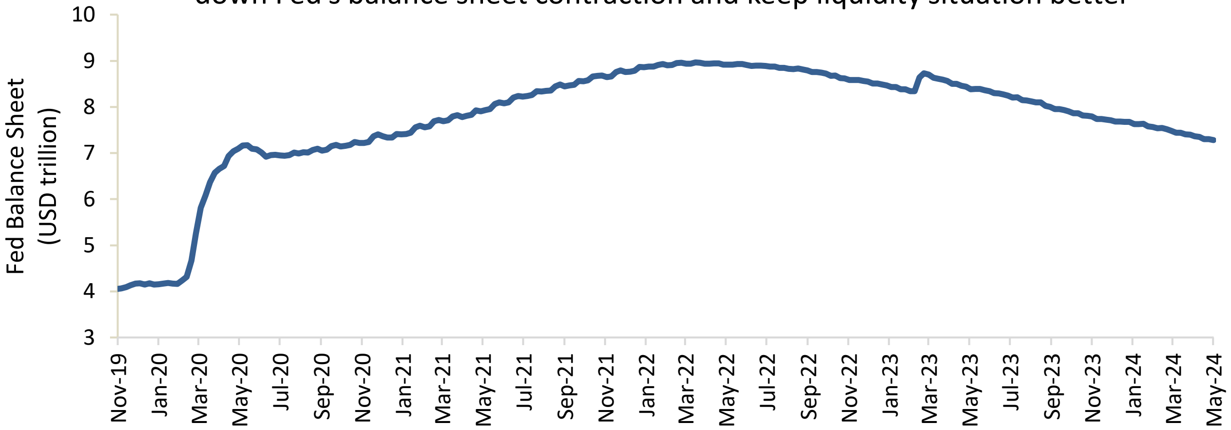
Source: Bloomberg

Fed's preferred inflation metric remains steady



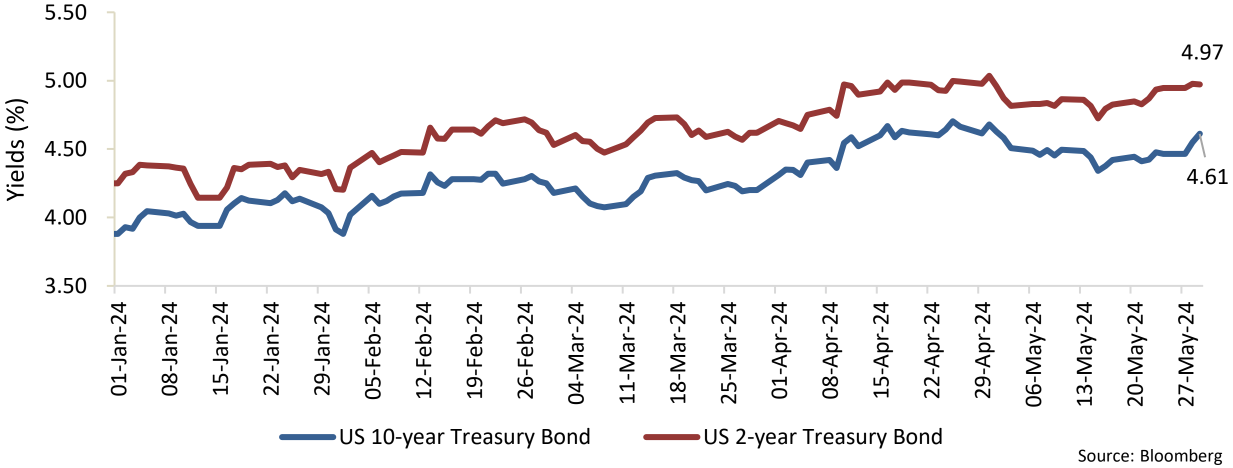
Source: Bloomberg

Reduction of quantitative tapering from USD 95 bn to USD 60 bn may slow down Fed's balance sheet contraction and keep liquidity situation better



Source: Bloomberg

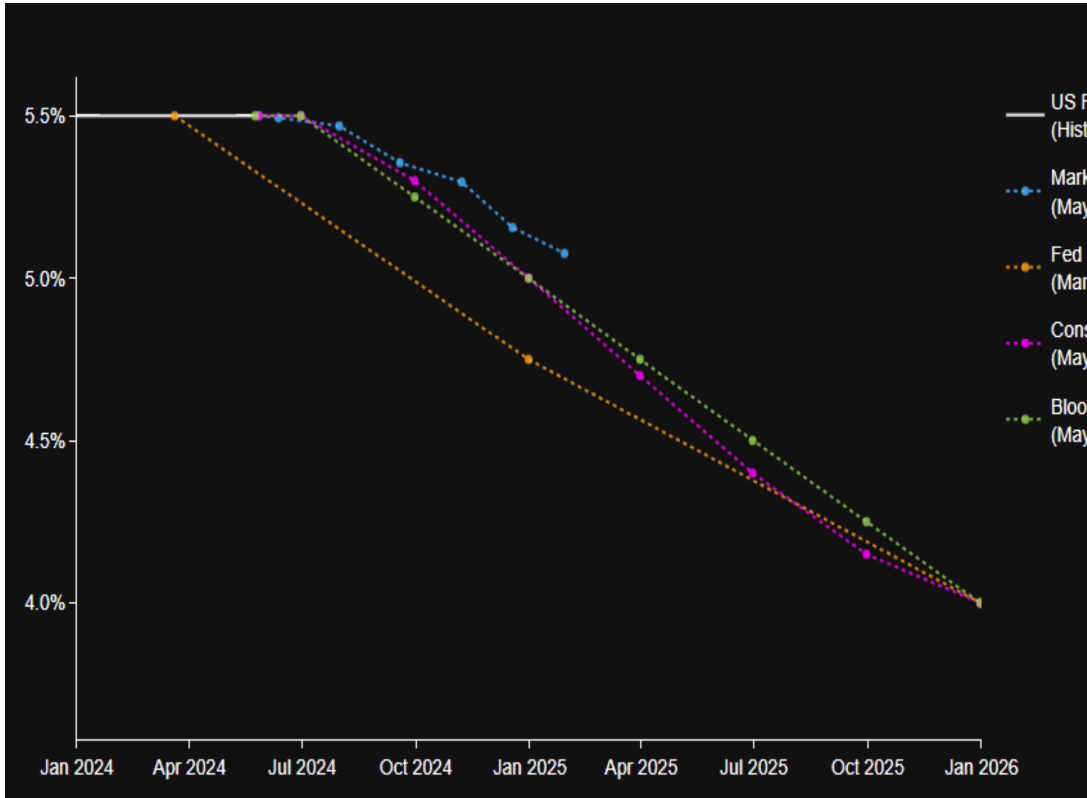
Hawkish Fed sentiment kept US yields elevated



Source: Bloomberg

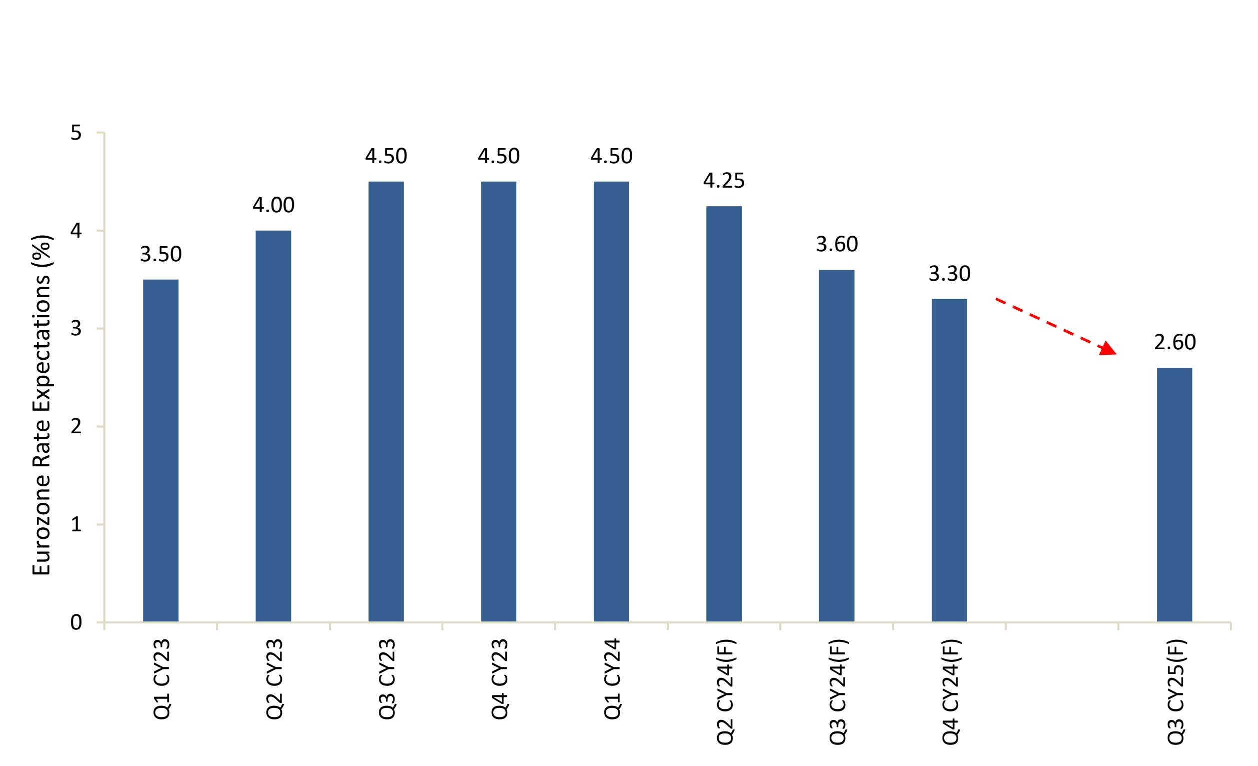
Hawkish Fed minutes reduced the rate cut expectations in September 2024; however, ECB signals easing ahead

Rate cuts expectations by the Fed have been pushed forward



Source: Bloomberg

ECB may cut rate by 25 bps in June 2024 Policy

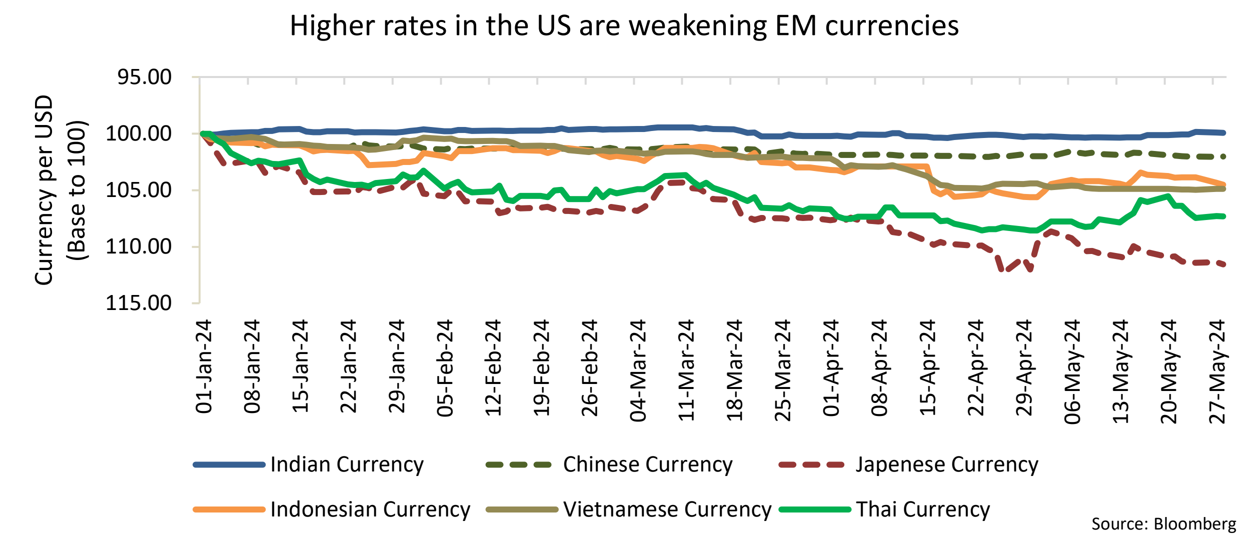


Source: Bloomberg

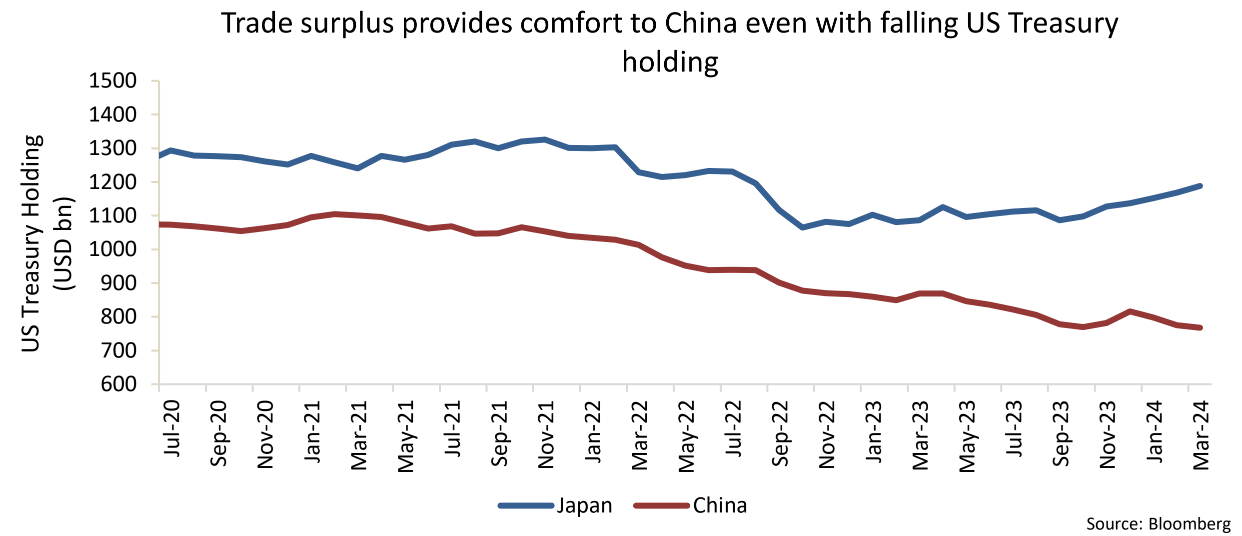
“Participants observed that while inflation had eased over the past year, in recent months there had been a lack of further progress toward the Committee's 2 percent objective. The recent monthly data had showed significant increases in components of both goods and services price inflation…. Various participants mentioned a willingness to tighten policy further should risks to inflation materialize in a way that such an action became appropriate”

– Minutes of FOMC meeting (Apr 30 – May 1, 2024)

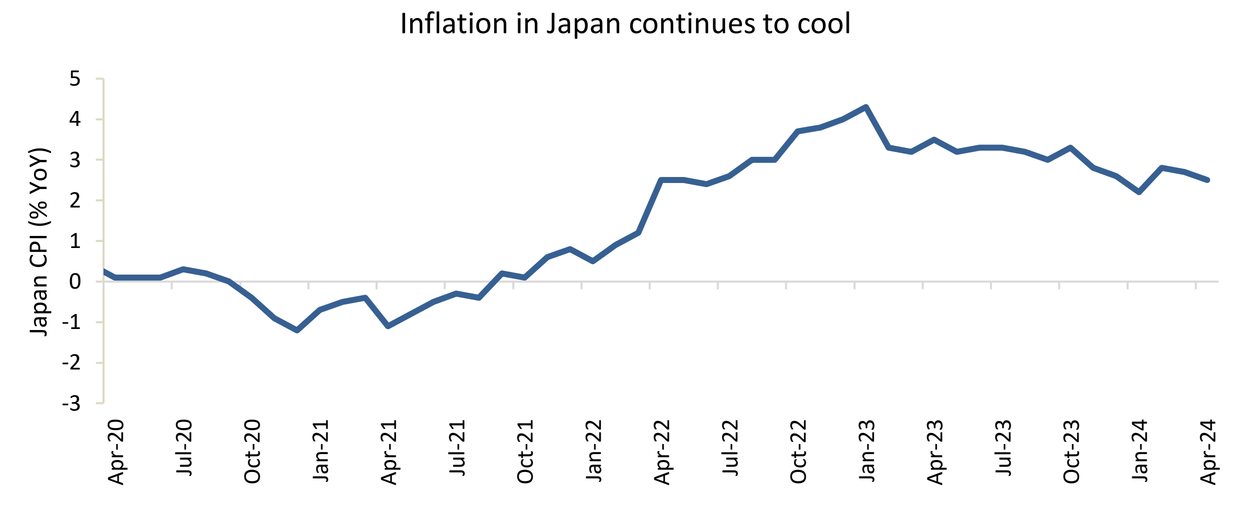
Yen depreciation seems to have a rub-off effect on the currencies of other EMs



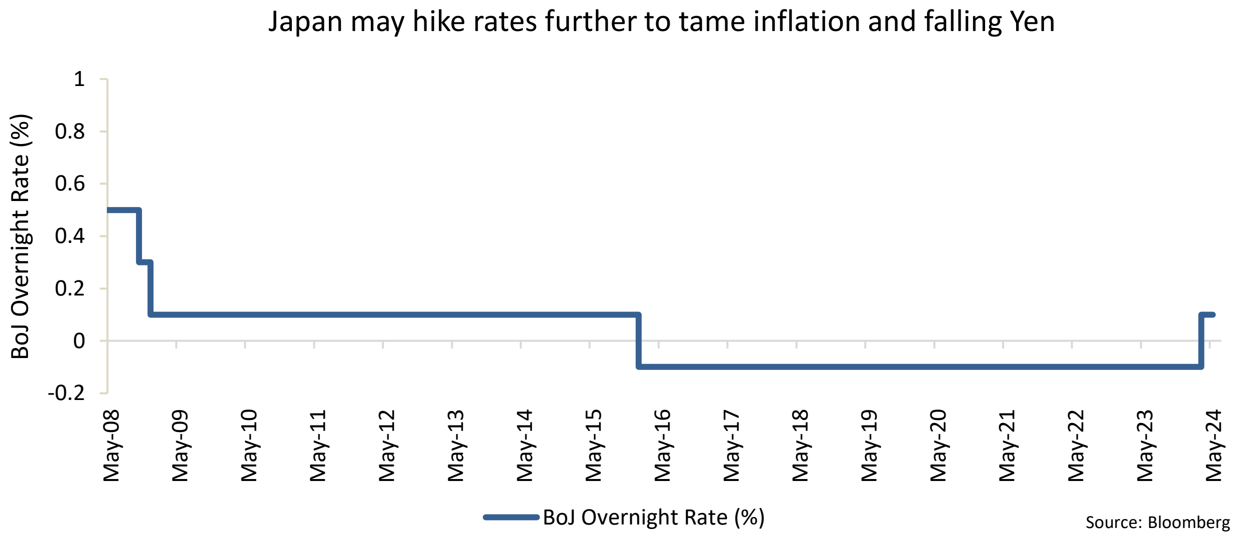
Source: Bloomberg



Source: Bloomberg

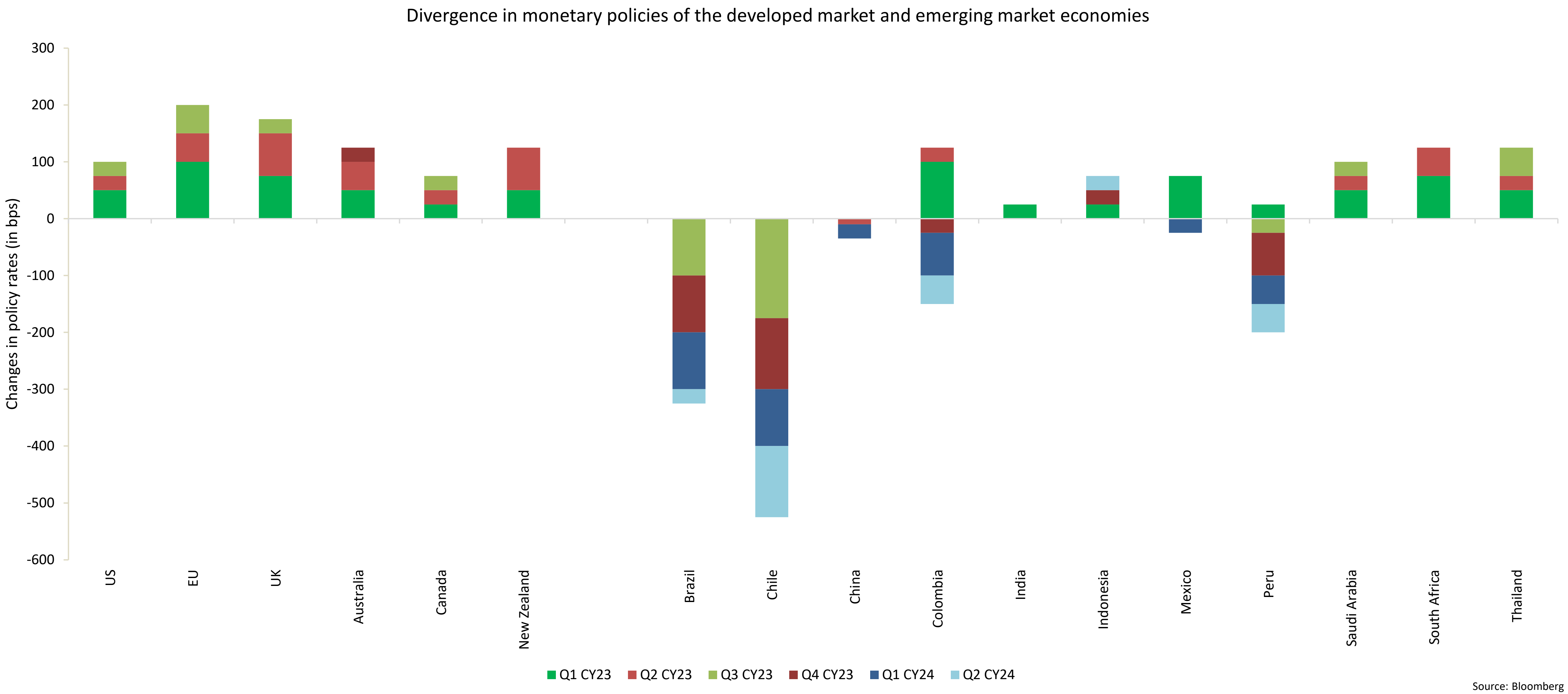


Source: Bloomberg



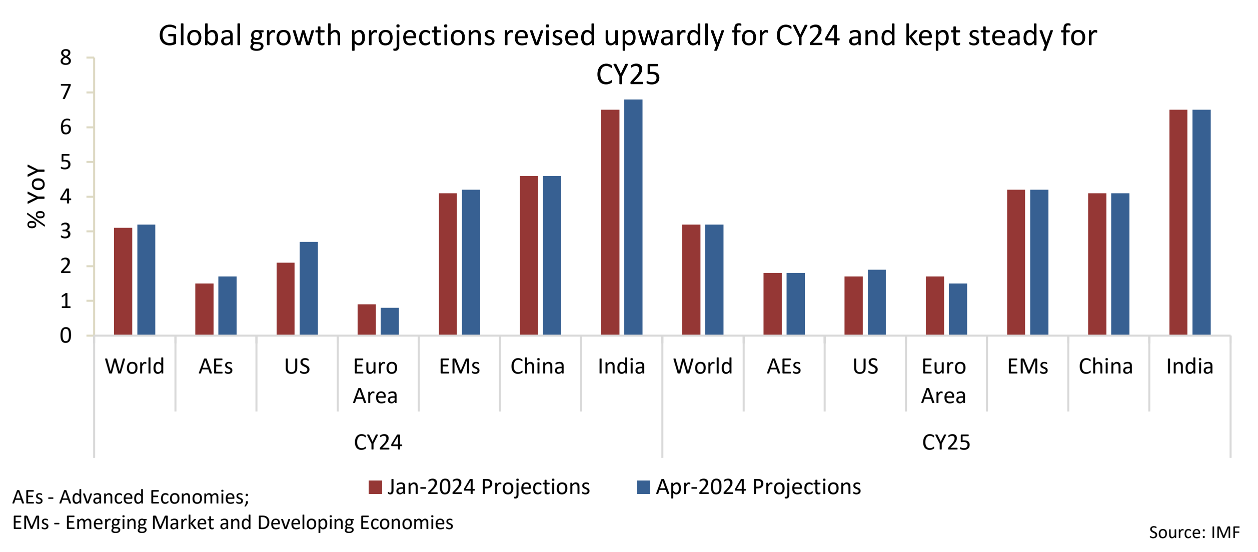
Source: Bloomberg

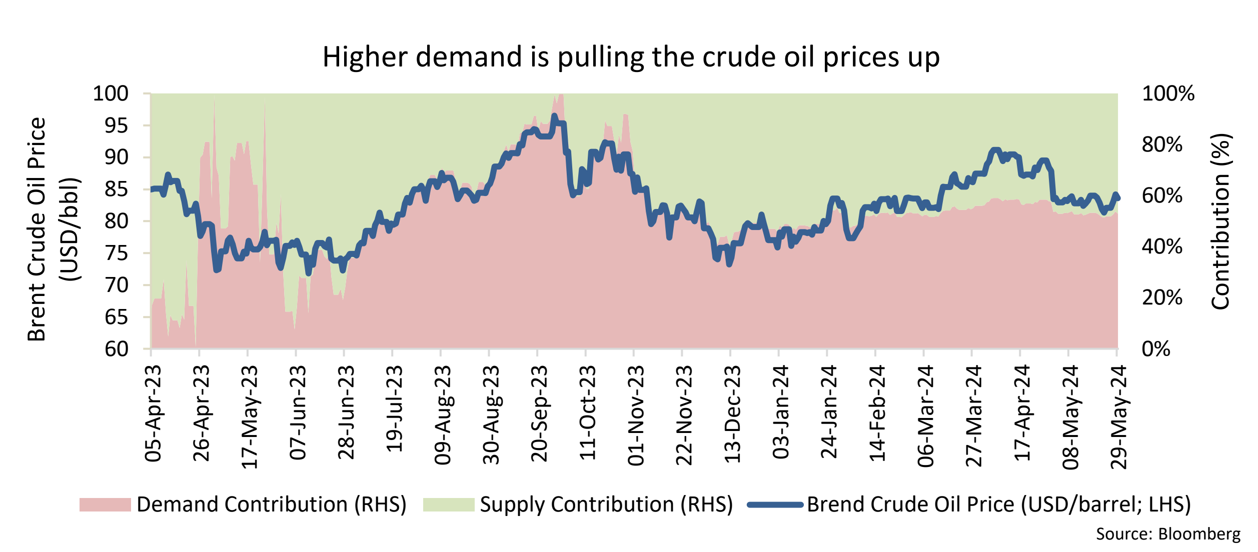
Monetary policy actions across the economies to reflect local fundamentals

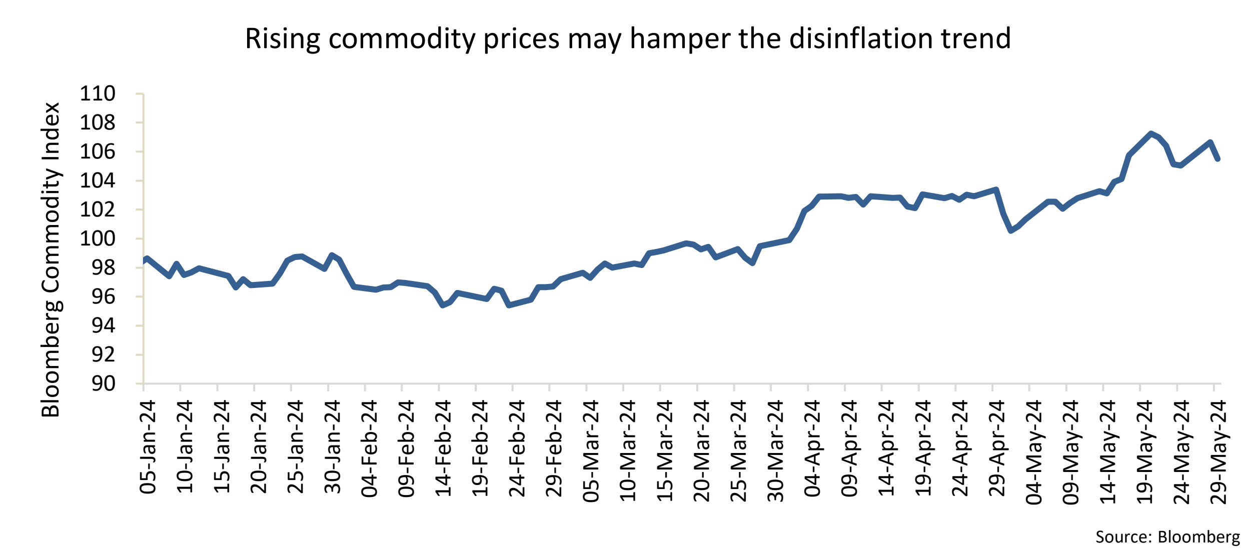


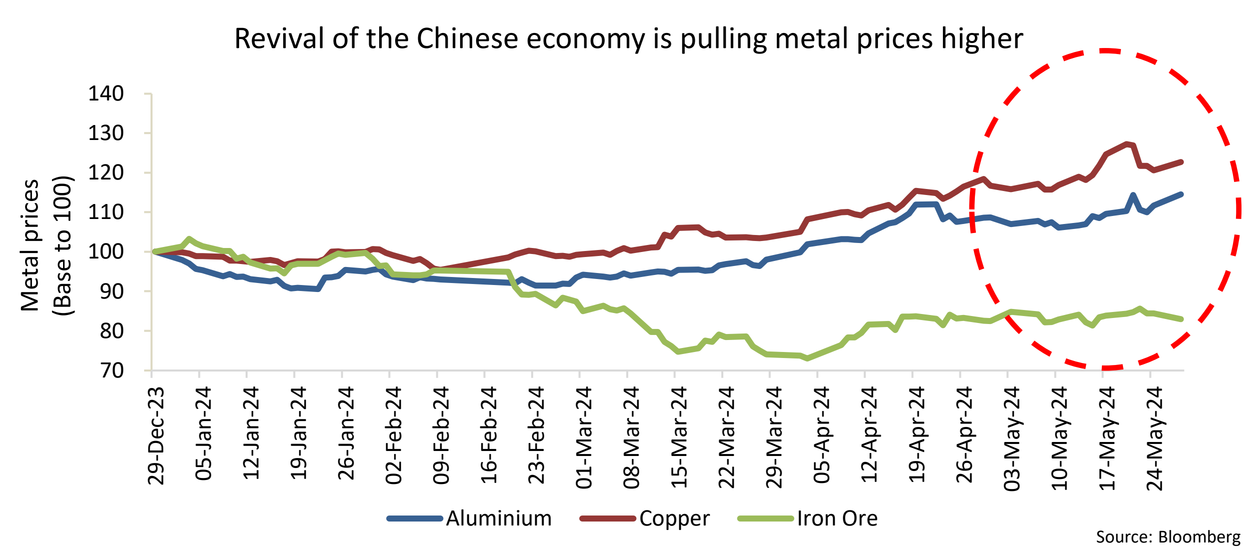
Source: Bloomberg

Increase in global growth and resurgence in Chinese economy driving commodity prices higher

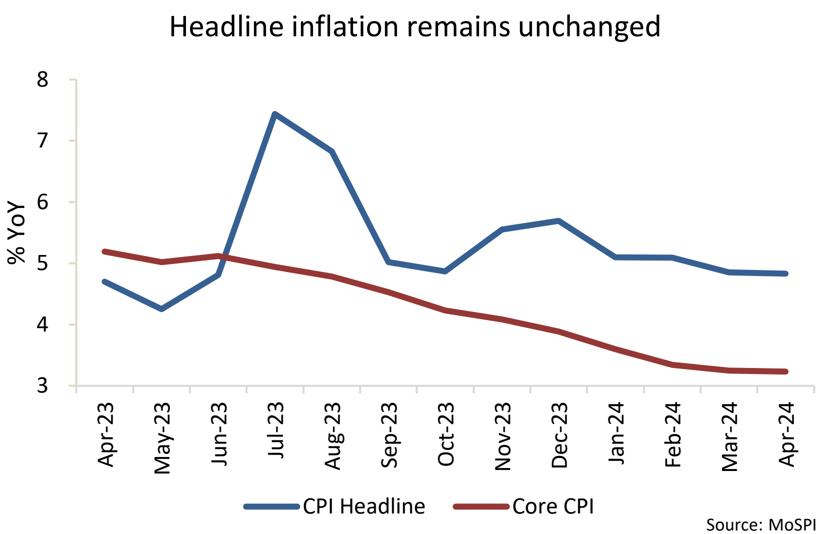




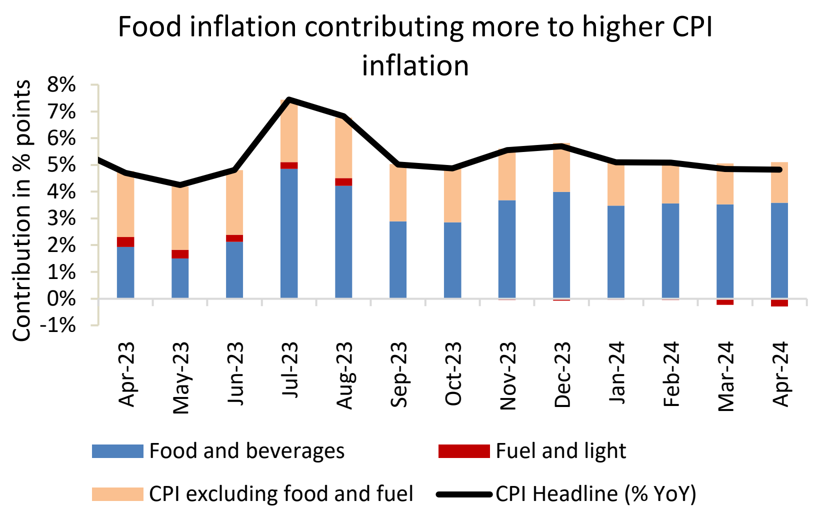




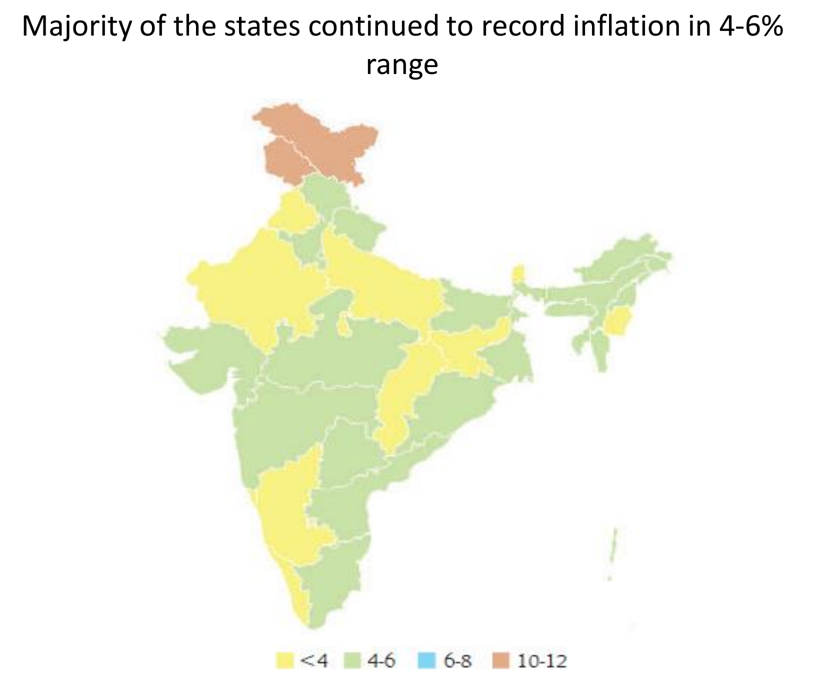
Higher food prices keeping inflation decline under check in India…



Source: MoSPI

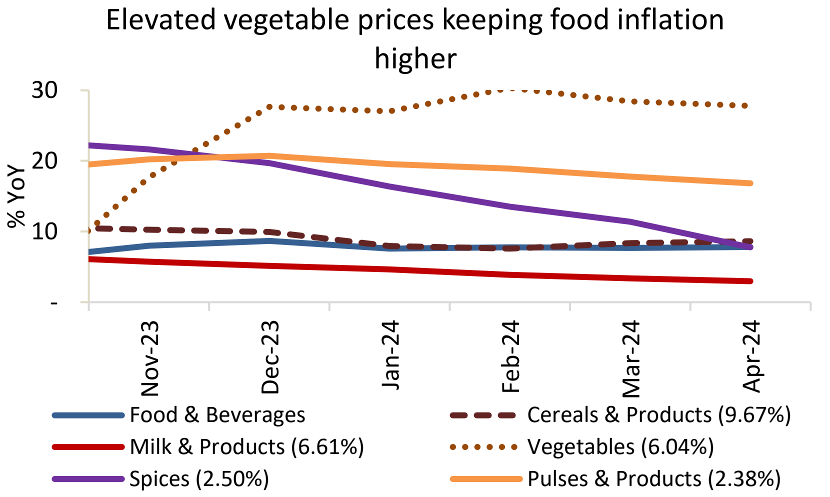


Source: MoSPI



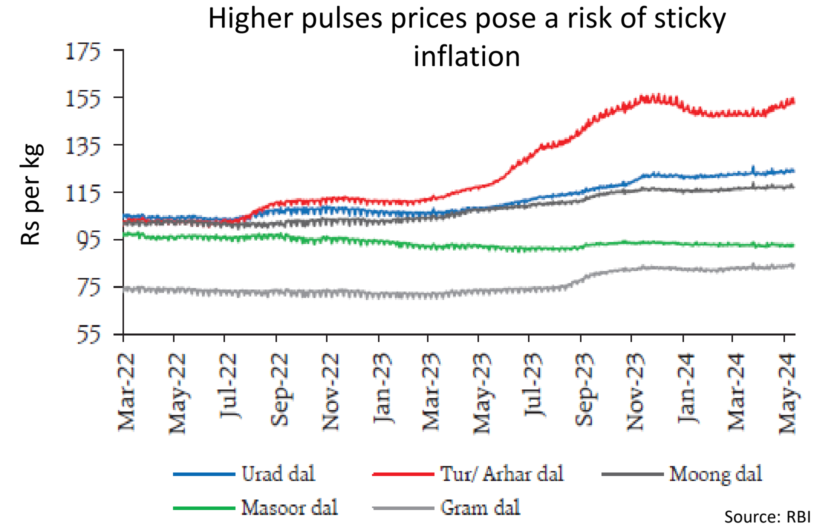
Note: Map is for illustrative purposes only

Source: NSD; RBI



Note: Data in parenthesis denotes weight of category in CPI basket

Source: MoSPI



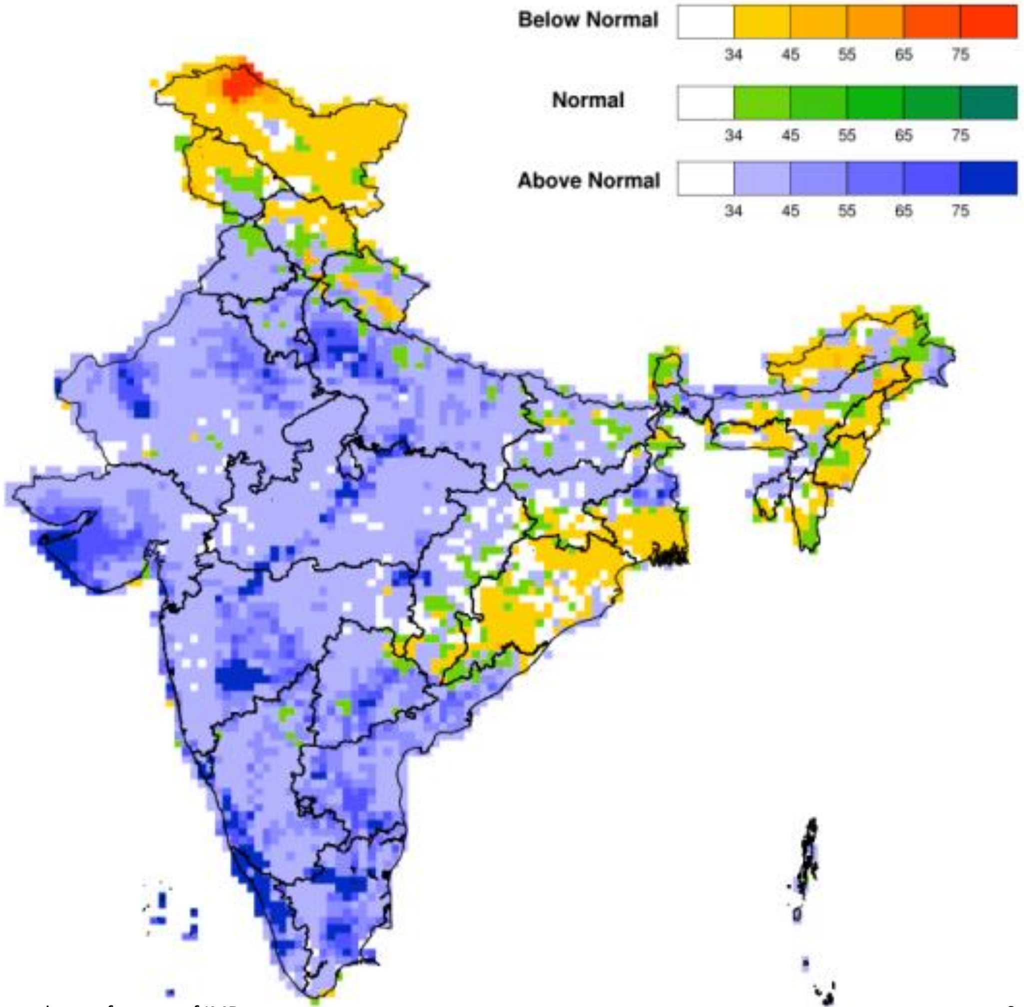
Source: RBI

"The increasing incidence of climate shocks, however, imparts considerable uncertainty to the food inflation and overall inflation outlook."

- RBI's Annual Report, FY24

… Expectations of normal monsoon to ease food prices

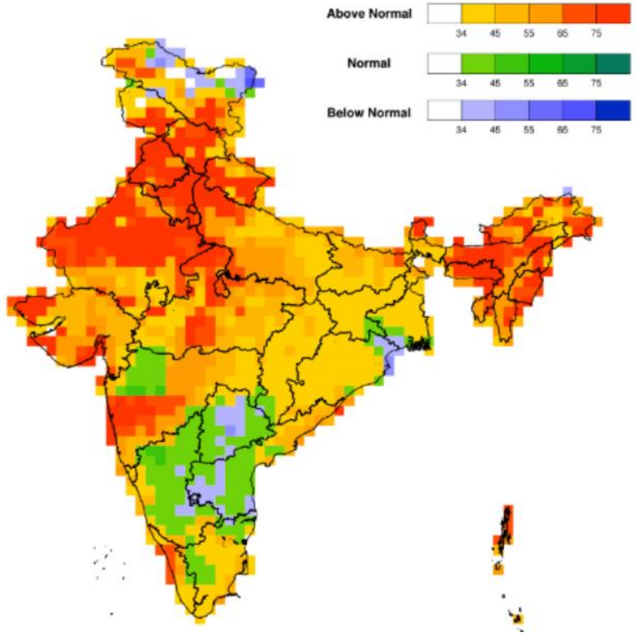
Southwest monsoon rainfall is expected at 106% of long period average



Note: As per second stage forecast of IMD

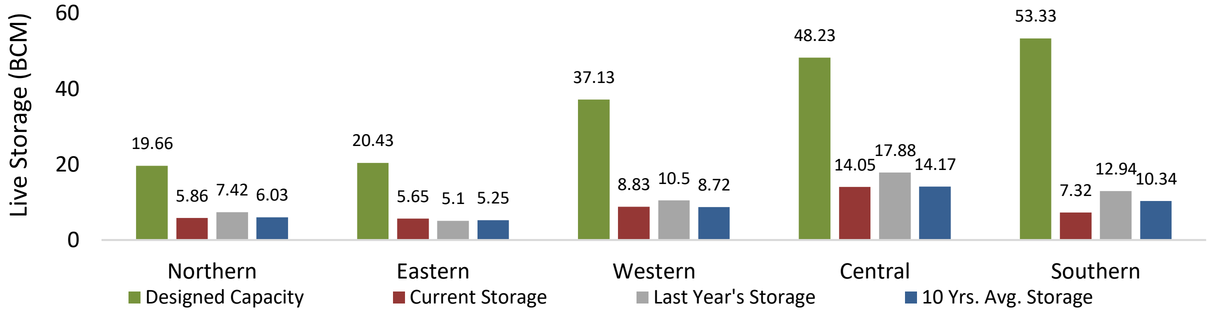
Source: IMD

Heatwaves are likely to affect Northwest and Central India in June 2024



Source: IMD

Dependence on monsoon remains high as reservoir levels are low

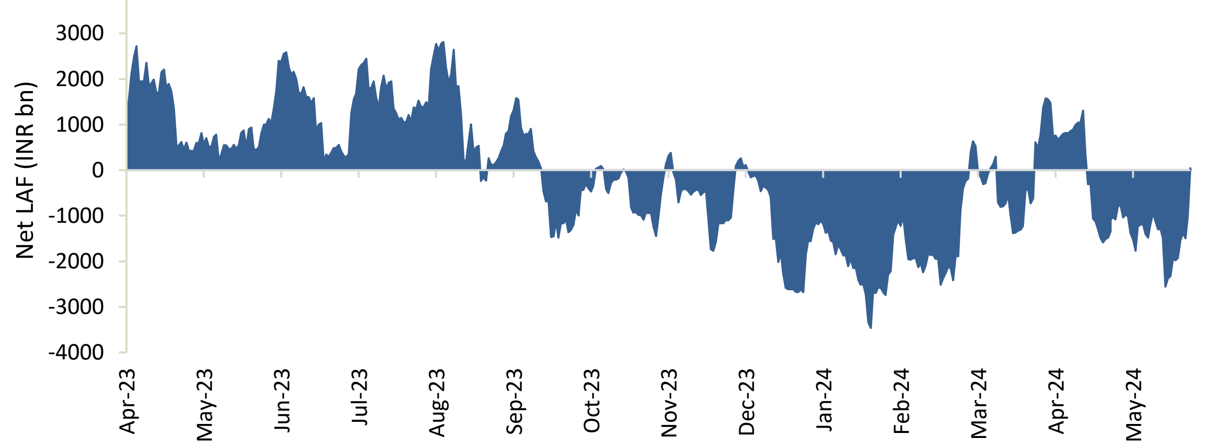


Note: Data as on 30-May-2024

Source: Central Water Commission

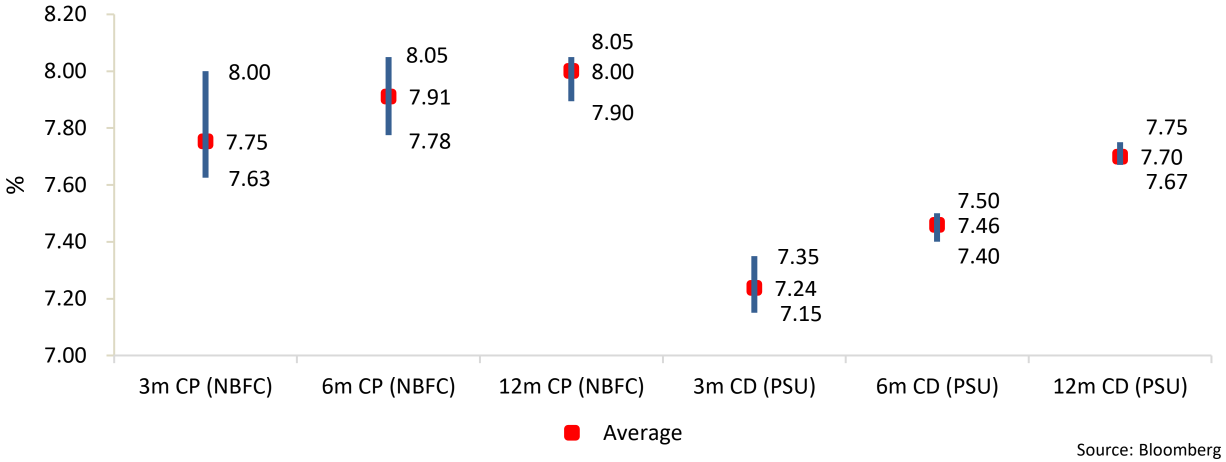
While liquidity remains tight, lower G-Sec issuance and buyback of G-secs to improve liquidity

Liquidity remained in deficit in May 2024



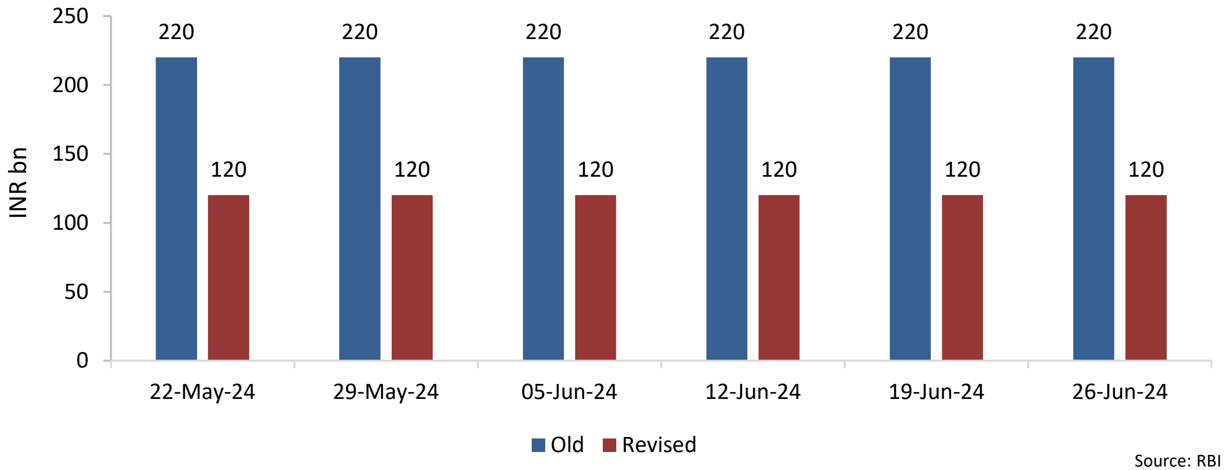
Source: Bloomberg

CP/CD rates reacted to system liquidity and supply



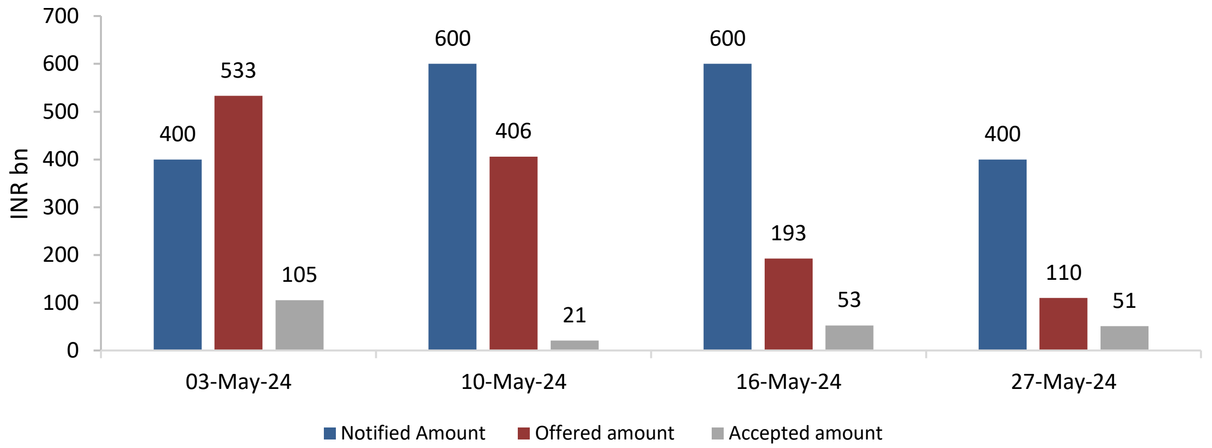
Source: Bloomberg

Lower T-Bill issuance to improve liquidity



Source: RBI

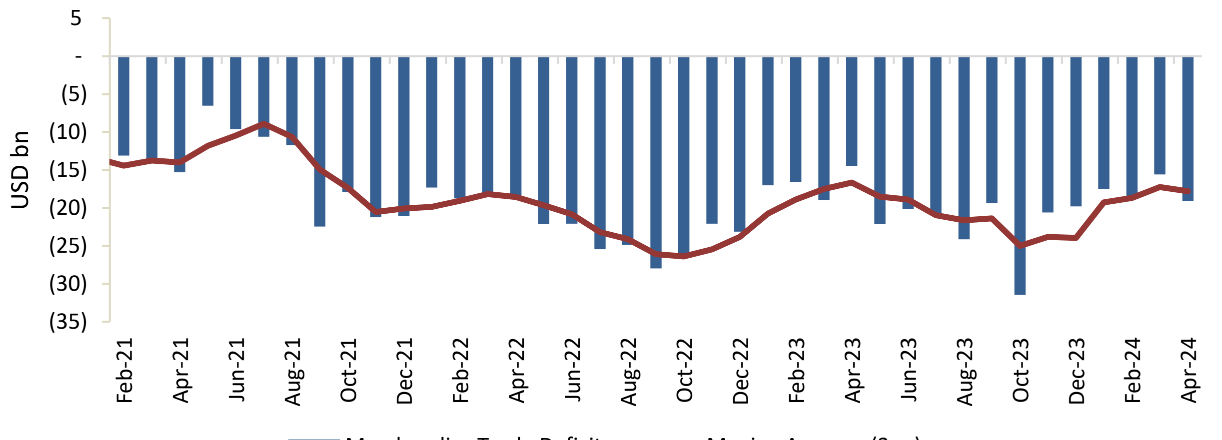
While G-sec buyback saw tepid response, it contributed to system liquidity



Source: RBI

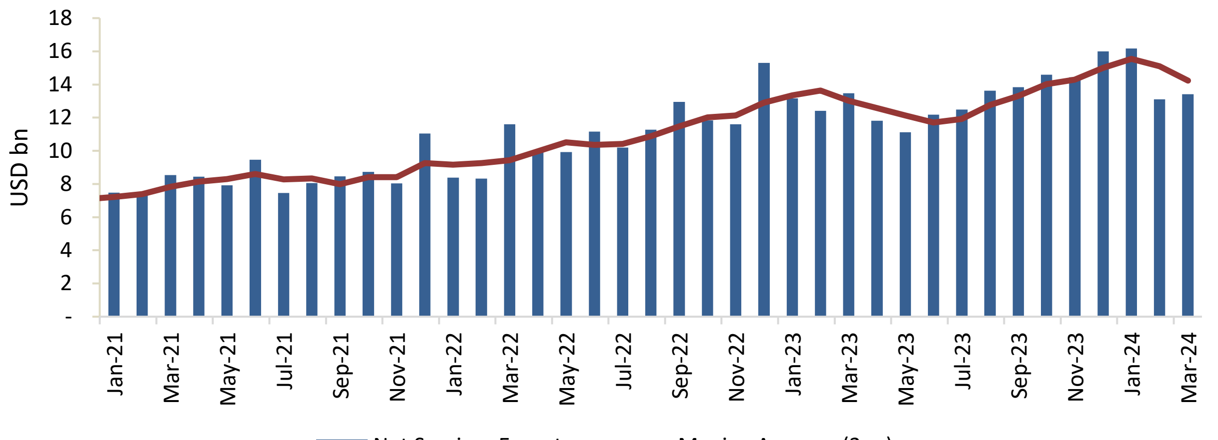
India's external sector remains strong on the back of lower CAD and higher forex reserves

Trade deficit has shown improvement



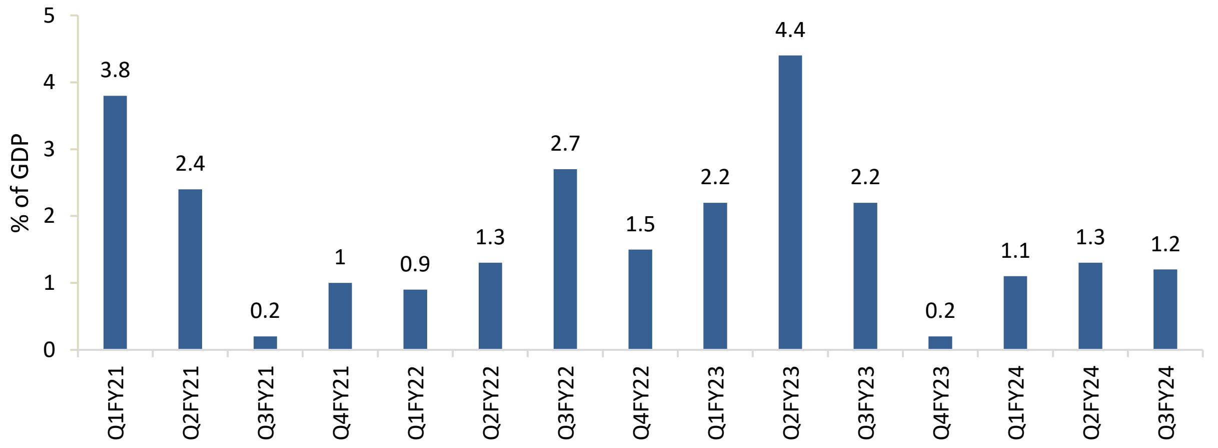
Source: Bloomberg

Services exports soar in FY24



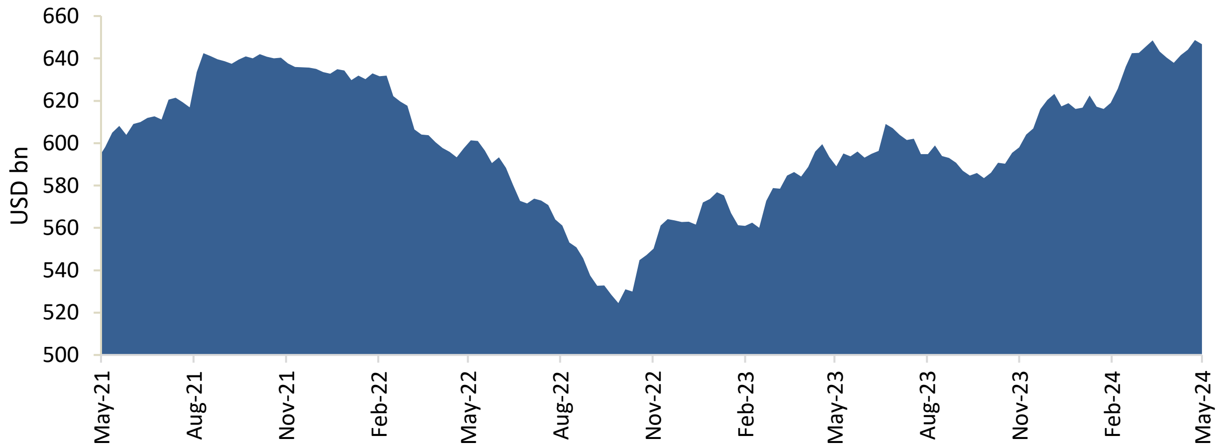
Source: Bloomberg

Services exports are providing support to CAD



Source: Cogencis

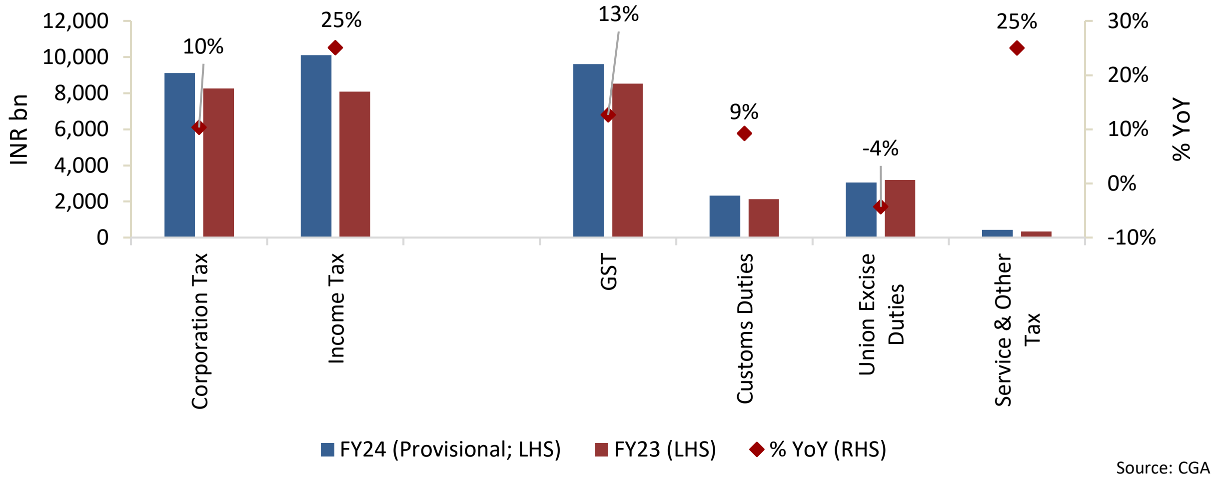
Forex reserves surged to an all-time high in May 2024



Source: Cogencis

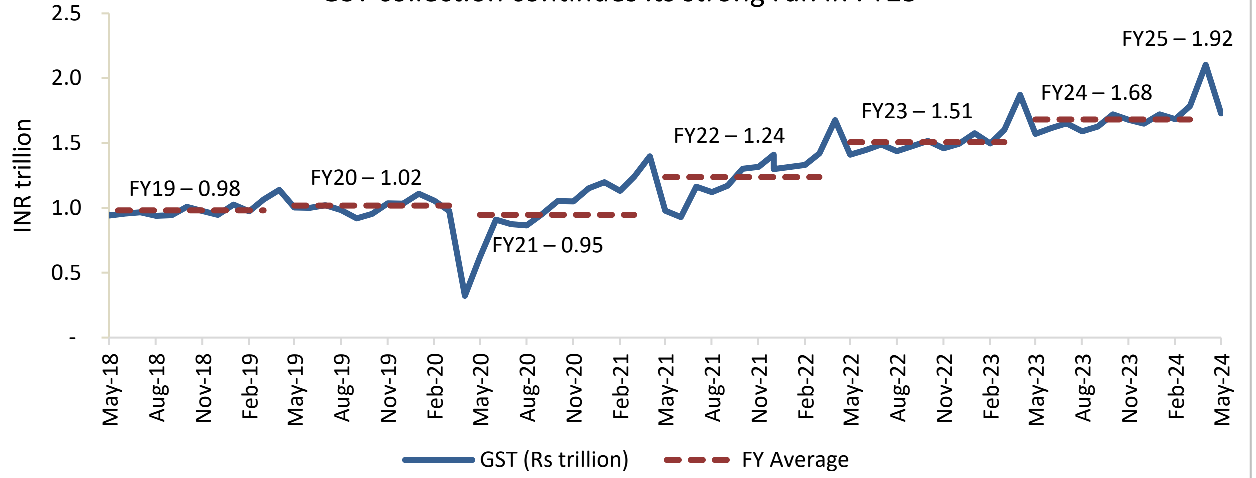
Higher tax revenue keeps the fiscal deficit in check, which may lower interest rates structurally over the long term

Tax collection remained buoyant in FY24



Source: CGA

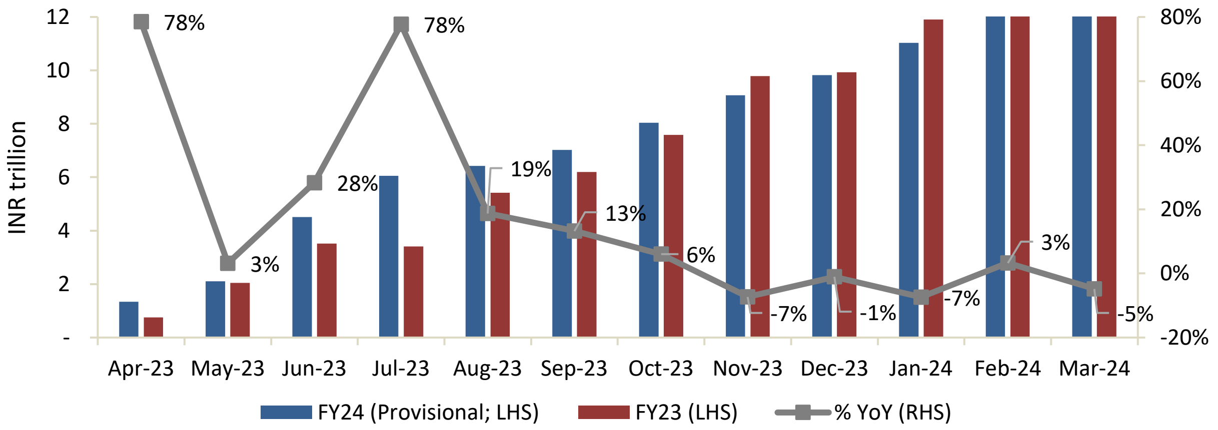
GST collection continues its strong run in FY25



Note: FY25 data till May 2024

Source: Cogencis

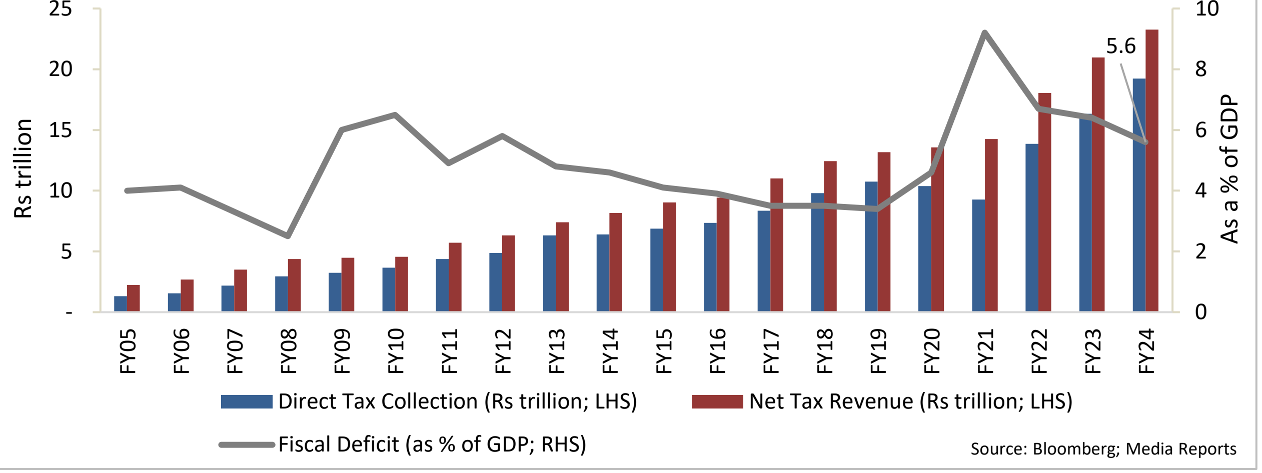
Fiscal deficit improves in FY24



Note: Cumulative data as of the respective month end

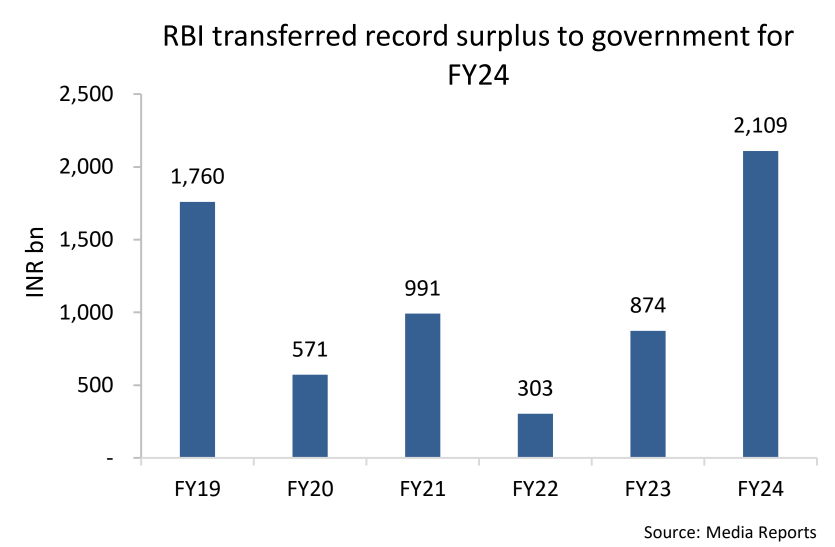
Source: CGA

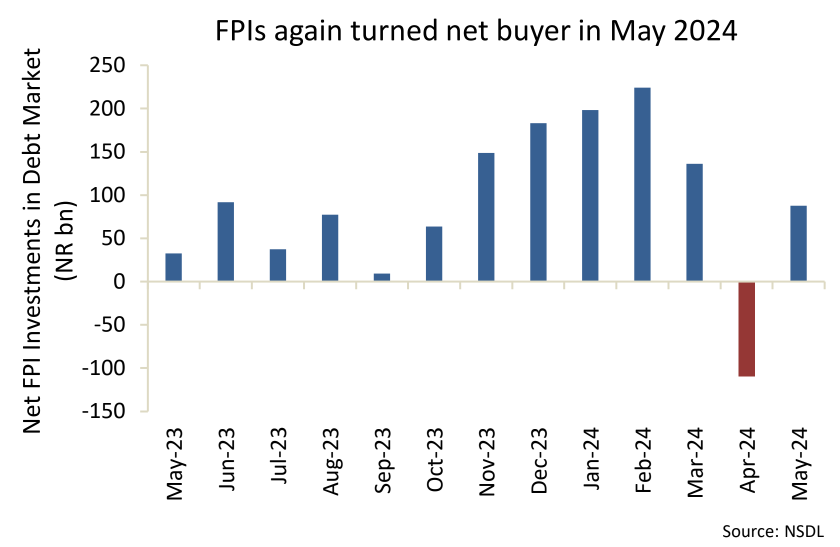
Fiscal deficit for FY24 came in at 5.6% of GDP, better than the revised estimate of 5.8%

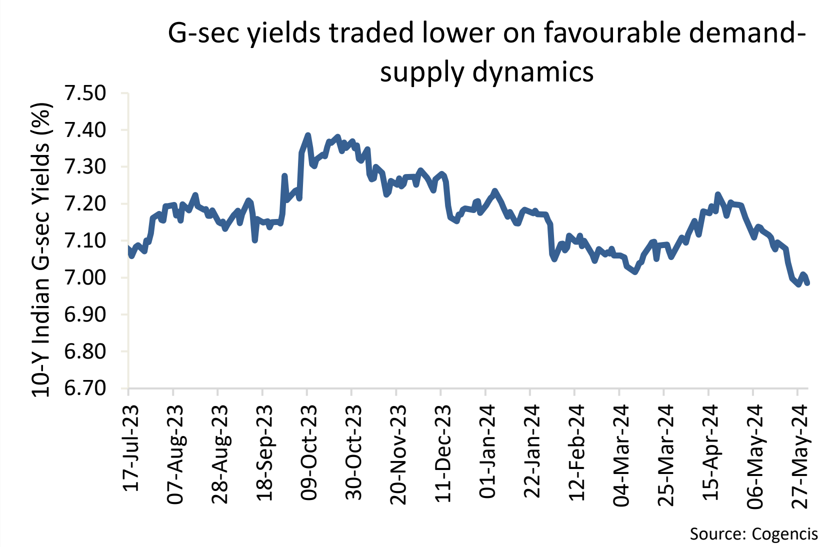


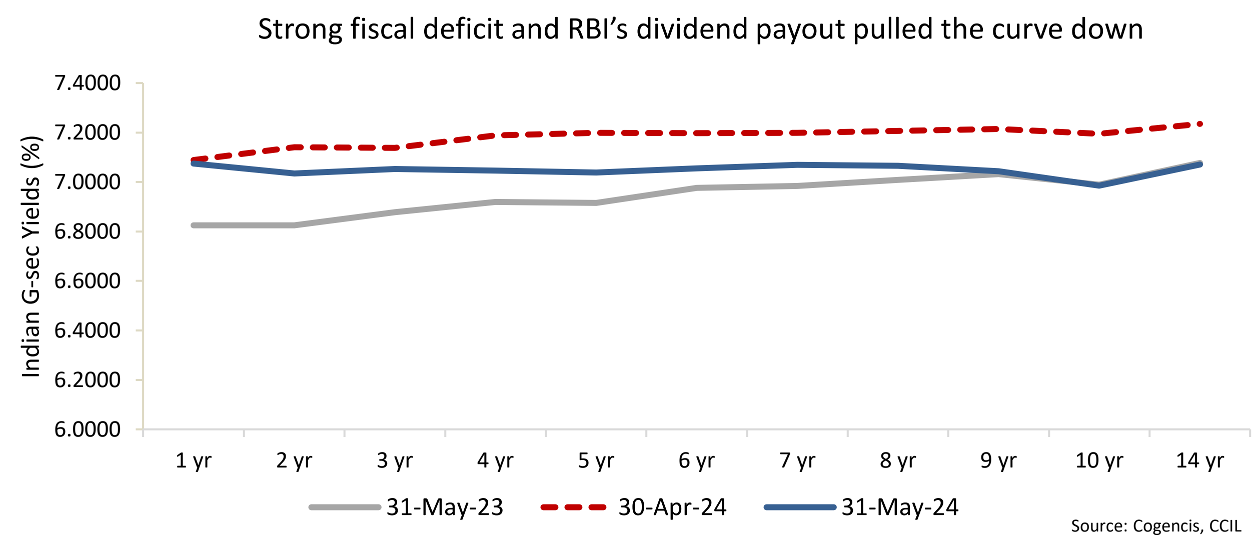
Source: Bloomberg; Media Reports

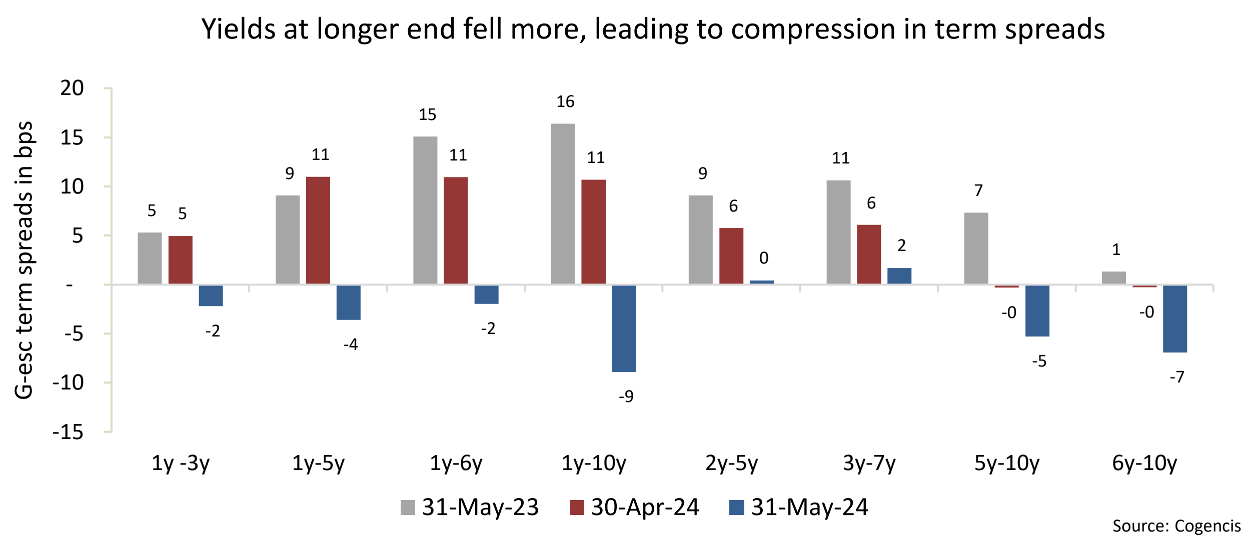
Lower fiscal deficit, surplus transfer by the RBI and the FPI inflows pulled the yields down





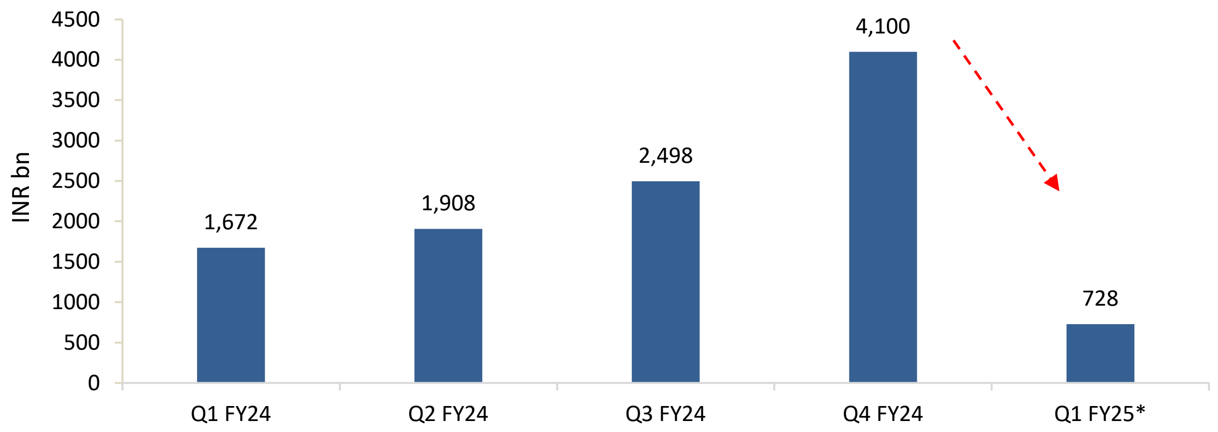






SDL and corporate bond spreads improved, making accrual attractive from risk-reward perspective

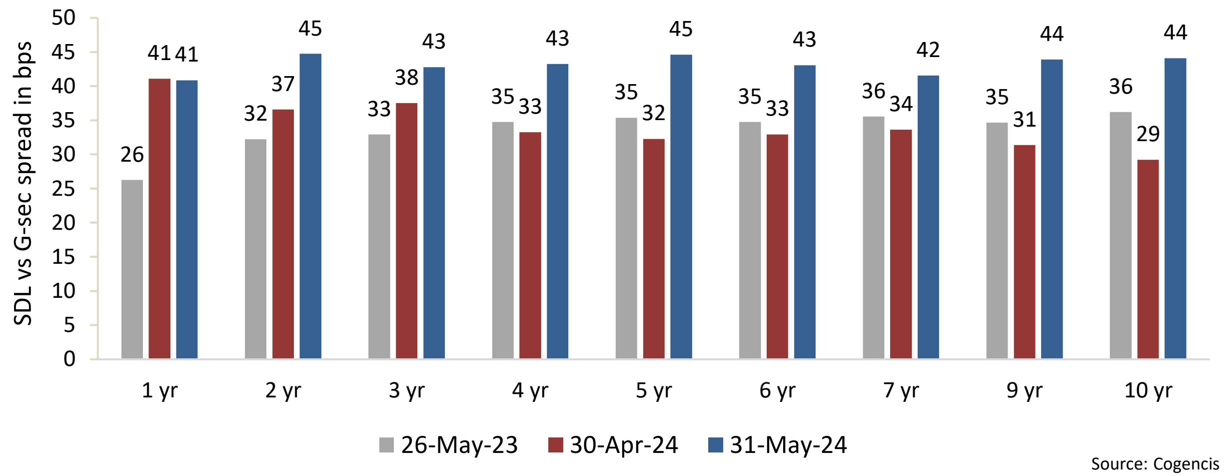
SDL issuances decline significantly in Q1 FY25*



Note: * Q1 FY25 data is up to 21-May-24

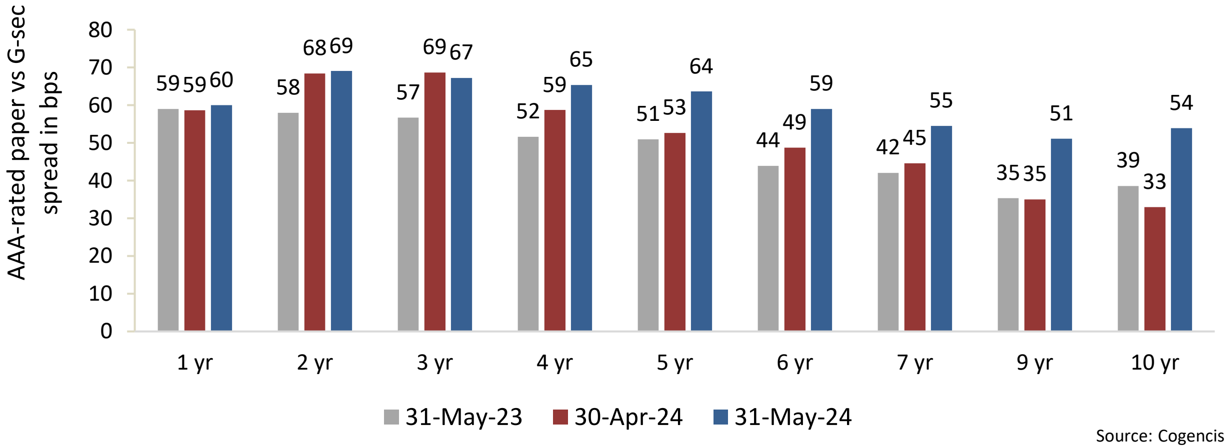
Source: Cogencis

Higher G-sec demand led to widening of SDL spreads…



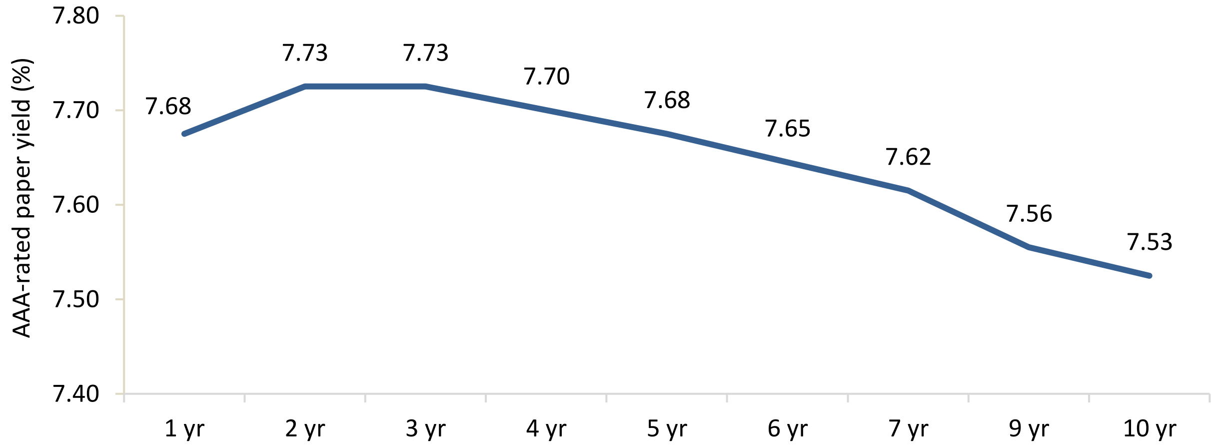
Source: Cogencis

… Similarly, higher G-sec demand also led to widening of corporate bond spreads



Source: Cogencis

Corporate bond yield curve remains inverted due to tight liquidity



Source: Cogencis

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