NETRA

Early Signals Through Charts

May 2023

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US Debt Ceiling: Another Political Slugfest

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US Debt Ceiling Can Spoil The Low Volatility Calm

The debt ceiling in US has been raised or suspended over 100 times since it was first established in 1917. It's a known unknown.

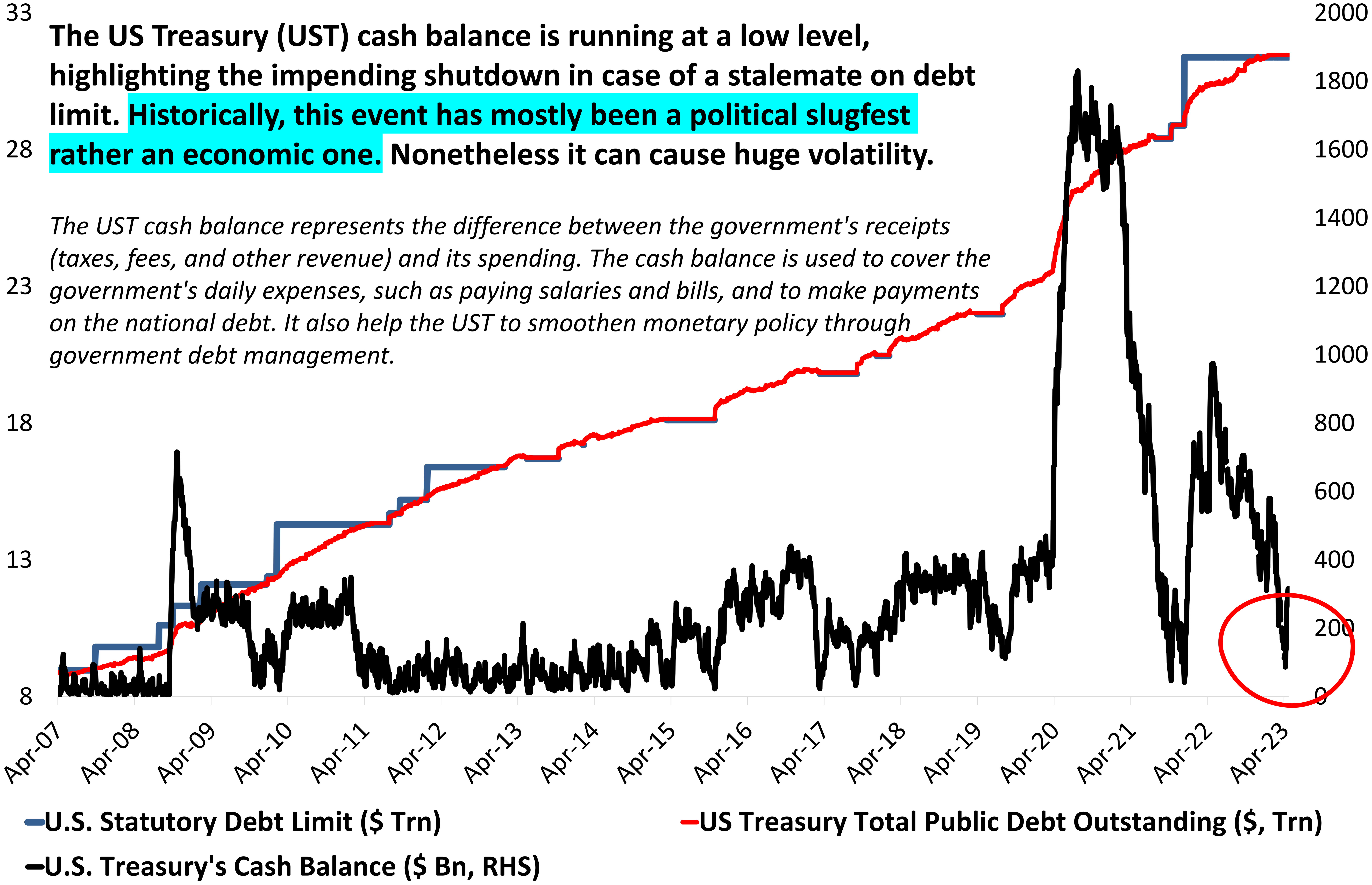
The US debt ceiling is a statutory limit on the amount of money the US government can borrow to finance its operations and obligations. The limit is set by Congress. It caps the amount of outstanding debt the government can have at any given time.

When the debt ceiling is reached, the Treasury Department takes measures to avoid defaulting by cutting expenditure or shutting down the government. Per the recent estimates from US Treasury and CBO, the debt limit will be breached by June or August 2023.

Historically, alarming statements from US Treasury about an impending default are part of political posturing and the limit is usually raised in the eleventh hour. **Nonetheless it can cause wild market moves in next one month because the magnitude of problem in case of no resolution could be very large.**

The US Treasury (UST) cash balance is running at a low level, highlighting the impending shutdown in case of a stalemate on debt limit. Historically, this event has mostly been a political slugfest rather an economic one. Nonetheless it can cause huge volatility.

The UST cash balance represents the difference between the government's receipts (taxes, fees, and other revenue) and its spending. The cash balance is used to cover the government's daily expenses, such as paying salaries and bills, and to make payments on the national debt. It also help the UST to smoothen monetary policy through government debt management.



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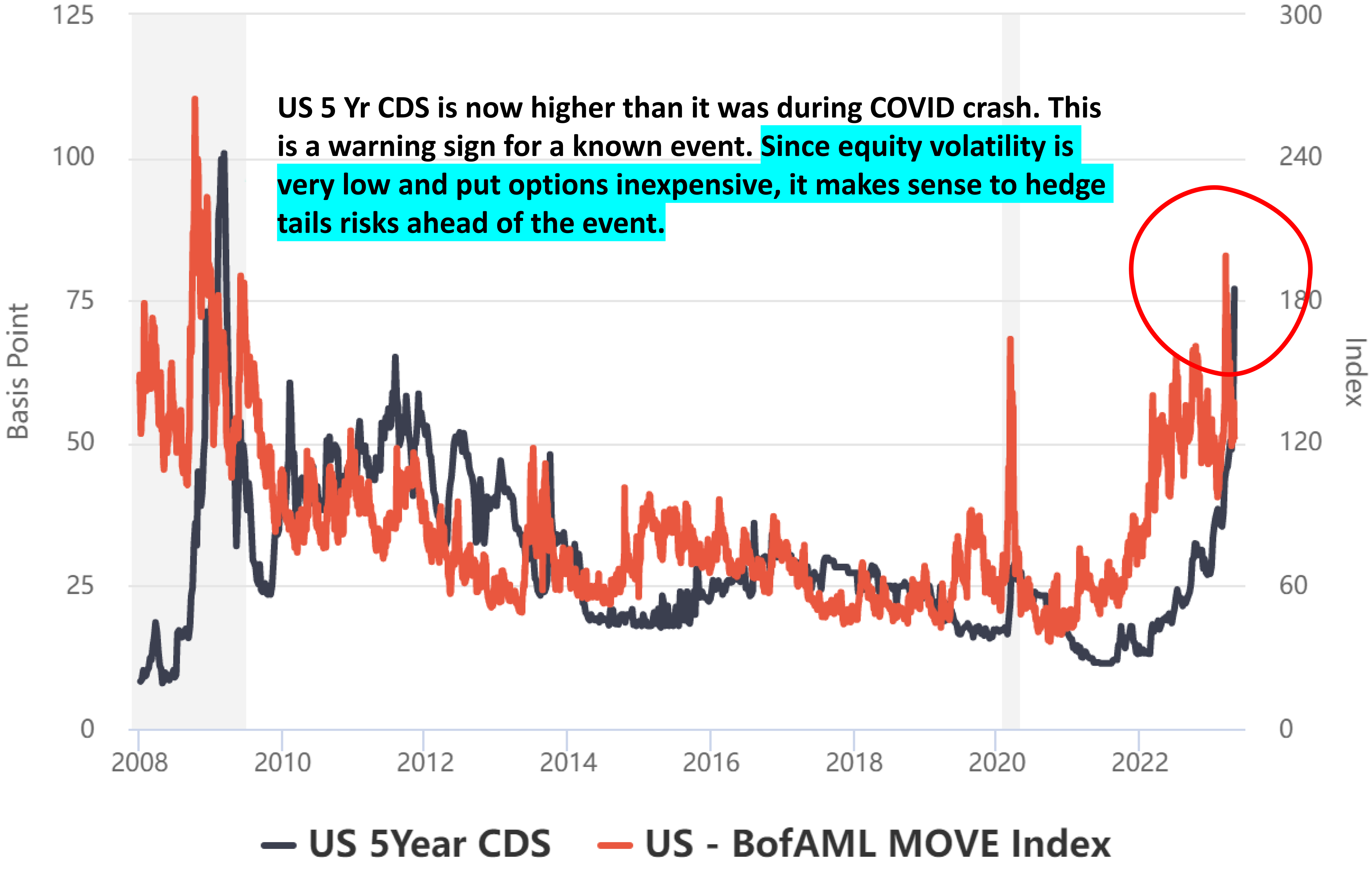
US Debt Ceiling: Another Source of Volatility?

The US CDS (Credit Default Swap) is a financial instrument that allows investors to protect themselves against the risk of a US government debt default. In the event that the US government defaults on its debt obligations, the holder of CDS receives a pay-in & is protected against its US Treasury holdings.

Rising CDS prices indicate that market participants see a rising risk of default.

The 5 Yr US CDS has risen to levels seen 15 years ago, which is a warning sign. At this point, it is a known unknown. The market is aware of the event but unsure of its outcome. If the US Congress fails to reach a consensus on a debt limit, this event will likely cause more volatility soon.

The barometer of bond market volatility, the Move Index, is also elevated, highlighting the already fragile sentiment in the US treasury market.



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Source: Macromicro.me, DSP, Data as on April 2023

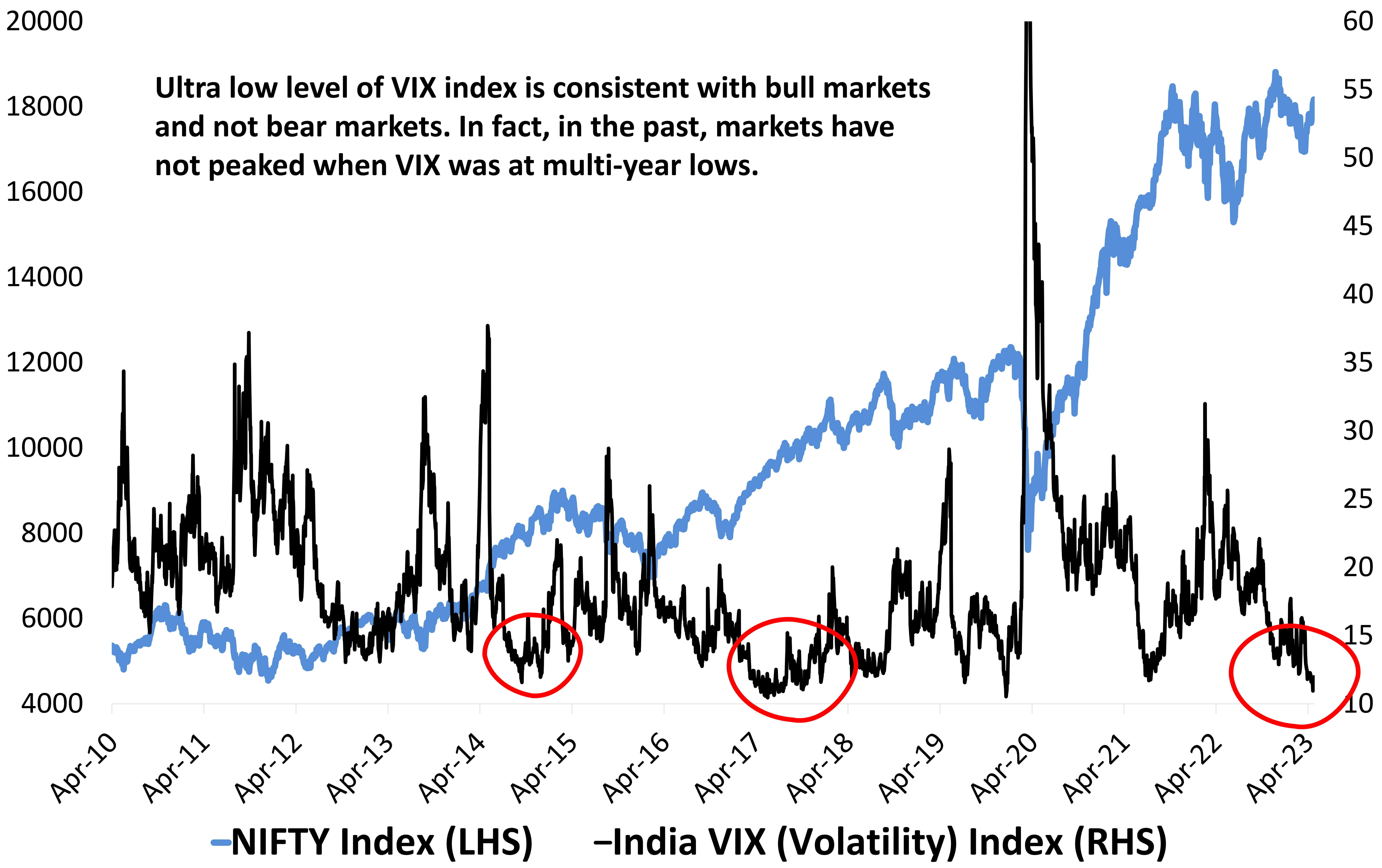
Volatility Crush: Complacency or A Bull Market?

The India volatility index recorded the lowest readings ex of COVID crash recently. Historically, a very high & rising level of VIX indicates ominous conditions for stock markets. But ultra low levels of VIX is consistent with bull markets rather than with complacency.

However, given that the US Debt limit is likely to be breached in the next few weeks or months, it is important to put a context to the current readings. Especially after a smooth run due to earnings beat by many large cap companies in the ongoing results season.

Since option premium is at a multi year low, it makes sense to hedge tail risks by buying deep out of the money put options. Data for Indian economy & corporate earnings remains robust pointing to underlying bullishness.

Therefore, it makes sense to keep equity allocations steady, but hedge for the upcoming event with 'not so expensive' hedges.



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Source: DSP, Bloomberg, Data as on April 2023

Can Growth Concerns Accelerate Disinflation & Help Gold?

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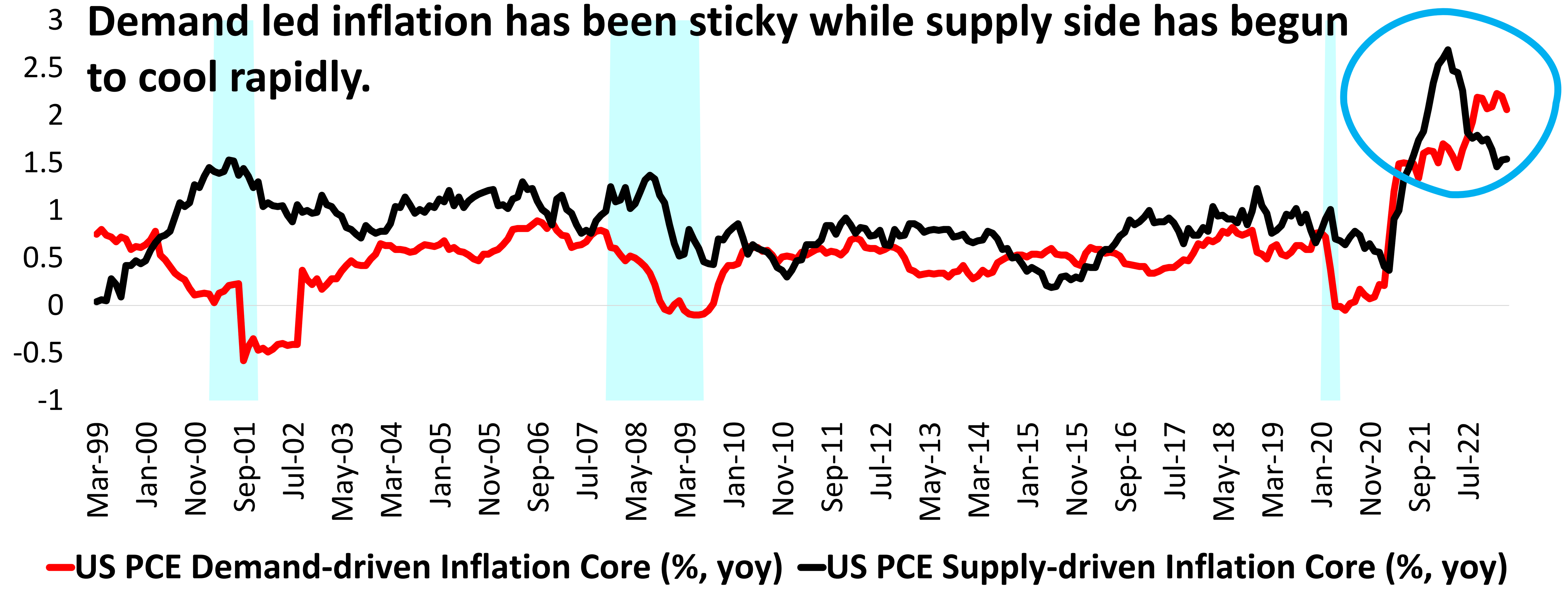
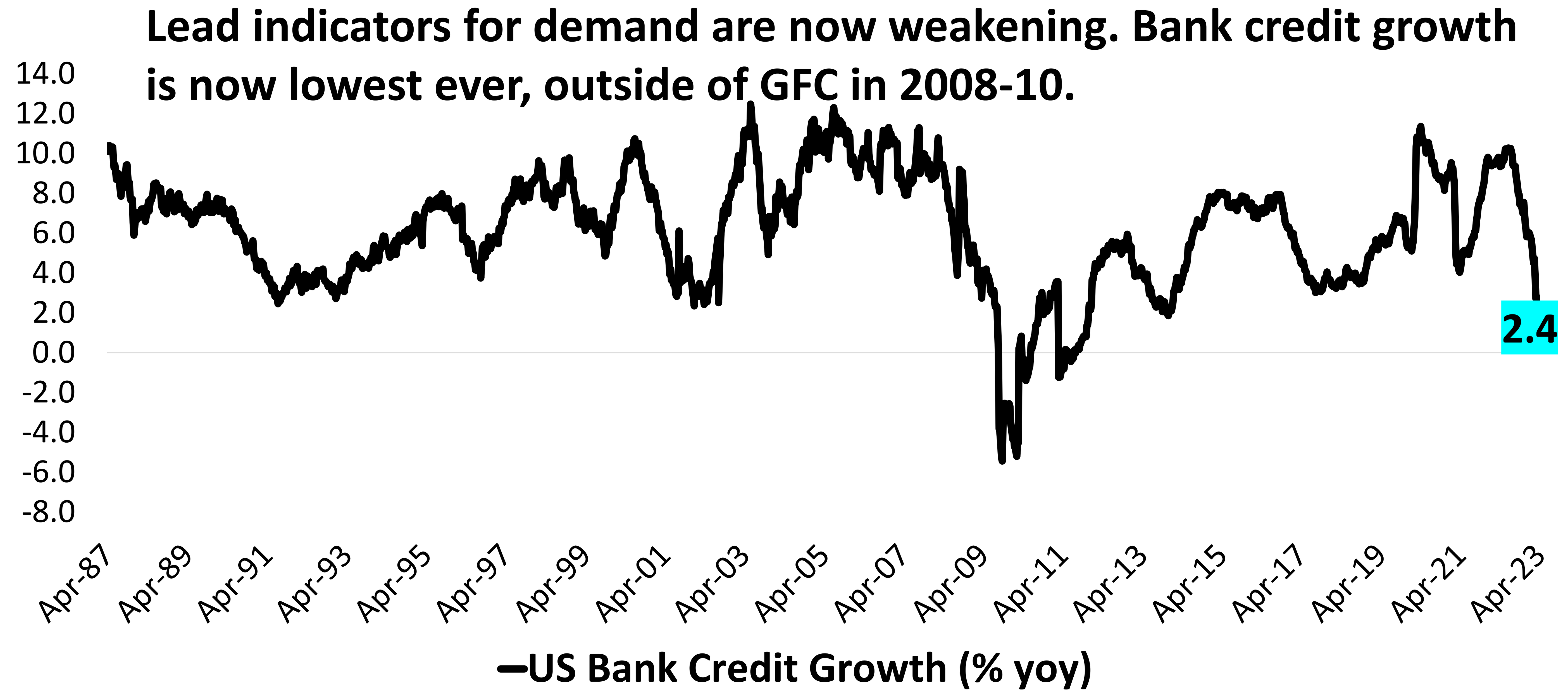
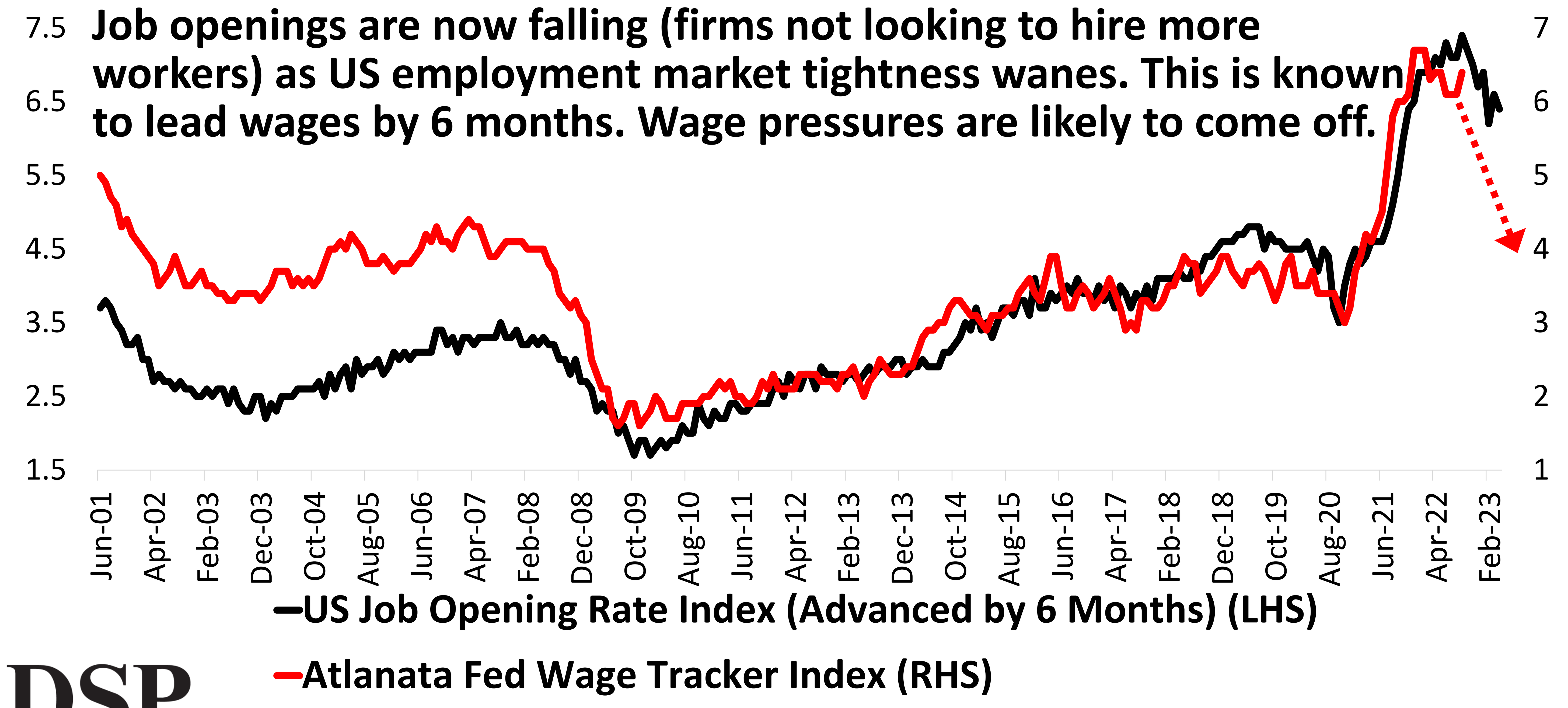
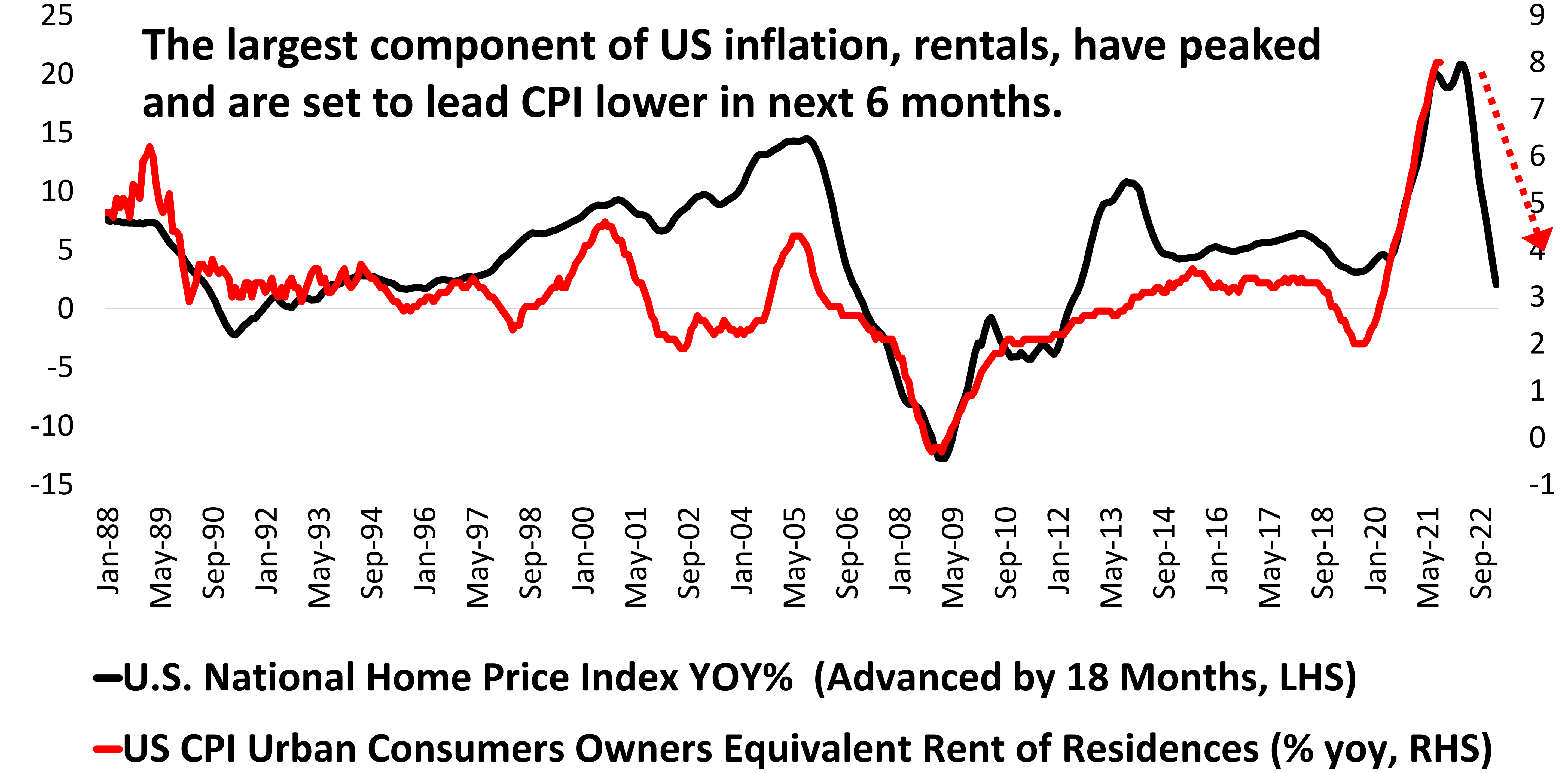
Demand Side Inflation Is Set To Test Fed's Hawkish Resolve









Source: DSP, Bloomberg, Data as on April 2023

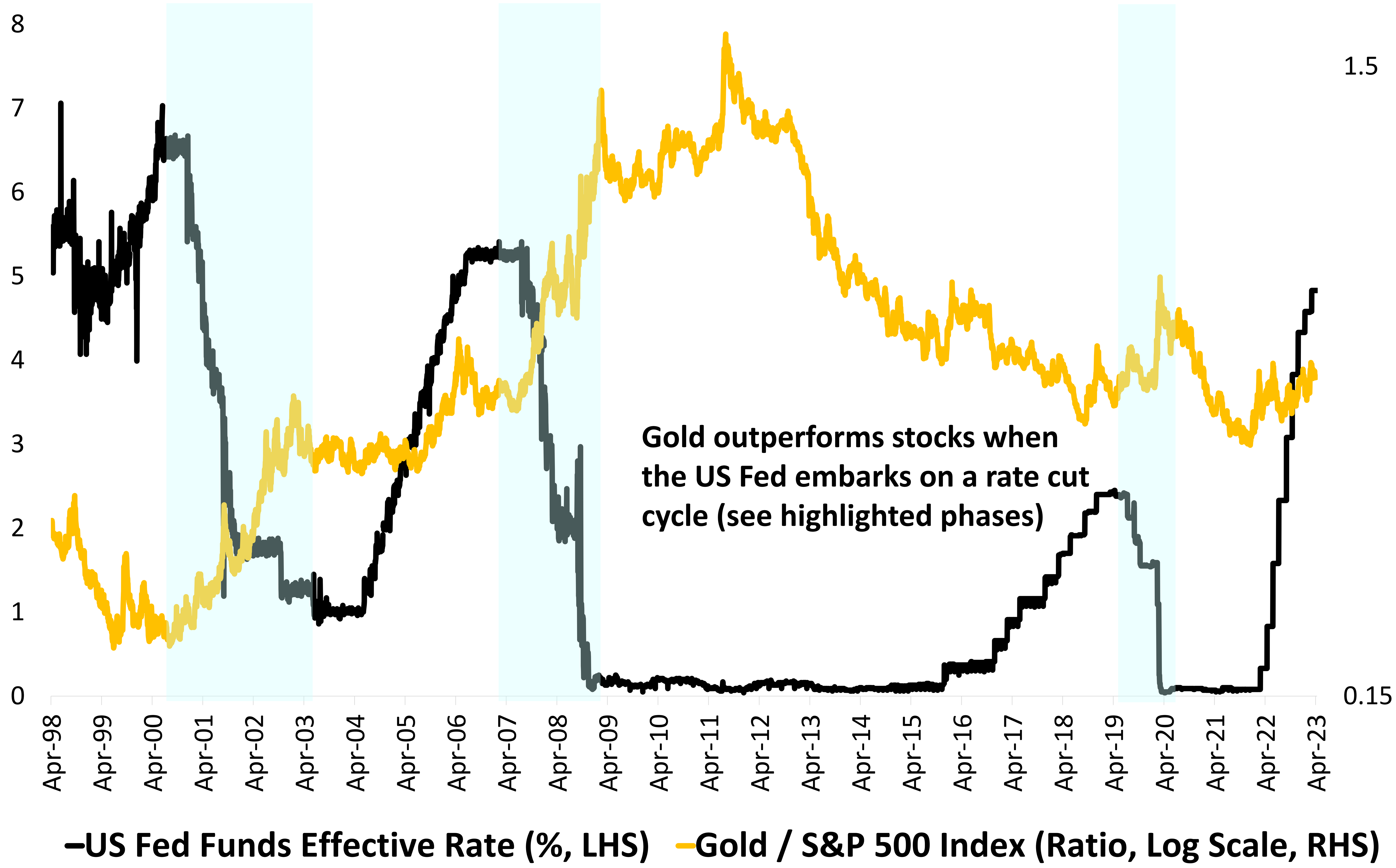
Gold Outperforms When US Fed Embarks On A Rate Cutting Cycle

Gold prices tend to rise when the US Federal Reserve cuts interest rates because lower interest rates reduce the opportunity cost of holding non-yielding assets such as gold. Since markets anticipate actual moves, it is to be noted that bond yields on US Treasury bonds have already fallen more than 100 basis points on 3-to 10-year bonds.

Lower interest rates can also be seen as a sign of economic uncertainty or instability, which can increase demand for safe-haven assets like gold as a hedge against market volatility.

In the past, the US dollar has softened during economic slowdown. The US dollar index has recently fallen after hitting multi-decade highs on its REER (real effective exchange rate). A lower US dollar is beneficial for gold.

If gold were to break towards a new lifetime high, it would indicate the birth of a new bull market. Expect it to head towards $2500 in such a scenario.



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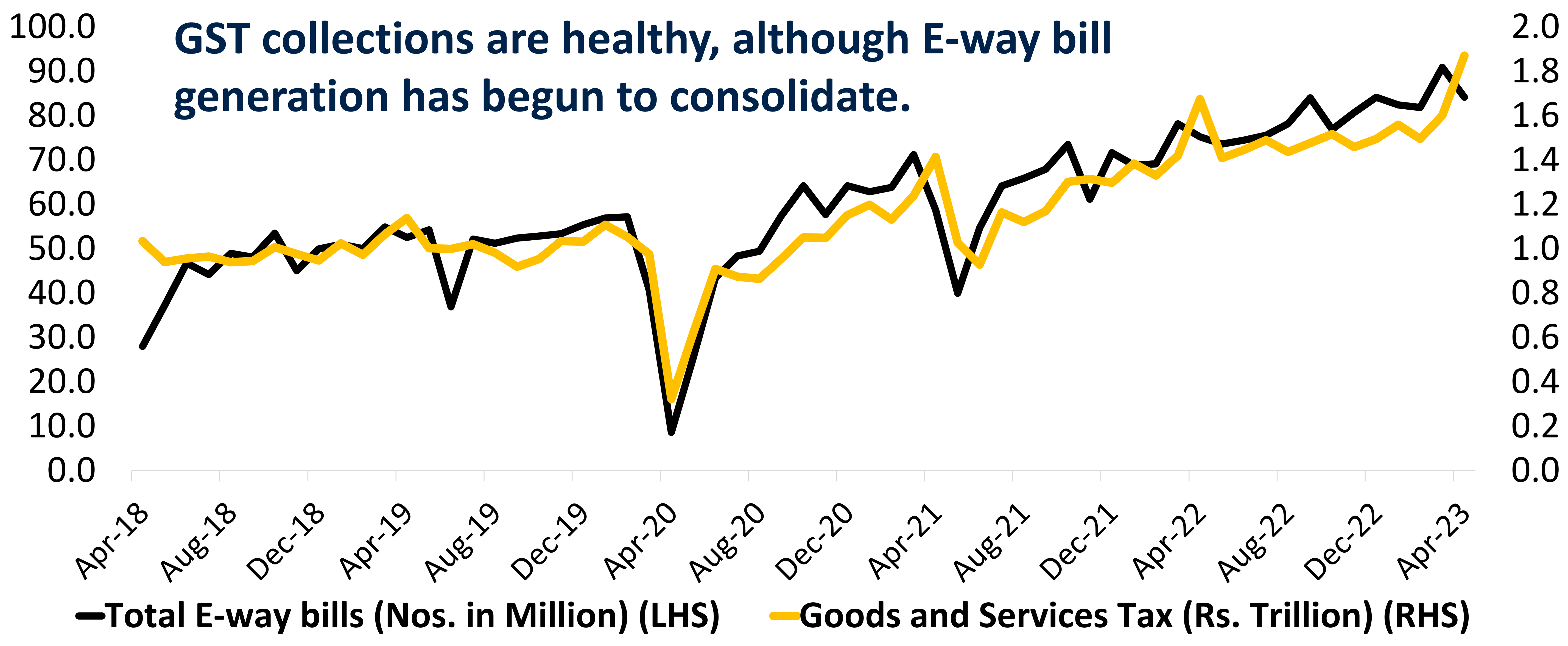
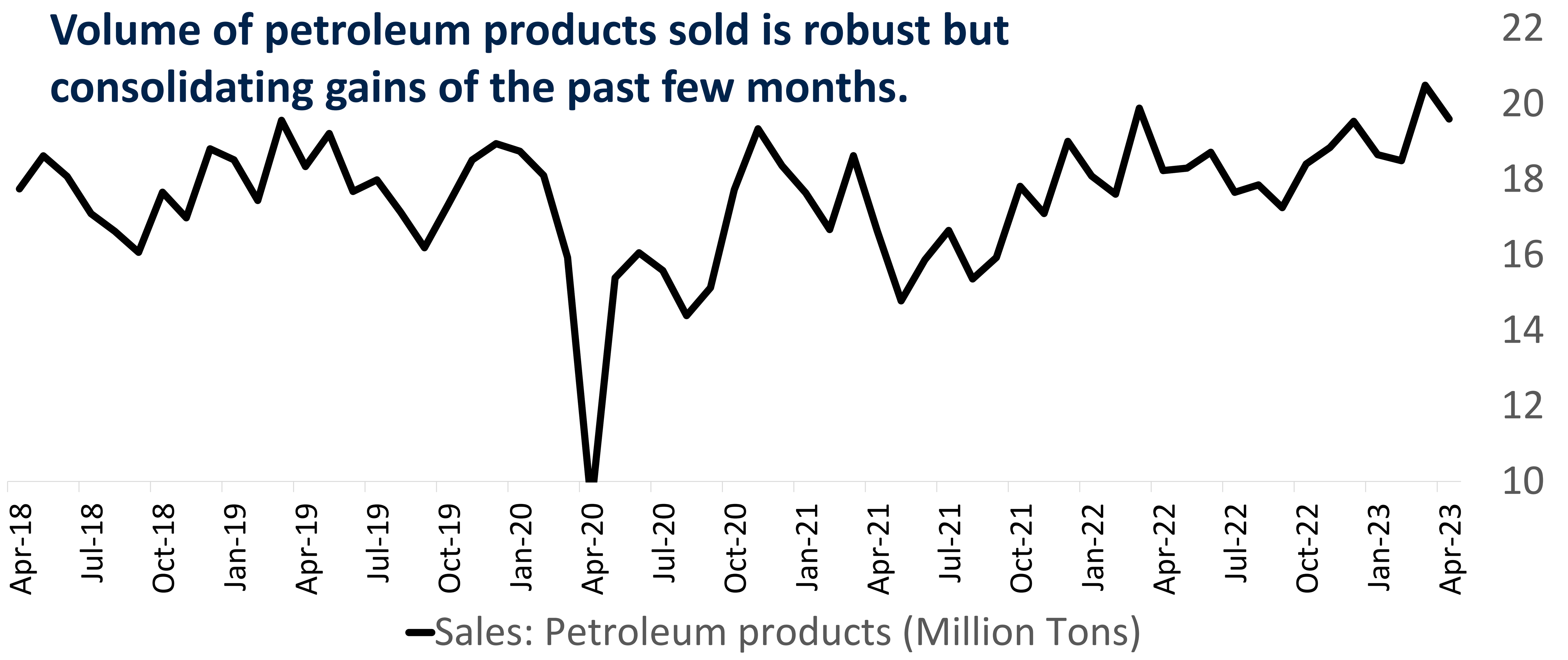
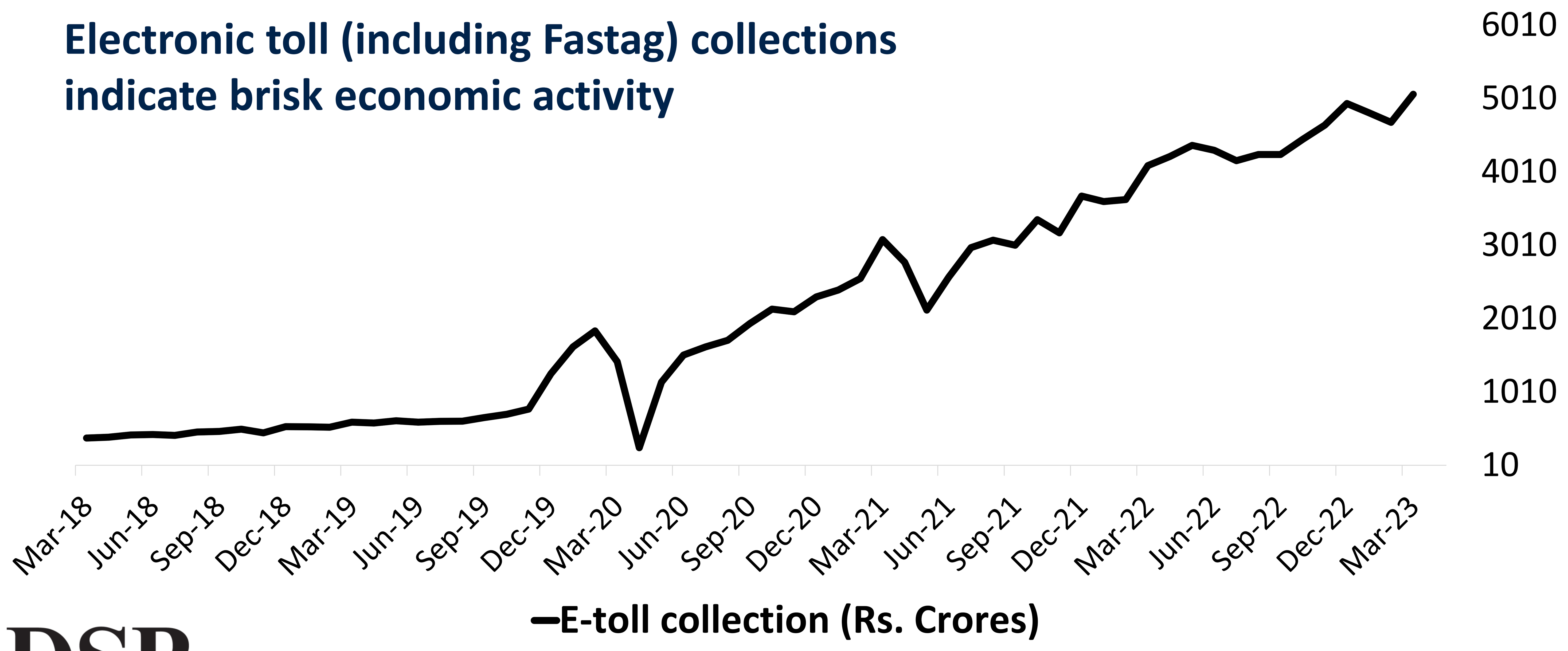
Source: DSP, Bloomberg, Data as on April 2023

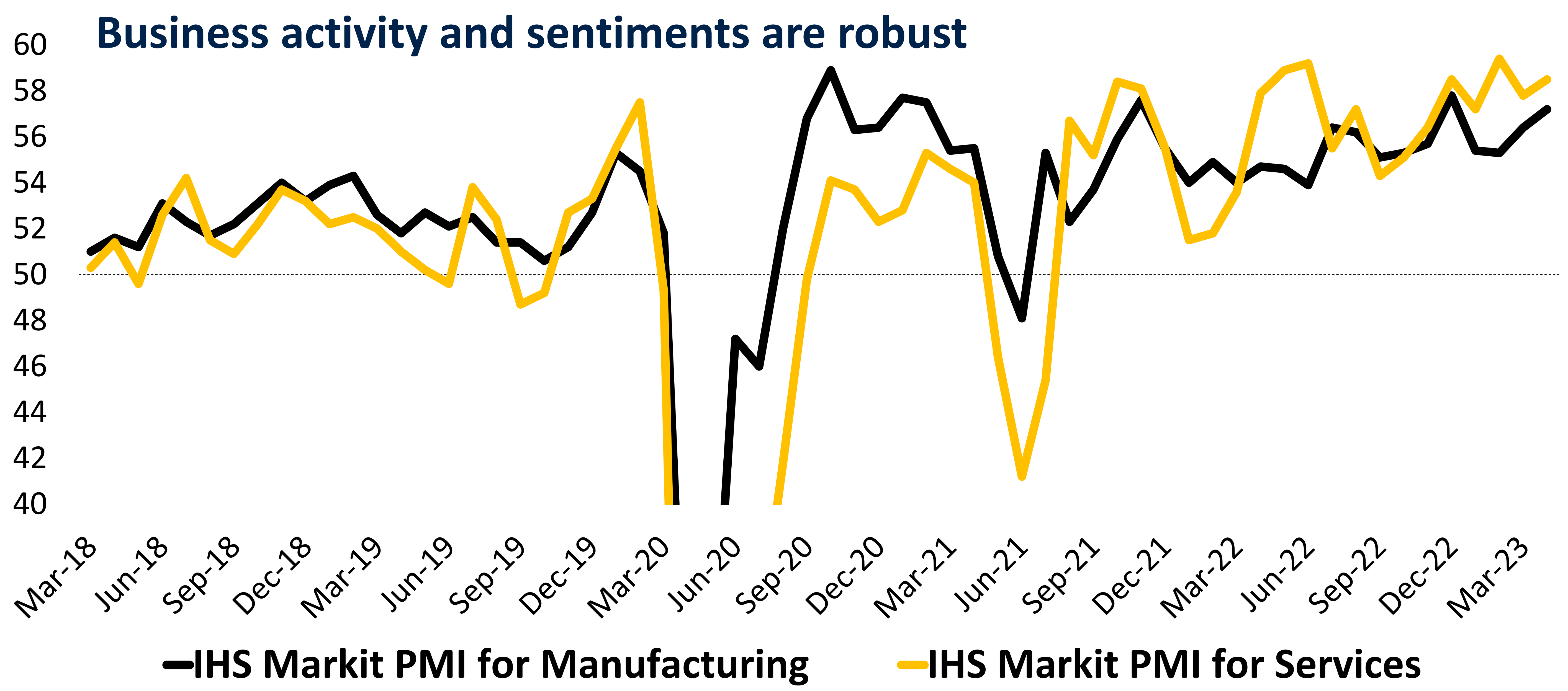
India: A Steady Ship In Choppy Waters

India High Frequency Indicators Are Steady









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Source: CMIE, DSP As on April 2023

India Macro Offers Stability

Even after raising interest rates to multi-year highs and at one of the fastest paces, most countries are struggling to bring inflation back within their target bands. This is in the context of nearly six months of disinflationary trends from peak inflation rates and of consistent rate hikes globally.

Recently, RBI hit the pause button on its rate hike cycle. Inflation nowcast models are indicating further softening of inflation in India. This makes India stand out compared to its peer group. Its monetary policy is currently well suited to support a growth recovery, and the tapering of current account worries would help India's external position as well.

This removes a key negative from Indian financial markets. In such a scenario, a focus on valuations and earnings growth is likely to result in better investment outcomes.

	Real 10Y Treasury Yield	Real policy rate	CPI Inflation	Inflation Target (% range)
UK	-6.4	-5.9	10.1	2.0
EU	-4.6	-3.9	6.9	2.0
Japan	-2.8	-3.3	3.2	2.0
Thailand	**-0.3**	**-1.1**	**2.8**	**2 ± 1**
Malaysia	0.3	-0.7	3.4	3.3
USA	-1.4	-0.2	5.0	2.0
South Africa	4.3	-0.1	7.1	4.5 ± 1.5
India	**1.5**	**0.8**	**5.7**	**4 ± 2**
Indonesia	2.2	1.4	4.3	3.0
China	2.1	2.1	0.7	3.0
Russia	12.5	4.0	3.5	4.0
Mexico	1.9	4.4	6.9	3.0
Brazil	7.7	9.0	4.7	3.0

Red box indicates inflation target miss

India has had a relatively better inflation trajectory and monetary policy management than most other countries globally.

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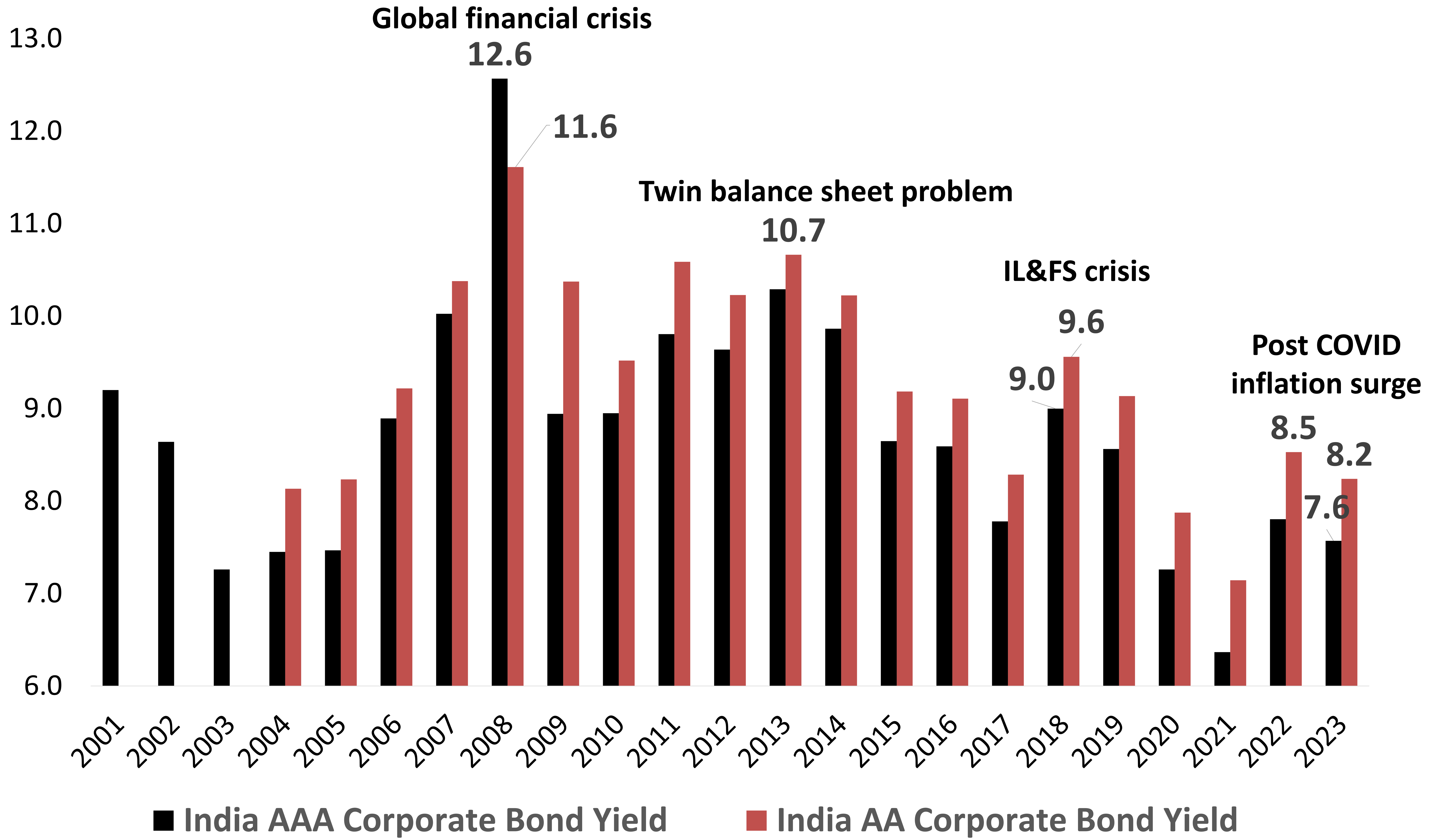
Source: DSP, Bloomberg, Data as on April 2023

Least Constrictive Monetary Tightening

RBI accelerated its monetary policy tightening in the aftermath of the Russia-Ukraine war to tackle a sticky inflation picture. In FY23, before hitting a pause, the RBI raised rates by 250 bps. **However, the monetary policy condition in India has been "least tight' when compared to past episodes of crisis & inflation upsurges. This is clearly visible in the lowest peak rates for corporate borrowers at the peak of rate hike cycles.**

This is likely because of two reasons. Firstly, the domestic measures of inflation have been slightly less buoyant than in past cycles, when inflation reached double-digit levels. Secondly, the RBI has adopted a more benign view of liquidity conditions this time. In the past, liquidity was kept too tight, which restricted growth in India.

A 100-bps lowering in borrowing costs helps GDP growth by 80 bps over a 5-year period.



Peak rates by year for corporate borrowers.

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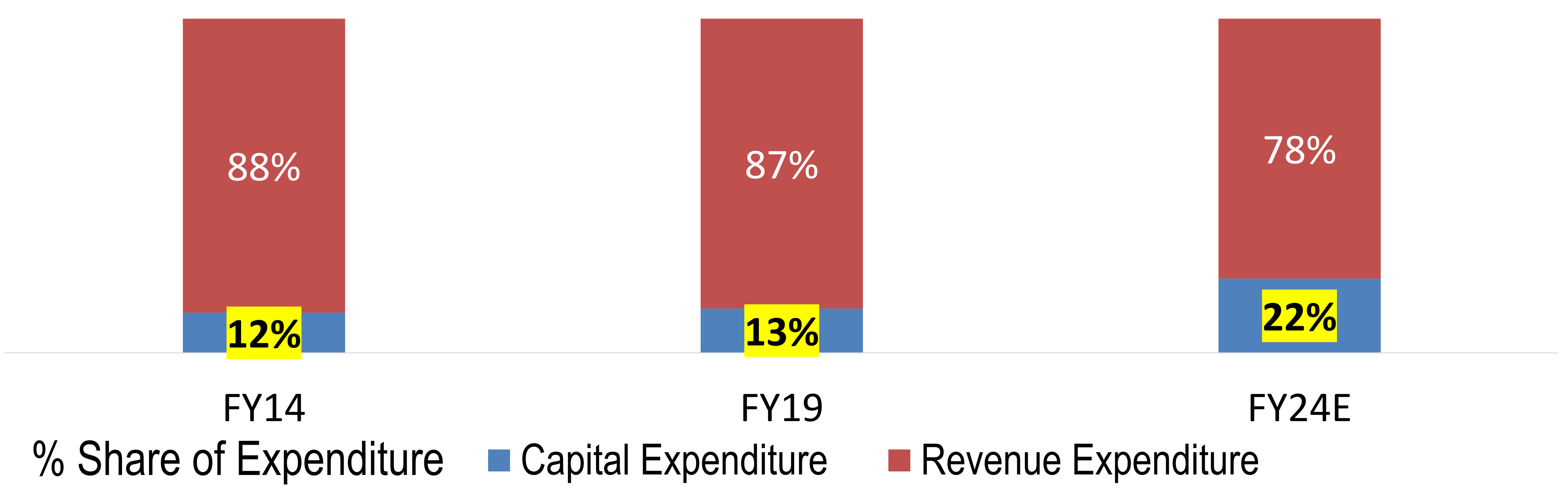
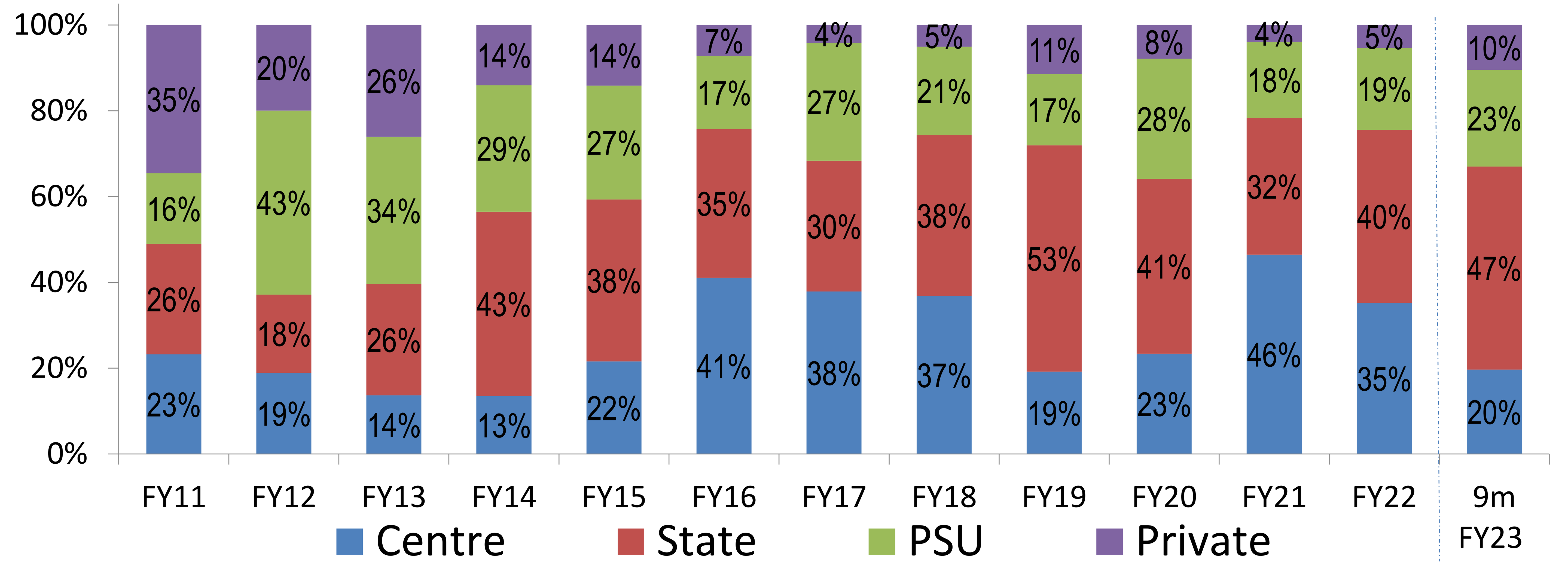
Source: DSP, Bloomberg, Data as on April 2023

Conducive Conditions For CAPEX Cycle

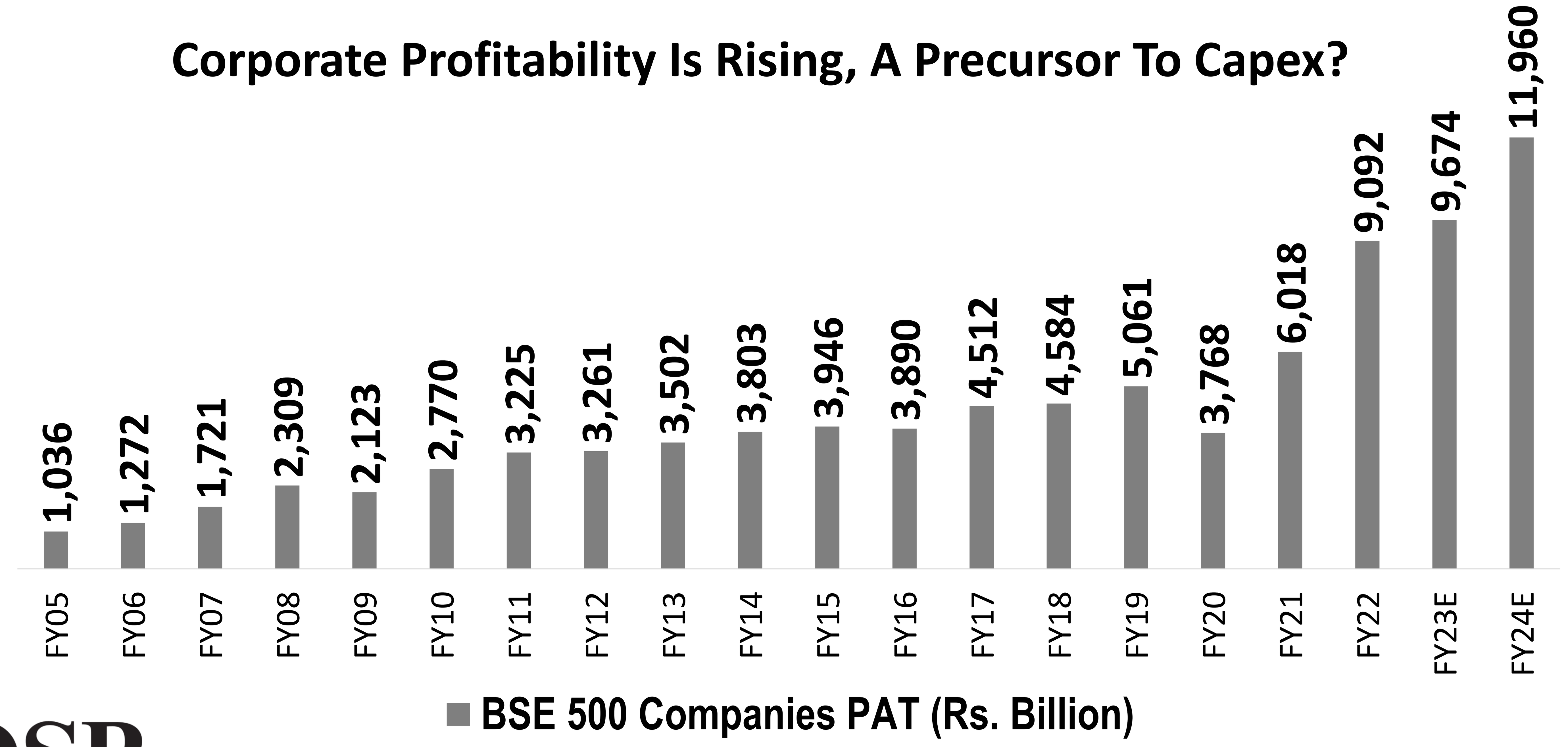
Share of Capital Expenditure By GOI On The Rise



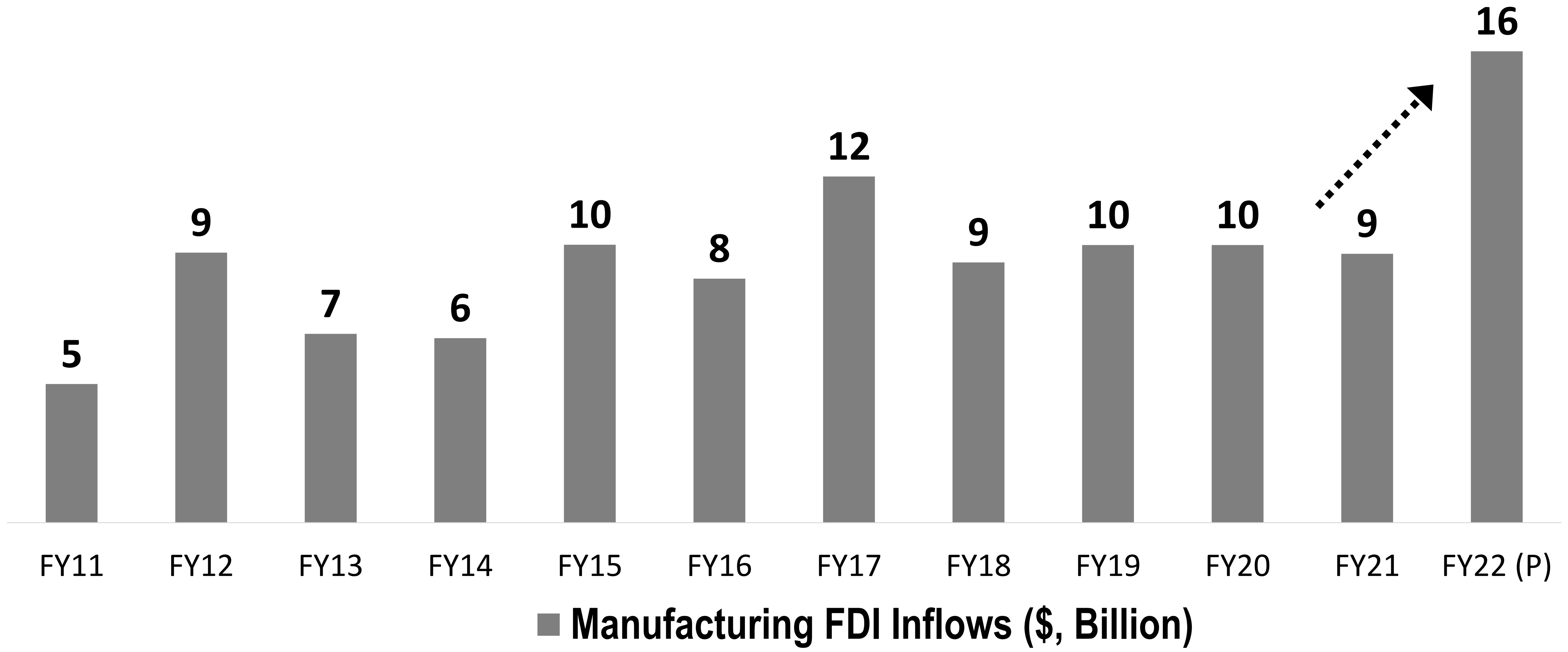
Green shoots in Private Capex after years seen in proportion of order awards



Corporate Profitability Is Rising, A Precursor To Capex?



Manufacturing FDI Inflows Are Record High



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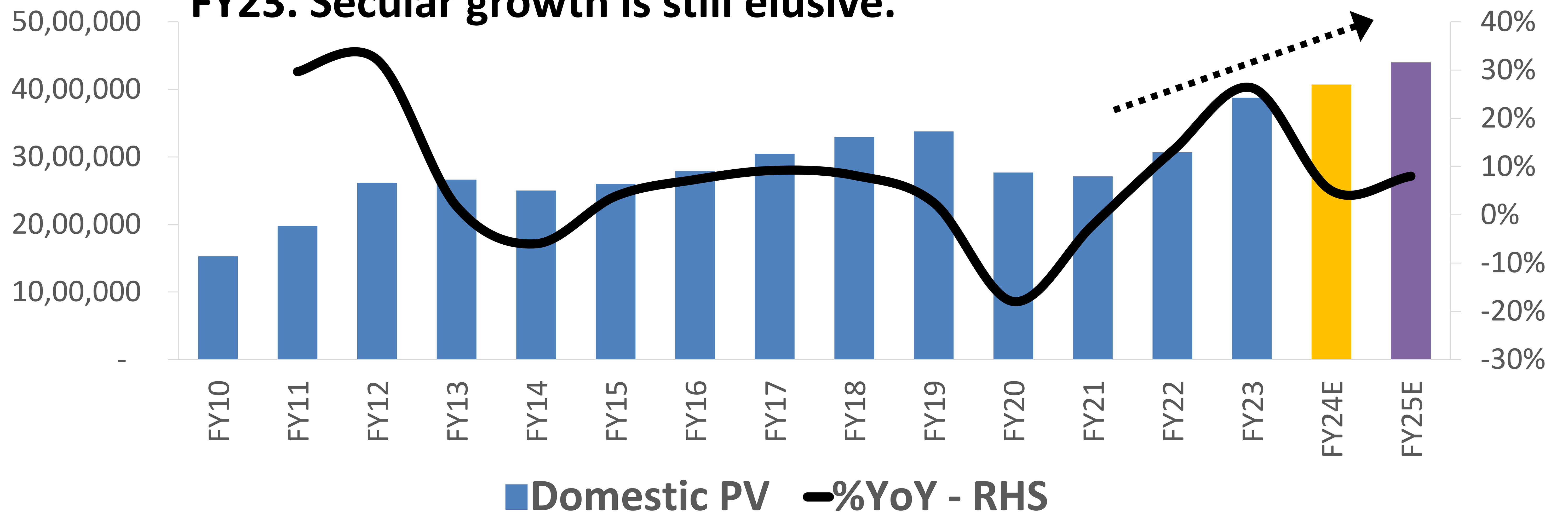
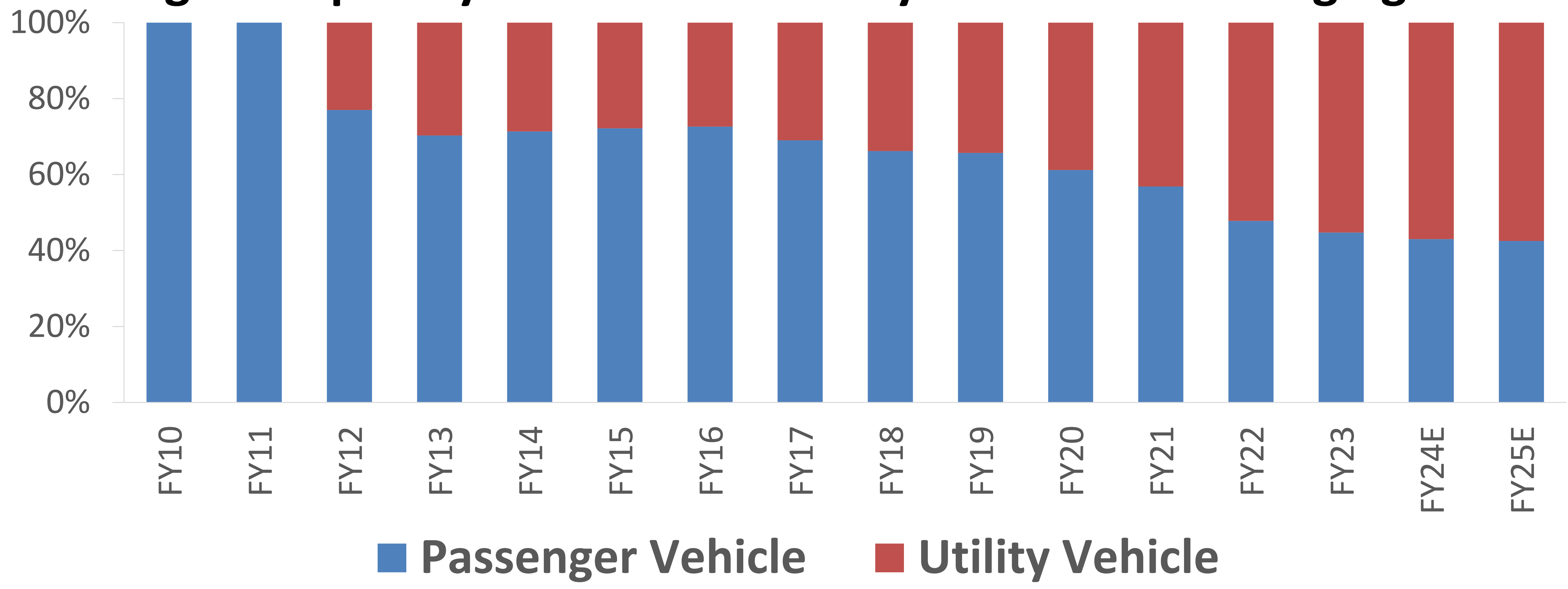
Source: DSP, Investec, Data as on April 2023

Auto Sector: Can It Witness Secular Growth After A Premiumization Cycle?

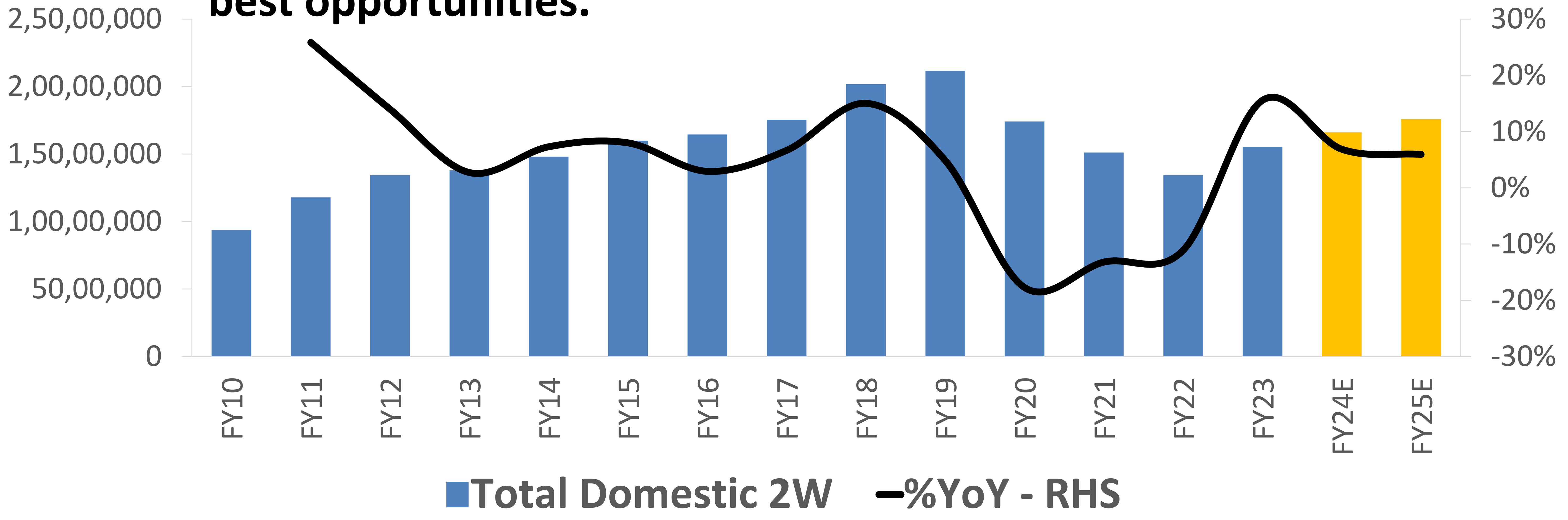
Passenger vehicle sales have risen above FY18 numbers in FY23. Secular growth is still elusive.



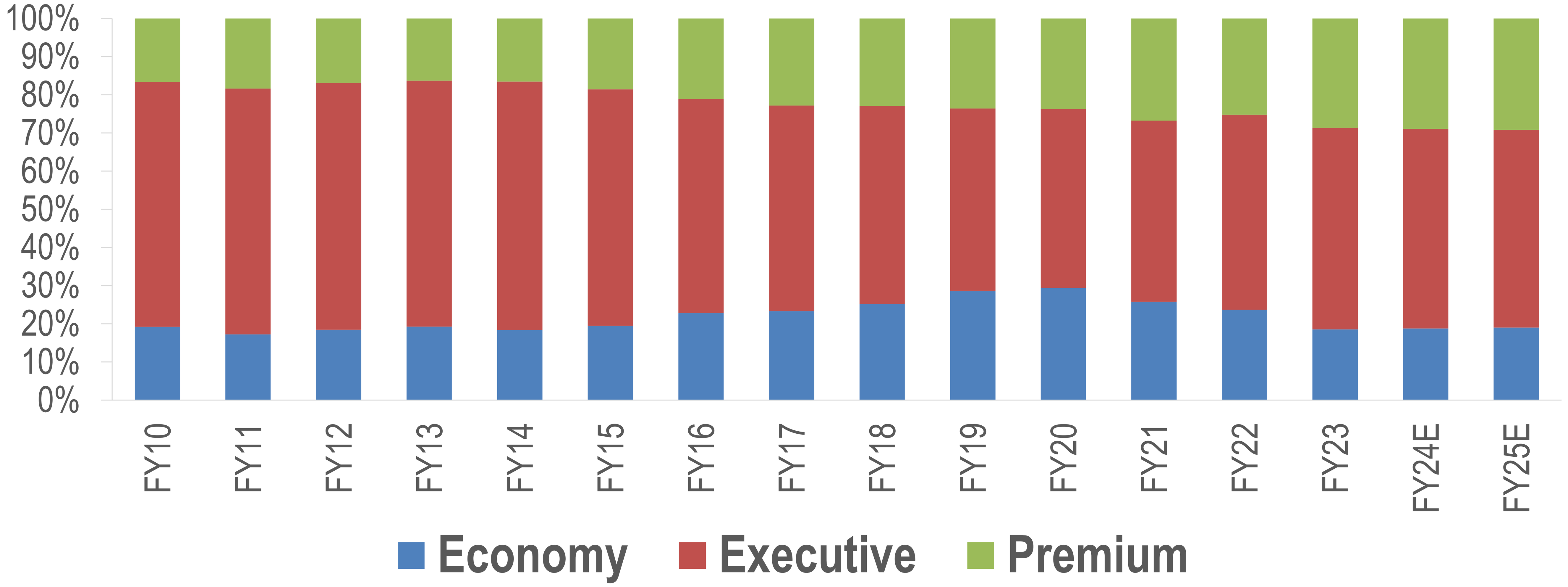
SUVs is the only segment which has contributed to growth. A sign of a patchy economic recovery. This is now changing.



Two-wheeler sales at levels seen nearly a decade ago. If rural & semi urban Indian economy recovers, this could be one of the best opportunities.



Two-wheeler segment has also seen a trend towards premiumization. A secular recovery will likely benefit this trend even more.



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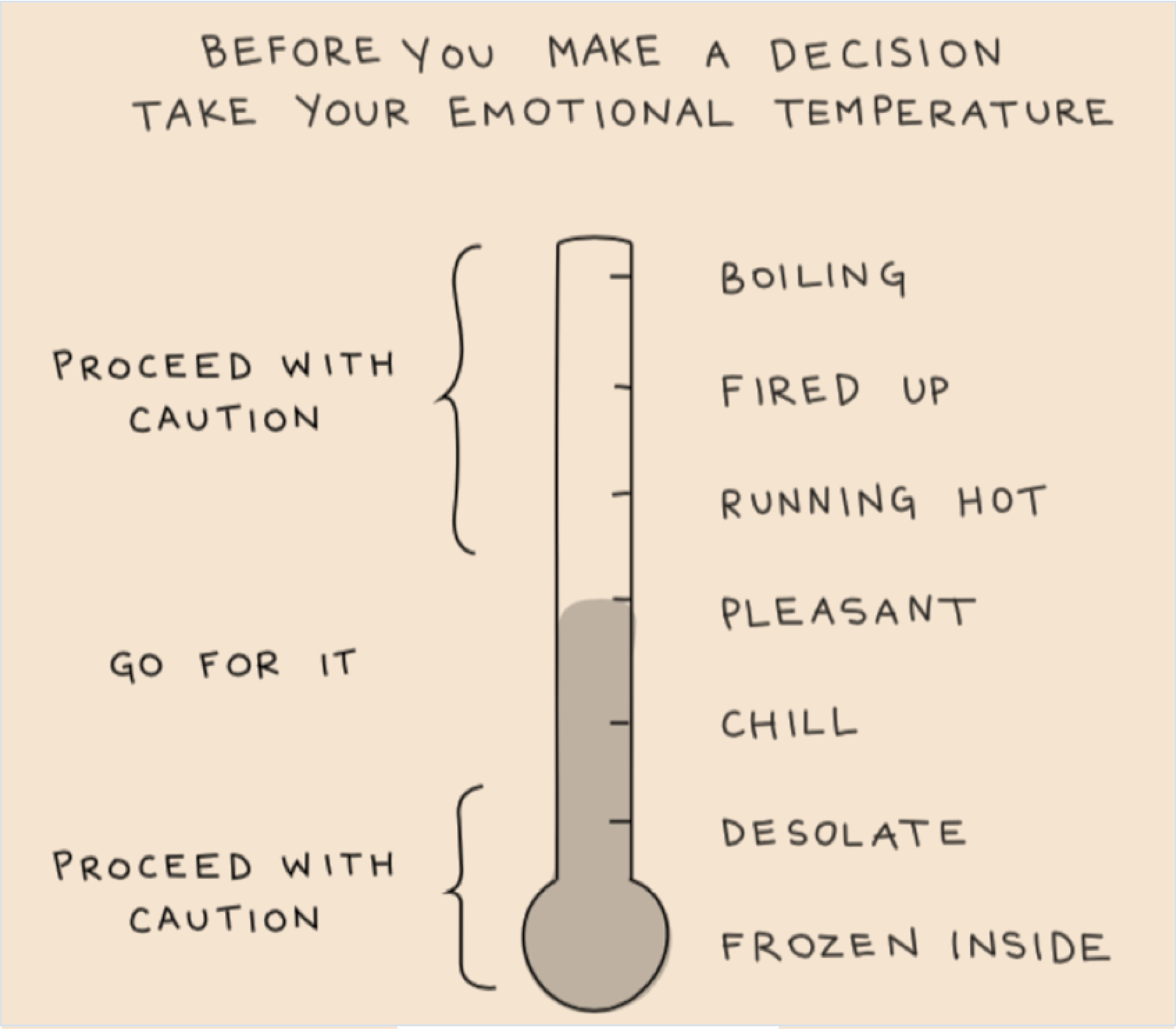
Source: DSP, Investec, Data as on April 2023

Systematic Investments Can Cushion Against Mistakes



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