



Financial market watch: All eyes on the Fed

August 30, 2024

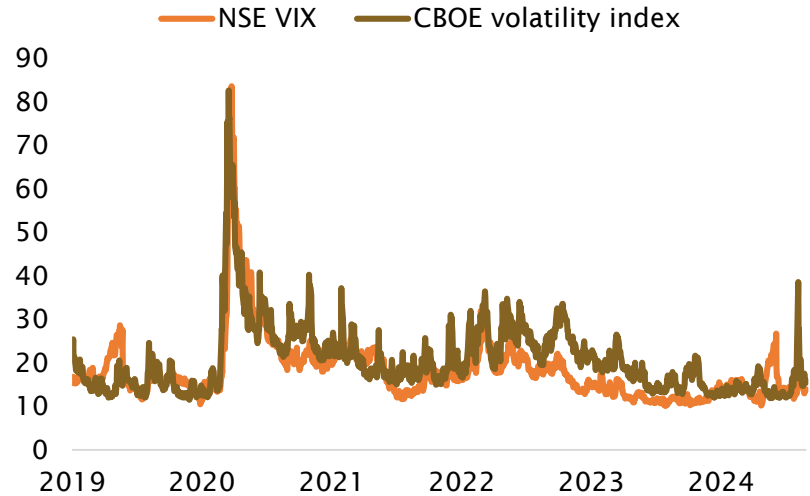




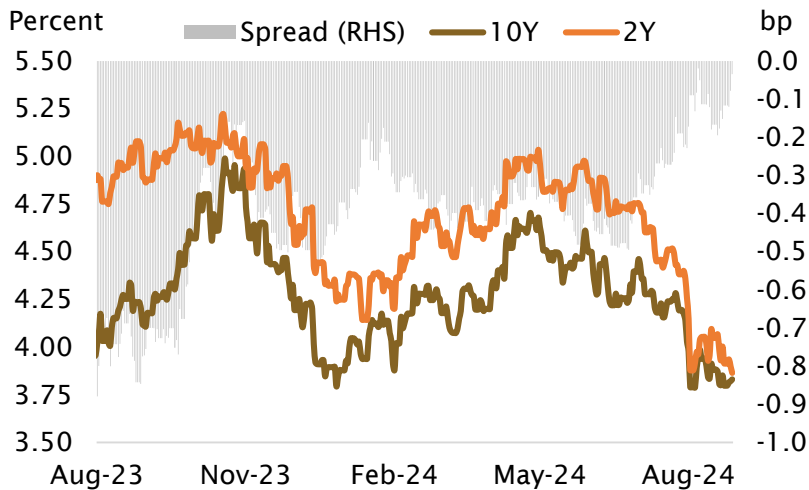
Financial market volatility has abated; markets eye Fed meet

- Financial markets turned volatile across the globe in early August as a hawkish Bank of Japan triggered unwinding of the yen carry trade and weak labour market data in the US sparked recession fears. Though volatility has abated, the yen remains vulnerable to comments from the BoJ.
- In the US, markets have moved past the poor employment report, as a flurry of data releases, including strong retail sales and upward revision to Q2 GDP indicate a rather solid economy. Though markets have priced in a 25bp cut at the Fed's meeting in September, chances of a steeper cut, and the future policy path in terms of the pace and extent of easing at subsequent meetings, remain vulnerable to signals from incoming data.

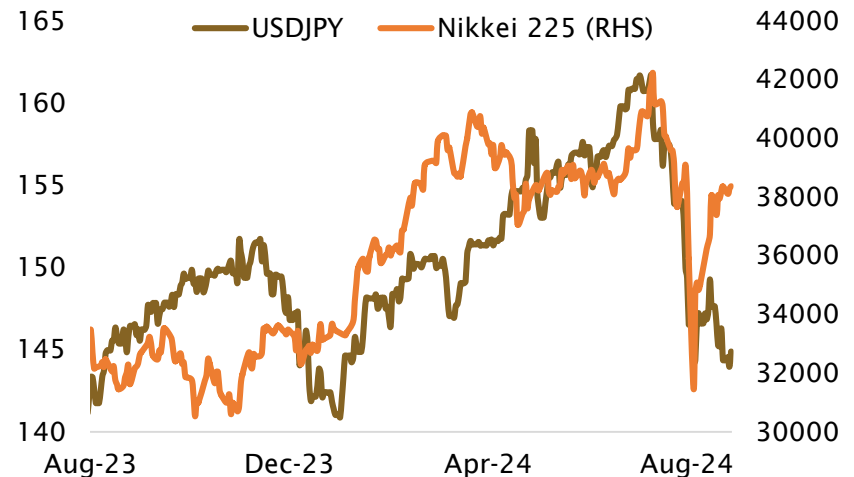
Volatility in global financial markets spiked in early August



US yields eased sharply after weak jobs data



Equities partly recouped losses, JPY vulnerable to BoJ views

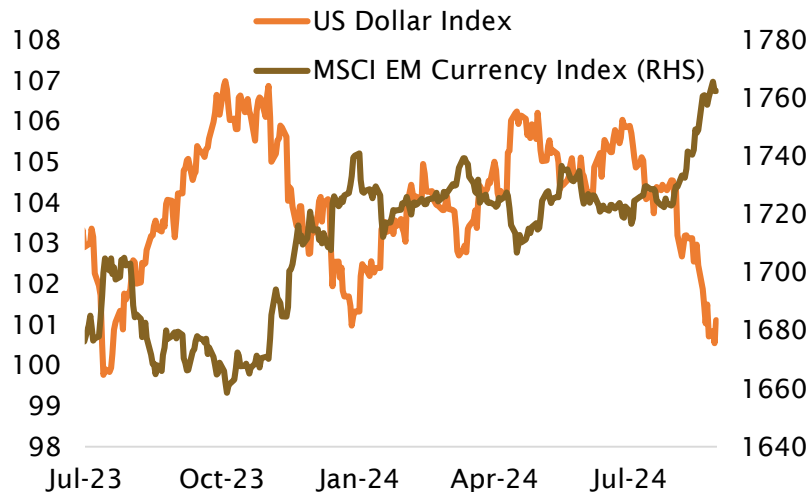




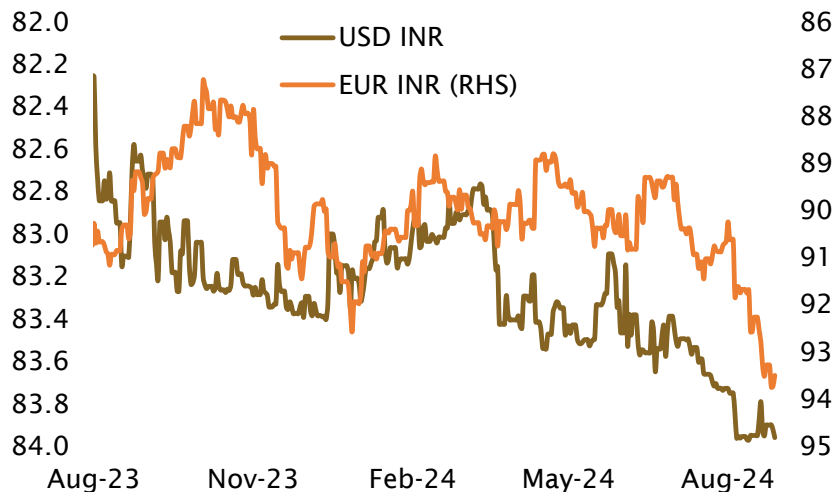
Dollar index hit 13-month low on buoyed prospects of a Fed cut

- Earlier this week, the US dollar index reached the lowest level in more than a year after comments from Fed Chair Powell at the annual Jackson Hole symposium cemented prospects of a rate cut at the Fed's meeting in September. The weak dollar spurred a rally in the EM currency index
- In August, strong dollar demand from local importers and FPI outflows from equities exerted pressure on the Indian rupee and dragged the USDINR close to 84 level but did not breach it amid support from state-run banks' dollar sales.
- In terms of effective exchange rates, the INR has held firm in nominal terms but is showing signs of overvaluation in real terms.

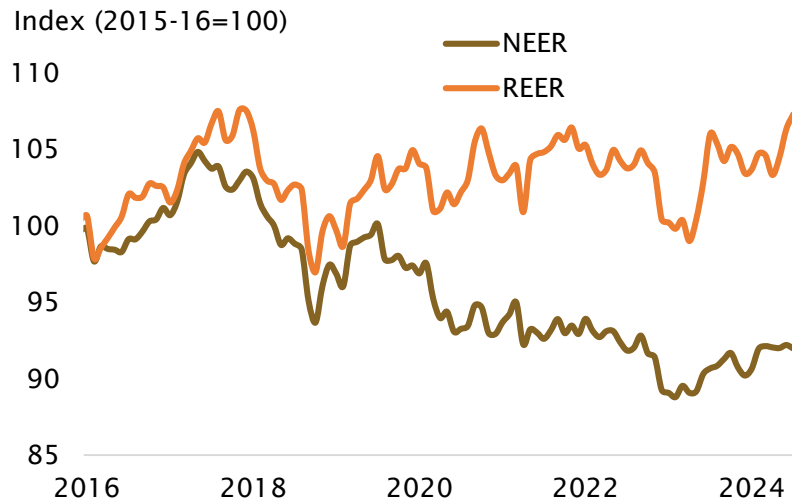
US dollar index at 13-month low; EM currencies strengthened



USDINR finding support at 84 level



INR overvalued in real terms

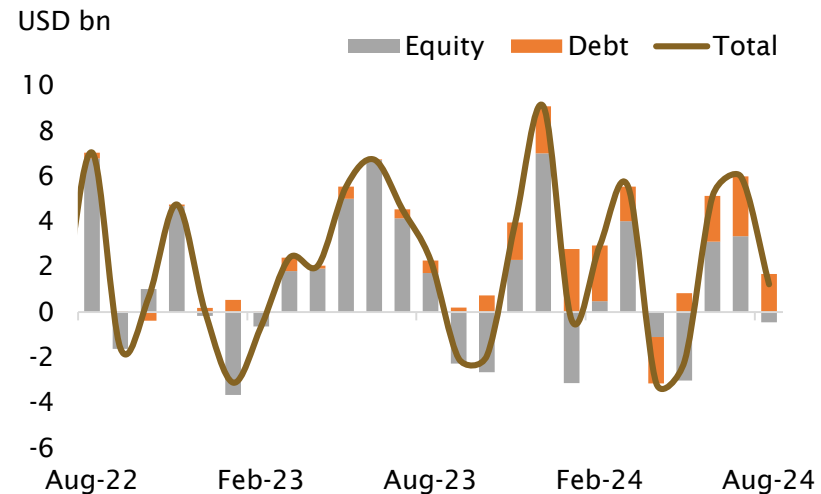




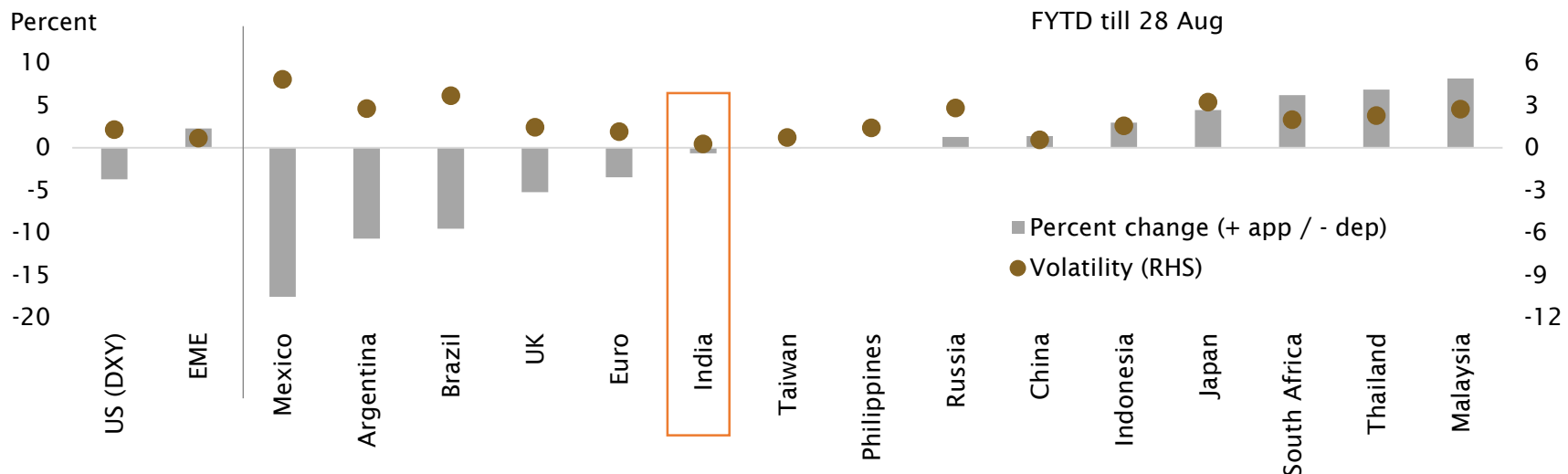
INR underperformed FYTD, though volatility remained low

- Data shows that weakness in the US dollar has supported the broad EM currency index in the current fiscal year. Though Asian currencies have led gains, the USDINR has been a relative underperformer, shedding 0.7% since April. On the bright side, the currency has been range-bound so that volatility remains low.
- Despite FPI outflows in equities exerting pressure on the USDINR, changes to the MSCI equity index effective end-August with a slight increase in the economy's weight in the EM index is expected to attract flows and lend support to the currency.
- Within EM, Latin American currencies have been weak, reflecting impact of the unwinding of carry trades, slowdown in China, softer commodity prices, and country-specific political uncertainties.

FPI outflows from equities exerted pressure on the INR



The Indian rupee has underperformed relative to peers but volatility remains muted

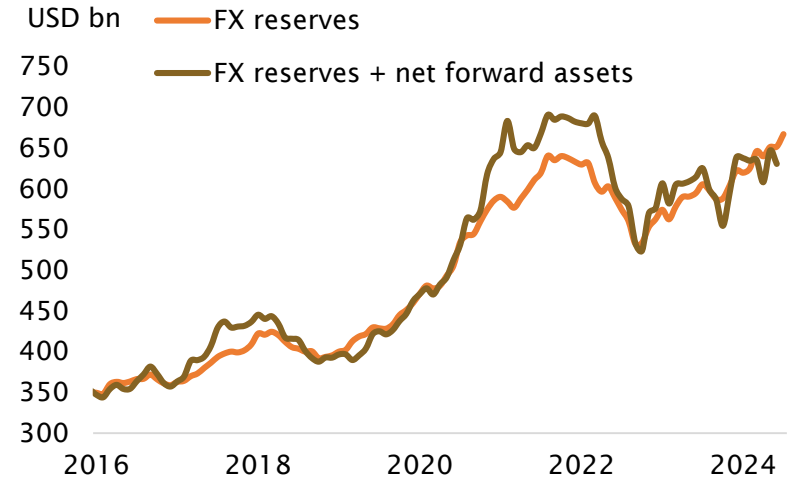




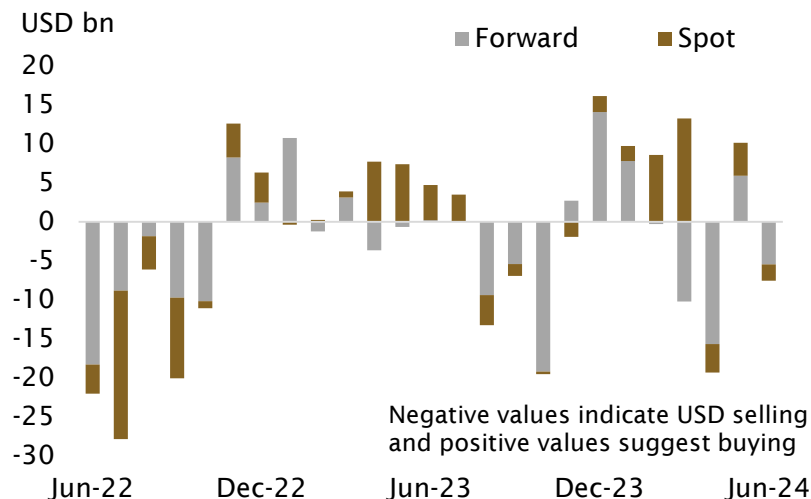
India's FX reserves near USD675bn, RBI net USD seller in Jun

- During the week ending August 16, India's foreign exchange reserves increased USD4.5bn from the previous week to USD674.7bn. The increase was driven by higher foreign currency assets and gold reserves. Earlier in the month, during the week ending August 2, foreign exchange reserves had reached a record high at USD674.9bn.
- In June, the central bank sold US dollars in both the spot and forward markets, marking a reversal from May. The central bank's outstanding forward book has been negative for four months up to June, indicating build up of short positions. In June, the net forward position of (-)USD15.8bn was under one-month maturity.
- In June, India ranked 12th in global rankings for holdings of US treasury securities at USD241.9bn.

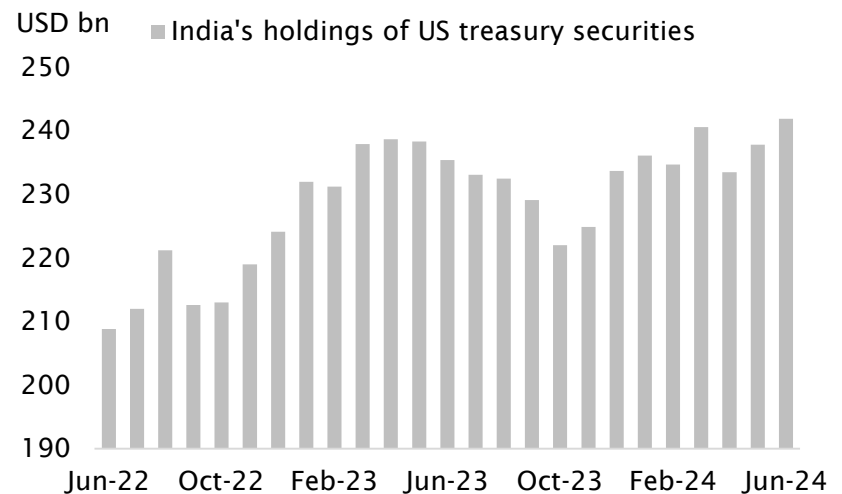
As of August 16, forex reserves remained close to USD675bn



In June, the RBI sold USD in the forward and spot markets



In June, India ranked 12th globally in UST securities holdings

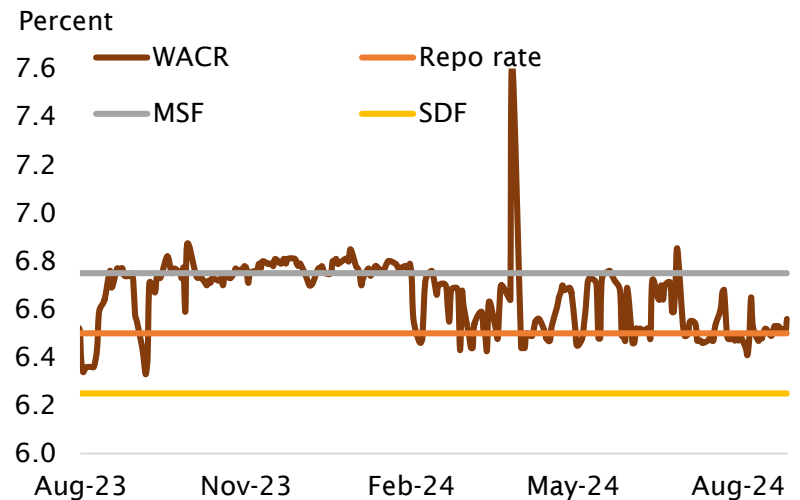




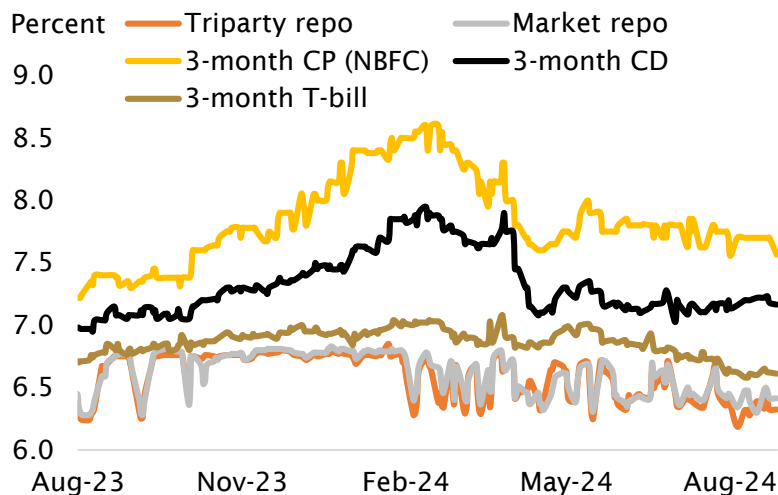
Overnight, money market rates eased further in August

- **Banking system liquidity remained in surplus** in August, though at less than half the peak of Rs.2.8 lakh crore reached earlier in the month. Reflecting easy liquidity, weighted average call rate continued to soften, with its differential vis-à-vis the repo rate narrowing further. Data till 28-Aug shows that the **WACR averaged 6.50, lower than 6.52 in July.**
- **Rates in the collateralised segment mirrored lower WACR.** On average, the triparty and market repo traded 17 and 7 basis points below the repo rate. In the short-term money market, 3M CD rates rose, while that on CP for NBFCs and T-bill yields eased.
- **Compared to July, yields trended lower, and more so at the long end of the curve.** Lower easing at the short end probably reflected the RBI's slightly hawkish commentary at the latest policy meet.

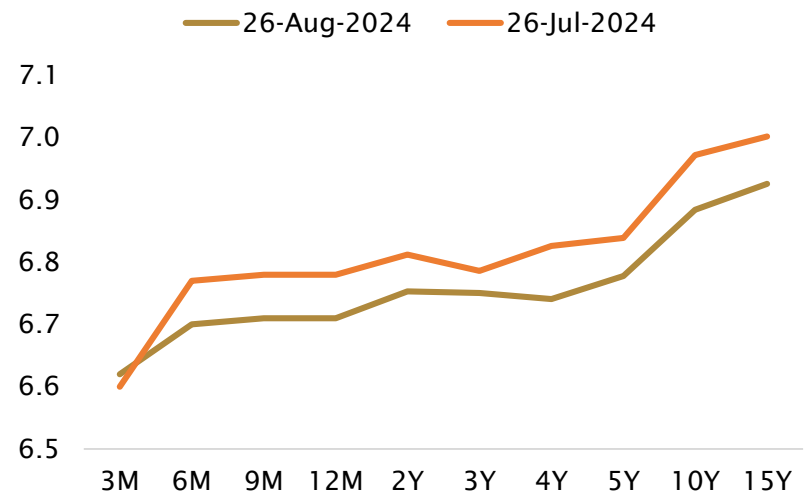
WACR trended lower in August vis-à-vis the repo rate



Money market rates largely eased in Aug, 3M CD rates rose



Yields eased in August, more so at the long end of the curve

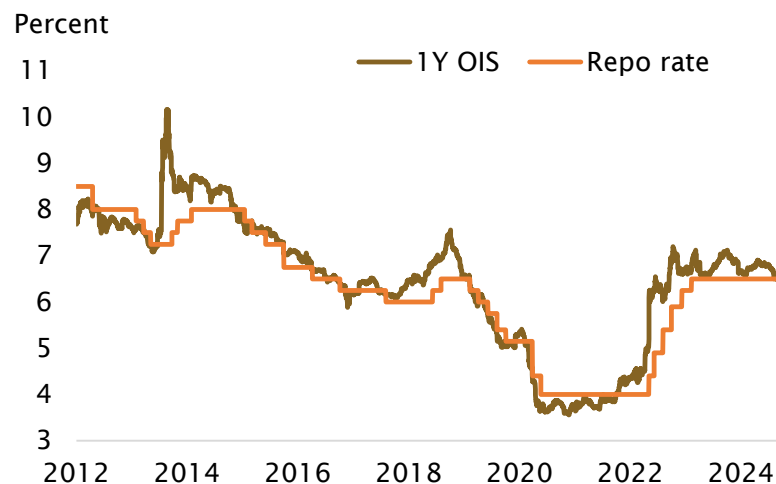




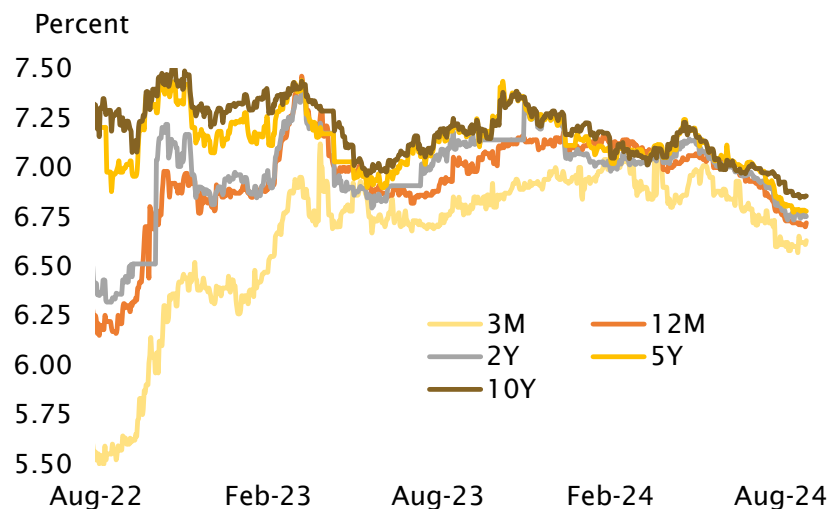
India 10Y benchmark, 1Y OIS slipped below 6.5% in August

- In August, the softening in yields was supported by favourable demand supply dynamics due to: 1) lower government borrowing, reiterated in the final Union Budget for FY25 2) equities sell-off in early part of the month 3) inflows induced by bond index inclusion 4) demand from local banks after RBI's draft rules to raise their liquidity resilience.
- The 10-year benchmark slipped below 6.5% after more than two years. Even as yields softened across the curve, spreads remained largely stable.
- The one-year overnight index swap rate slipped below 6.5%. Fed Chair Powell's comments at the Jackson Hole meet not only cemented rate cut hopes but also opened a window for EM central banks to ease. This is probably prompting market participants to pencil in an easing bias by the RBI.

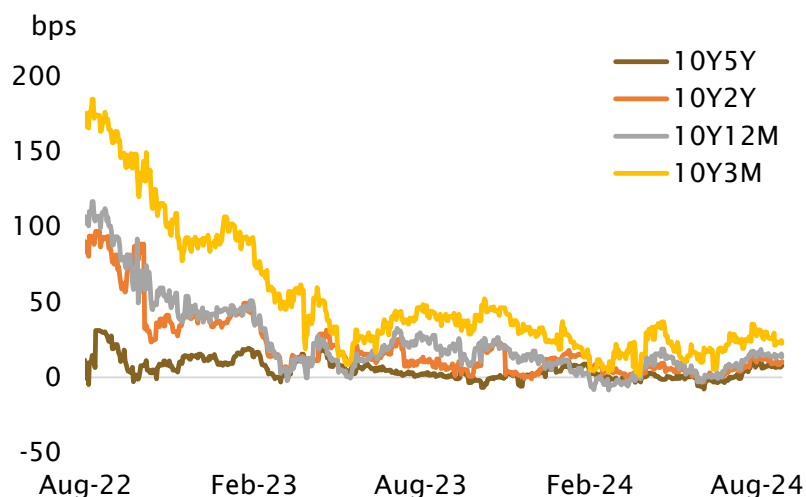
1Y OIS slipped below 6.50% in August



Yields firmed up in August



Spreads remained largely stable in August

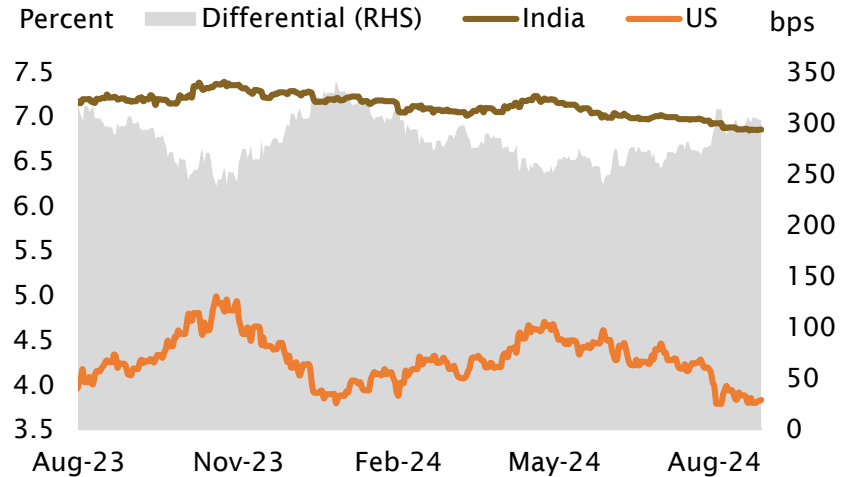




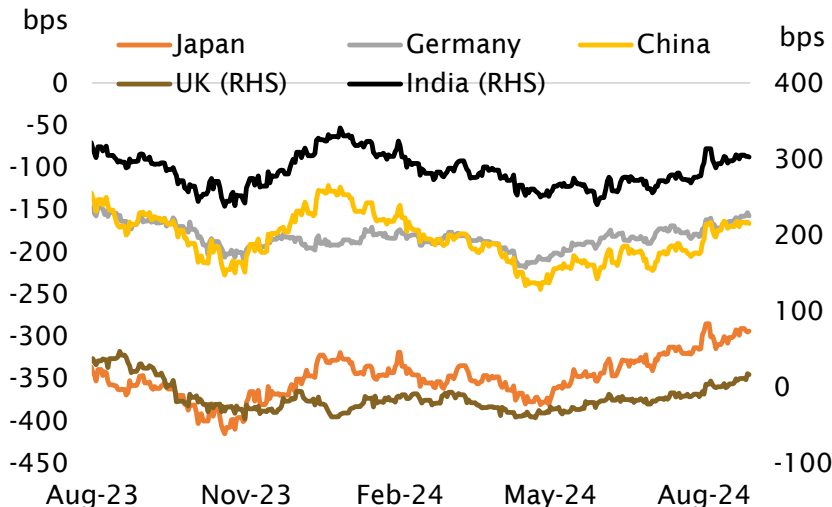
Financial conditions remained loose across most economies in Jul

- Even as the 10-year India benchmark yield slipped below 6.5%, the fall in US yields was sharper earlier in the month after a weak labour market report spooked recession fears and triggered a risk-off sentiment. The spread vis-à-vis the US 10-year benchmark yield widened, not just in case of India but across other economies as well. Despite the increase, spreads vis-à-vis the US 10-year remain negative in case of China, Japan and Germany due to relatively lower yields in these economies. On an average, spreads turned slightly positive in case of the UK during the month.
- In July, financial conditions remained loose or eased across most major economies, including the US. The Eurozone was an exception with slight tightening.

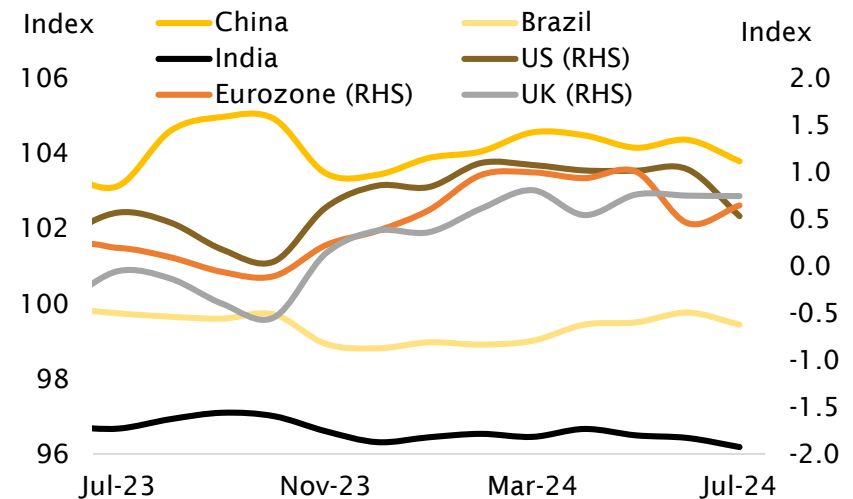
US, India 10Y benchmark yields and differential



Spread against US 10Y widened in August



Financial conditions eased across most key economies in Jul

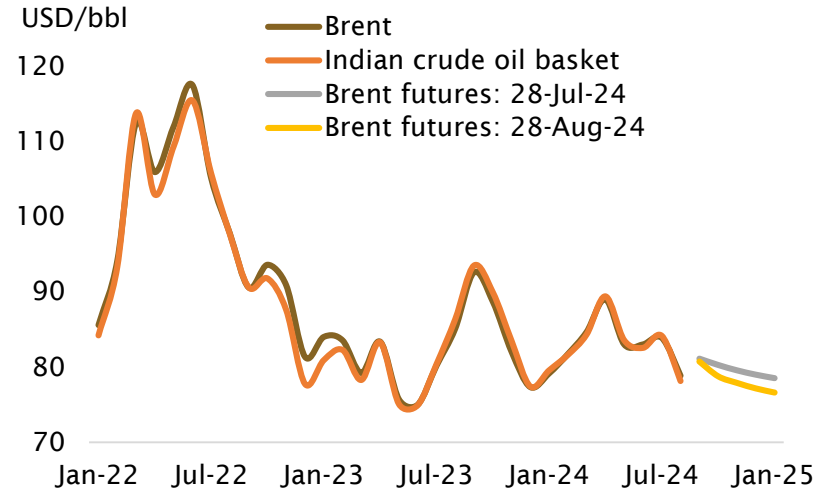




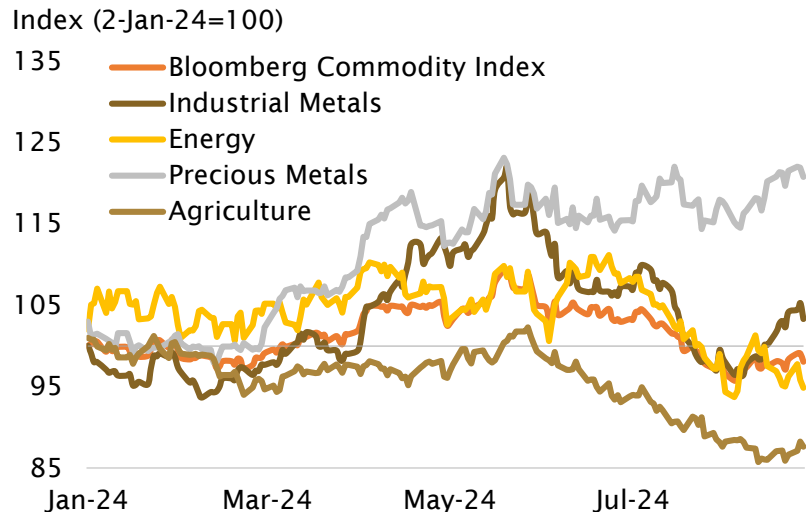
Commodities edged lower in August, industrial metals recovering

- On an average, the Bloomberg commodity index was lower in August compared to July with decline across commodities, except for precious metals that continued to rise on safe haven demand amid global financial market volatility. The headline index averaged below the level at the beginning of the year amid weakness across sub-indices, except metals. The industrial metals group has shed most of gains since the peak in May, but remains above the levels at the beginning of 2024. The sub-index seems to be tracking copper prices that had corrected in June and July amid reports of exports from China due to muted domestic demand but seem to be recovering.
- Crude oil prices slipped below USD80/bbl in August and futures prices indicate further easing.

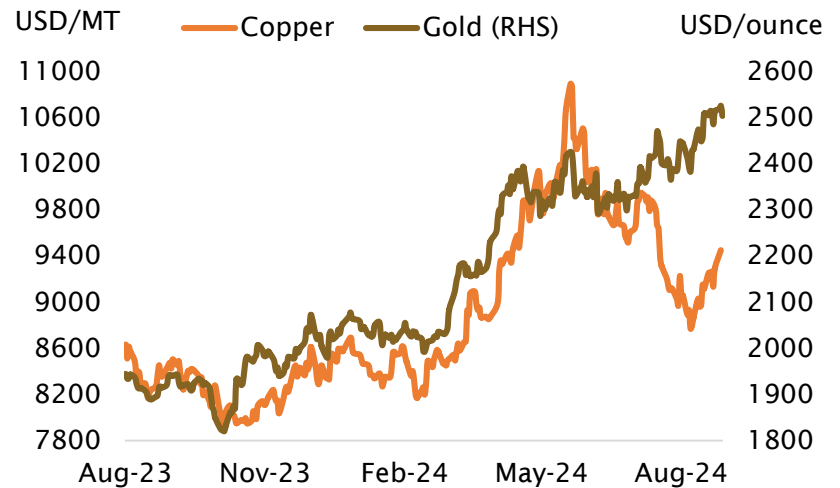
Futures prices suggest further softening in crude oil prices



Bloomberg commodity index



Gold and copper

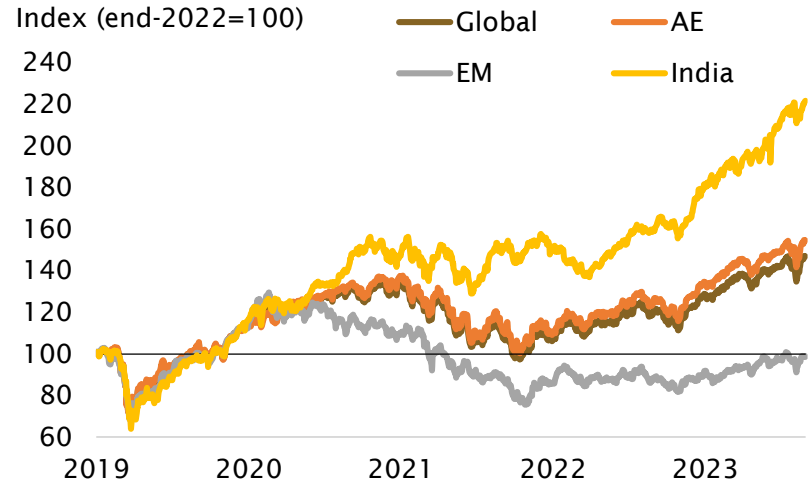




Taiwan led gains in equities in 2024; Indian equities overvalued

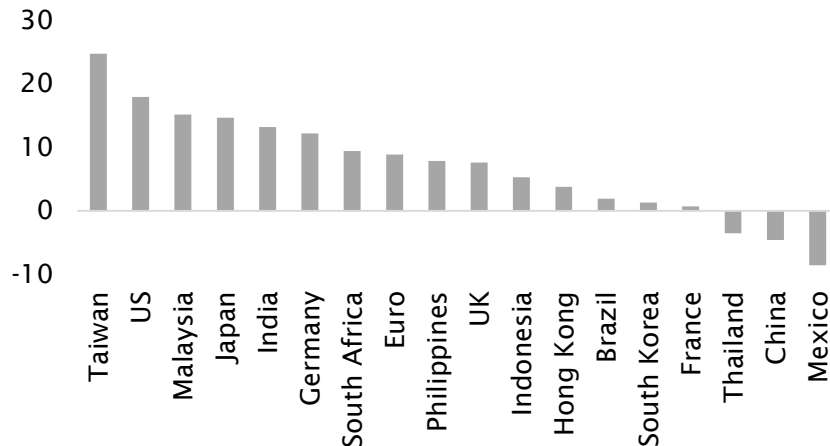
- Since the pandemic, emerging market equities have underperformed relative to their counterparts in advanced economies. In fact, the MSCI EM index is still trading below the pre-pandemic level.
- There are exceptions with certain EM economies, including India, outperforming benchmark indices in advanced economies. However, Indian equities remain overvalued when looked at from the perspective of 12-month forward P/E ratio, which particularly brings out the froth in the mid- and small-cap segments.
- In 2024, Taiwan has led the gains in equities so far, followed by the US. On the other hand, Mexico, China and Thailand have been laggards.

MSCI equity indices



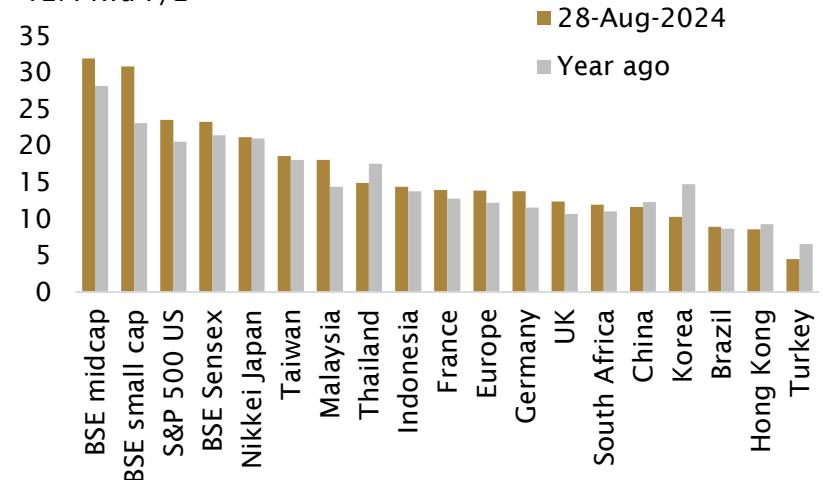
Global equity market performance in 2024

Percent change



BSE mid- and small-cap valuations higher than US S&P500

12M fwd P/E

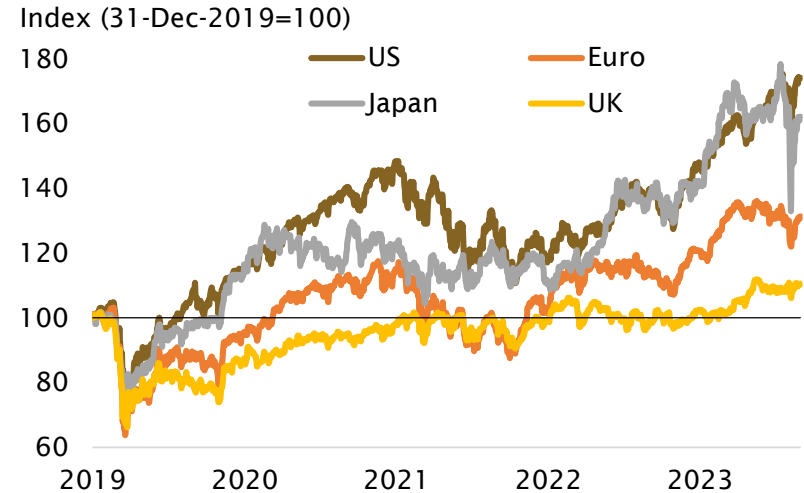




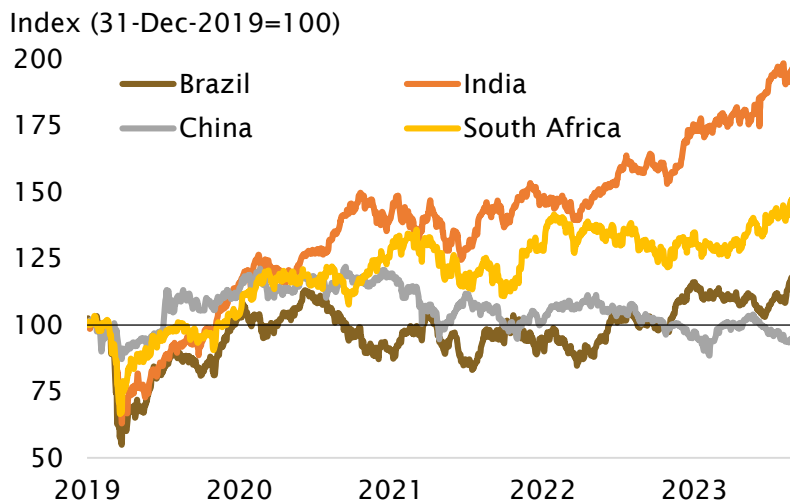
Since the pandemic, India and Taiwan equities have outperformed

- Within advanced economies, the US has been leading gains in equities since the pandemic, with Japan following closely. However, Bank of Japan's hawkish stance triggered a free fall in the benchmark index that was accentuated by US recession fears in early August. Equities have since then partly recouped losses.
- In emerging markets, equities in India and Taiwan have been outperformers since the pandemic, though the Taiwan benchmark also bore the brunt of recession fears in the US, but has partially recovered thereafter.

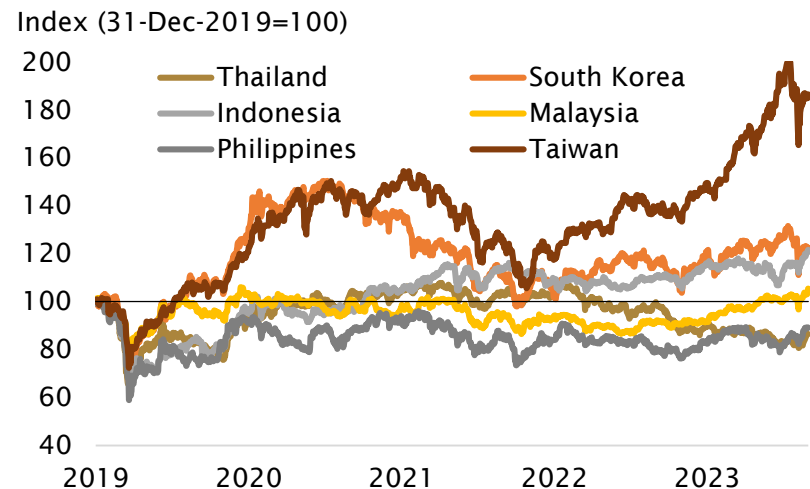
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