Annual Fixed Income Outlook CY22

Macros and Markets

Aditya Birla Sun Life AMC Ltd.
(A part of Aditya Birla Capital Ltd.)

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Summary

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- ✓ **Global growth:** 2021 turned out to be the mirror image of growth compared to 2020 with growth rebounding from 2020 pandemic lows across the world. However, DM economies led by US have been the clear leader in this growth revival. EM growth recovery adjusted for base was relatively modest except for commodity exporters. The divergence in policy response between DMs and EMs turned out to be the key differentiator in growth outcomes.
- ✓ Although fiscal was expansionary across the globe, it was DMs which underwent large expansionary policy to stimulate demand by direct/indirect transfers to households. Most of the Emerging Market (EMs) saw expansionary fiscal on account of shortfall in receipts due to collapse in economic activity. Multiplier impact of such expansion is limited. This has resulted in divergence in growth normalization across economies. Going ahead both fiscal and monetary accommodation will be recalibrated towards consolidation with some glide path. This will bring growth momentum down from current levels. IMF is projecting its global growth 2021 at 5.9 percent for 2022 at 4.9 percent. We see downside risk to these projections.
- ✓ The emergence of Omicron variant towards the end of the year is a reminder that the pandemic continues to be an important variable to track for economic and market performance. In both 2020 and 2021 the evolution of the pandemic was the dominant variable. While the impact on growth outcomes has been receding in each subsequent wave, but it continued to influence inflation, as supply side response could not keep pace with the surge in demand given multifarious bottlenecks and drags caused by the pandemic in a globally diffused supply chain. With some economies, particularly China, still in zero Covid policy, the rise in Omicron and possibility of subsequent variants will continue to influence both growth and inflation in 2022 as well.
- ✓ We see US growth to remain strong but weaken from the current super high levels due to reversal to mean from the current super high consumer demand and normalisation of policy stimulus, particularly from the fiscal side. However, we still see US growth to be significantly higher from the pre-Covid trend given the healthy household balance sheets, inventory rebuilding, strong labour market and still considerable, albeit declining policy stimulus.

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- ✓ **Global Inflation:** 2021's inflation was on account of both demand and supply side factors. The global supply bottlenecks and the pro-inflationary government policies were both triggered by the pandemic-related economic disruptions. However, if we look closely at the inflation distribution, it's still largely in DMs & commodity exporters. Within DMs as well, its mostly in countries where outsized handouts to consumers were given to counter negative impacts of the pandemic. EMs deviation from pre-pandemic trend inflation is much lesser. Having said that, long-term inflation expectation remain well anchored for all economies.
- ✓ Global inflation is likely to settle higher than the pre-pandemic set up and arguments over next year will be focussed on new appropriate levels. Energy prices, particularly crude, will remain a crucial driver for inflationary pressure. The deft supply management by OPEC-2, lower US shale production and low capex in last many years has potential to keep crude prices elevated. Renewal of Iran production and faster than expected rise in US shale can provide relief.
- ✓ **Global policy and markets:** DM central bankers, specifically US, are behind the curve on policy normalisation, but we still believe that policy makers are not yet prepared to accept slower growth and higher unemployment in exchange for keeping inflation under control. Financial repression, which was the backbone of covid response policies, is here to stay. Emerging Markets (EMs) are ahead in policy normalisation and better prepared to handle DM's normalisation move. Market is expecting 3 rate hikes by US Fed but long-term terminal rate expectation have remained low. While majority of global central banks are expected to raise interest rates in 2022, ECB should continue with its accommodative stance.
- ✓ **India growth:** Falling infections, rapid vaccination coverage and quick normalisation of mobility indicators have facilitated the recovery in economic activity over the last year. Rural demand has remained resilient while urban demand has also recovered with pent-up demand supporting the recovery in contact-intensive sectors. We are witnessing steady economic recovery in India from the troughs of delta wave, but the recovery is far from complete, and it is a K shaped recovery with segments most impacted like trade, hotel, transport and other high contact services still running below pre-pandemic levels. Private final consumption expenditure and consumption sentiment survey have ben weak. However, recovery has moved much further in industrial sector, construction and exports.

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- ✓ With Omicron wave taking shape, we are expecting another down-leg in growth in 1QCY22. However, the impact should be less than what we saw in the first two Covid waves. We expect growth to be 9.25% both in FY22 and FY23, but corresponding run rate of growth is closer to 4% once you adjust for Covid base of FY22. While conditions are improving for long term capex recovery, near term headwinds of poor consumer sentiments and low capacity utilization would delay the recovery. The Omicron variant, renewed virus waves in some countries, volatile energy prices and faster normalisation of policy in advanced economies pose downside risks to the outlook.
- ✓ **India Inflation:** We expect inflation to average 5.25% for FY 2023 which is in line with RBI estimates. Sudden rise in energy complex is key risk to inflation.
- ✓ **CAD & INR:** We see downside to dollar strength as US growth differentials and interest rate expectation differentials in US starts to unwind. We expect CAD to be around 2.50% of GDP and INR depreciation to be gradual and in sync with evolving inflation differentials.
- ✓ **India Monetary policy and fixed income market:** Focus around "Financial stability" & "Growth" will drive policy considerations over inflation. Interest rates have bottomed out but the real question is about "pace of normalization" and how far are we from "terminal rates". Liquidity normalization is likely to bigger policy focus. Markets are baking in somewhat aggressive rate hikes in 2022 but we see gradually policy normalization and operative rate to be 4.50% by end of 2022.
- ✓ Overarching priority for RBI remains growth, even though they maintain that they are also having a look at the price angle. With economy below pre-Covid levels, and the output gap remaining very wide RBI continues to remain committed to give economy all help it needs. We have seen announcement of aggressive variable rate reverse repo (VRRR) operations by RBI for short tenors which needs to be seen as normalisation of liquidity operations, however, overnight TREPS / Call continues to print lower than VRRR rates and will only inch up slowly

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- ✓ Financial repression is still in play with policy makers looking for opportunities to normalise rates from lower bounds. The combination of excessive liquidity/low rates and improving growth/elevated inflation has resulted in a very steep yield curve. The consensus view is of “bear flattening” playing out over the course of the next 12 months. However, given the “roll down” benefits offered by such steep curves with markets already pricing in aggressive rate hikes and skewed demand-supply dynamics going ahead, longer points can cause relatively more stress. In our view, the short end will be a better play given the balance of risk at this stage.
- ✓ Unless policy makers end up hiking rates more aggressively than being currently priced by markets, steep curves would more than compensate for the likely duration loss given the RBI’s guidance of gradual normalisation and their expected glide path of inflation falling towards 4% mark by FY23. In the current macro backdrop, fixed income investment strategies need to be looked upon as “yield maximation” strategies. Rather than staying in cash & alike instruments, one must choose appropriate points on the curve where ‘carry-adjusted-for-duration’ makes the most sense in accordance with investment horizon of investment.
- ✓ Floater and Short term funds continue to be the best risk adjusted places for fixed income investors over other fixed income assets. With ‘accrual returns’ in focus, investors can also look at allocating a part of their corpus to Credit Risk Fund where we are running a duration of 1.5 – 2 years. We continue to expect stronger corporate balance sheets and earnings which is likely to lead to a rating upgrade cycle resulting in spread reduction in credit papers.
- ✓ G-Sec / SDL curves continue to remain elevated upto the 5-year point and offer an attractive opportunity for investors having an investment horizon of 3 years+ to lock in rates in the current environment. Investors can participate in this through ABSL Government Securities Fund which is running a quasi-passive rolldown strategy with SDL allocation of 70%+ or any of our passive index / ETF strategies

Global

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Global recovery outstripped expectations in 2021

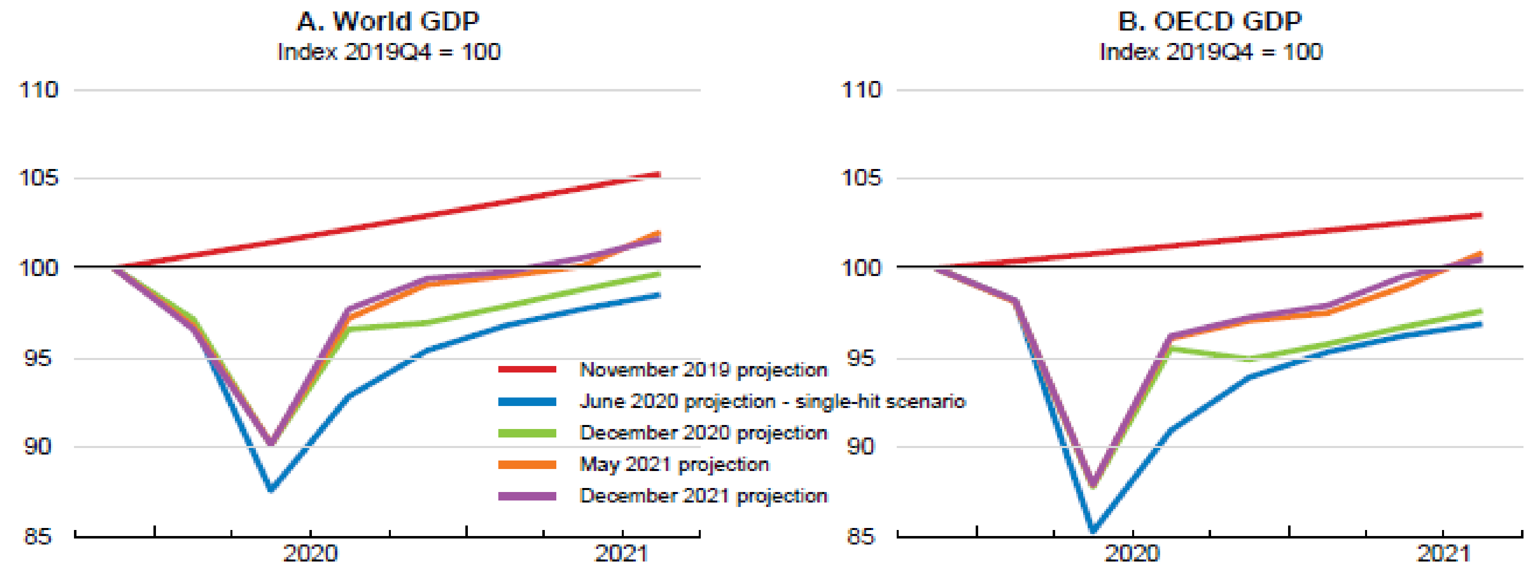


Exhibit 3: Global output gap, recovery from recessions

%, GDP relative to potential, year of trough shown

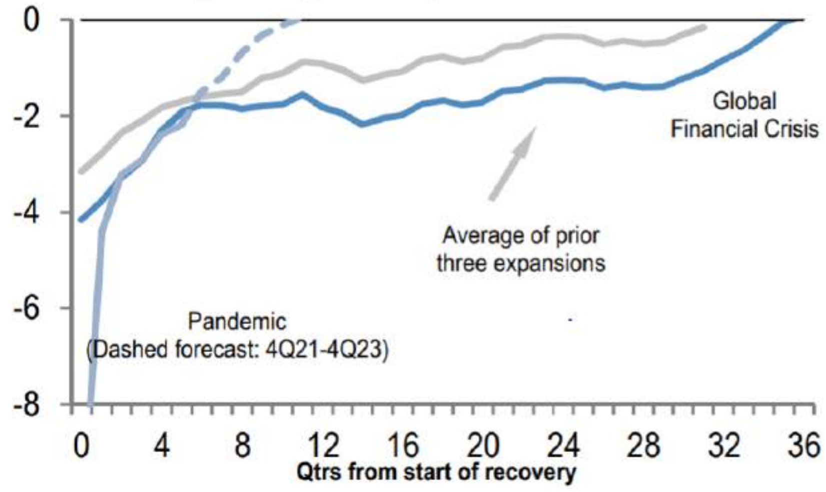
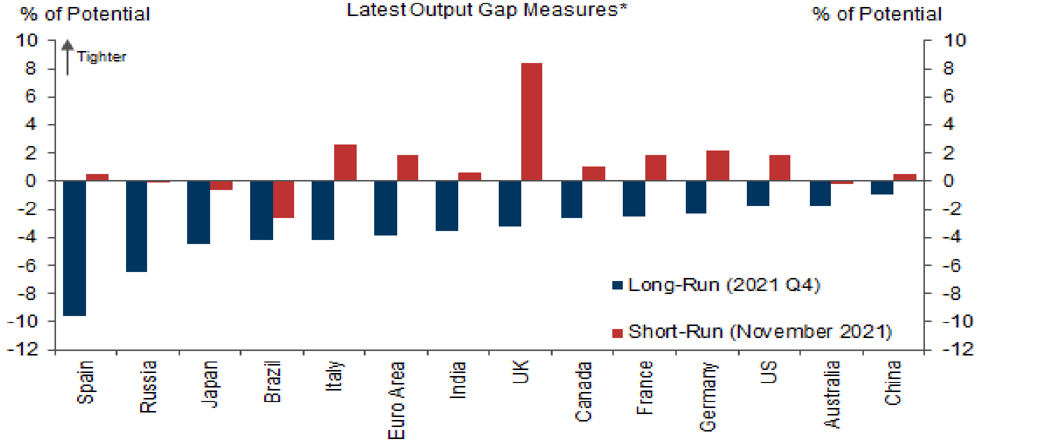


Exhibit 1: Measures of Short-Run Slack Are Generally Tight Amid Substantial Long-Run Slack



Brazil for October 2021.

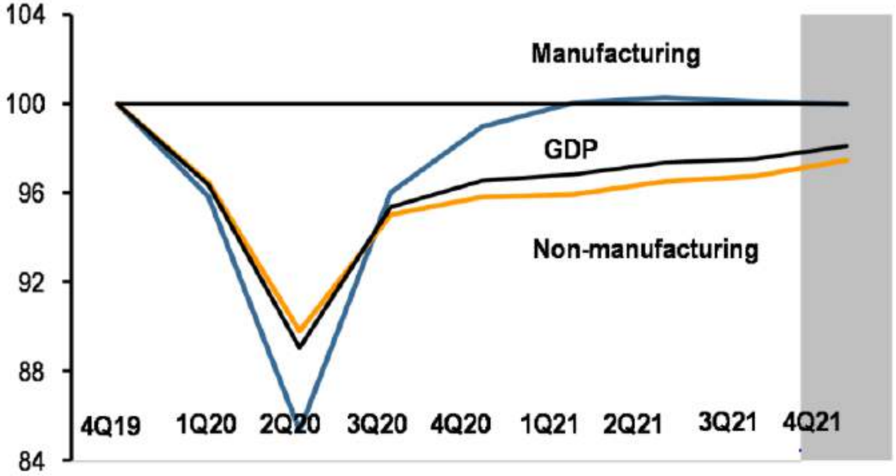
Source: Goldman Sachs Global Investment Research

The recovery in global economic activity has been more vigorous than expected, with output in most DMs now close to or above pre-pandemic levels. This reflects the prompt and massive policy support for firms and households including the additional measures announced this year, successful public health measures to limit transmission of the COVID-19 virus and, above all, the rapid rollout of effective vaccines.

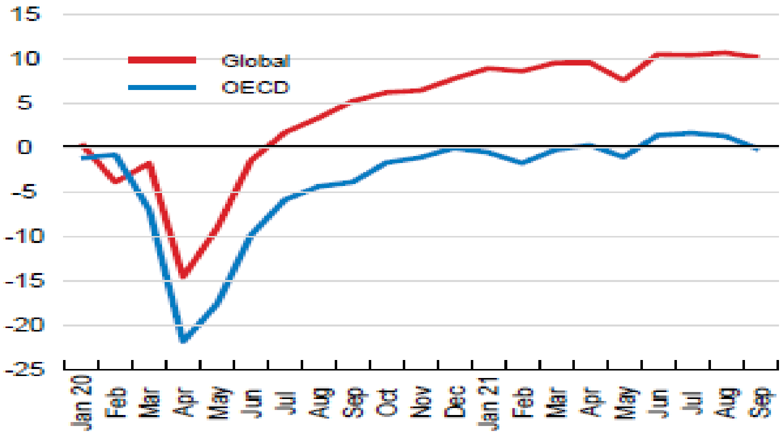
This is expected to be one of the quickest return to potential output from recession troughs.

Source: OECD, GS, JP Morgan

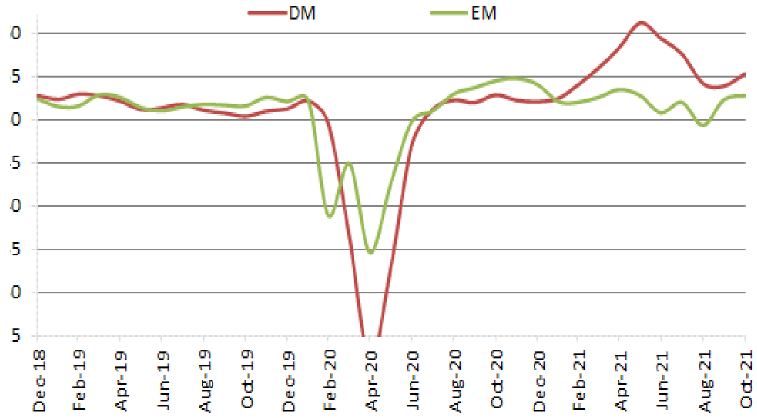
Recovery has been stronger in goods sector and DMs



C. Industrial production
% change from same month in 2019



Global composite PMI



A. World trade volume
Index 2019Q4 = 100

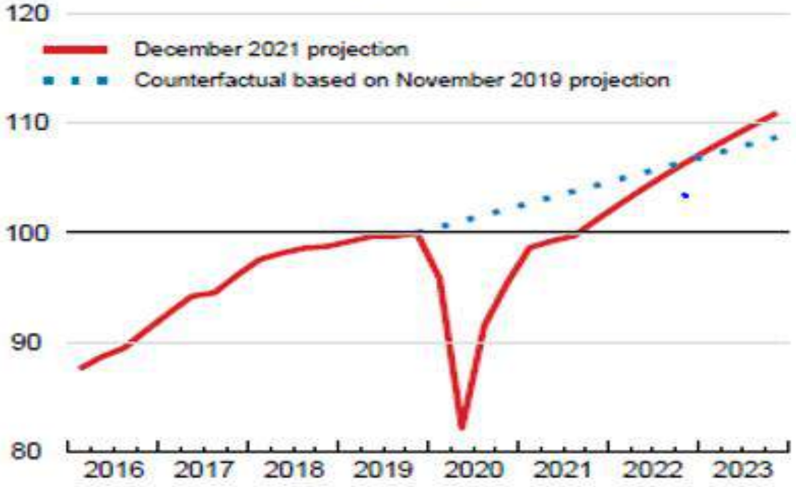
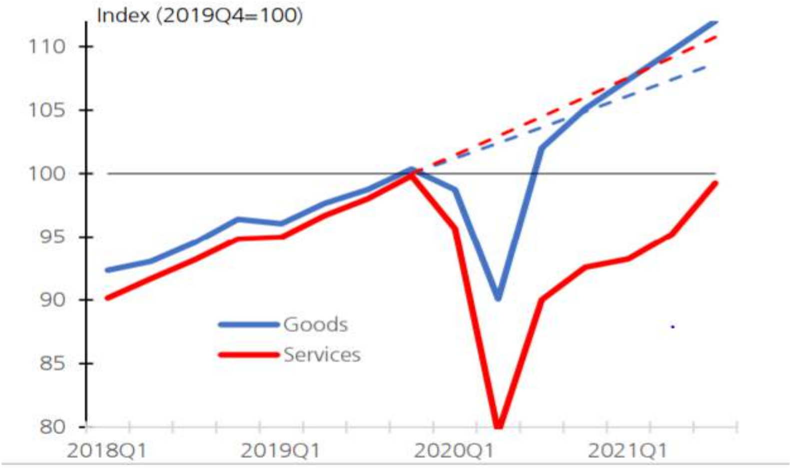


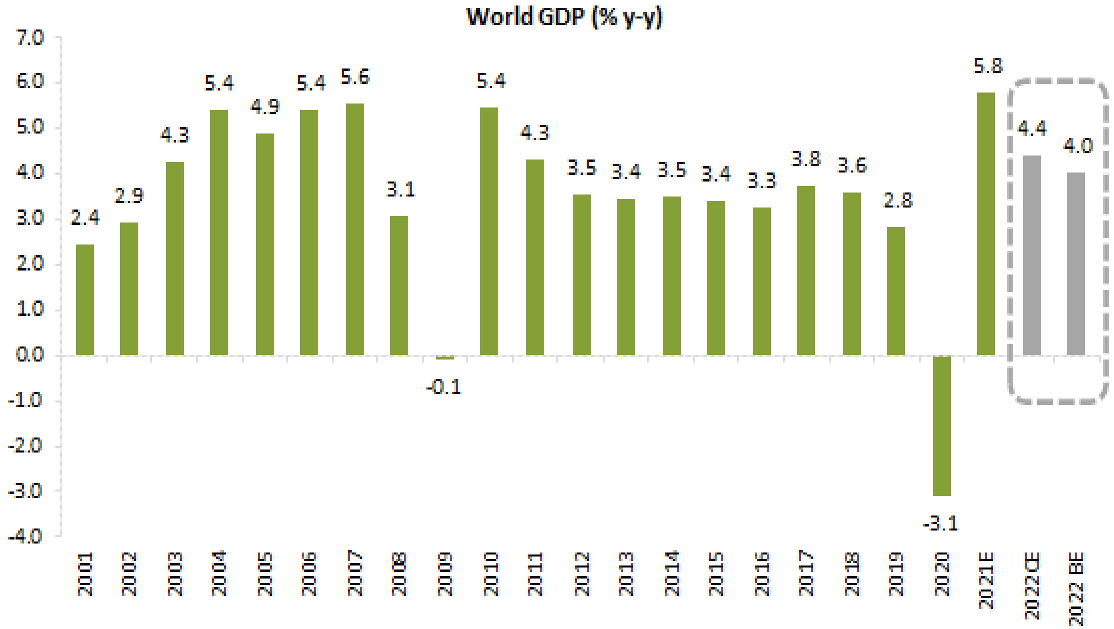
Figure 92: Global goods spending is above its pre-pandemic trend; services spending is 10% below



Recovery in growth has been more vigorous in goods sector with near complete recovery. However, services output is still running below pre-pandemic level given that Covid impact are not totally over till now. Another notable difference is between DMs and EMs, with DMs returning much faster due to greater policy support

Source: OECD, JP Morgan, Bloomberg

Growth expectations are strong for 2022 but face some downside risks



Growth expectations are very strong for most major economies, with most countries expected to grow much higher than their potential output. We are somewhat bearish compared to consensus on growth. We expect global growth to be about 4% compared to market consensus of 4.5%. Though we appreciate the strong growth momentum, the healthy household balance sheets in DMs and the pent-up trade in services, we believe that fiscal drag, withdrawal of the Omicron virus (and possible future strains), natural mean reversion and likely weakness in asset markets as monetary policy normalizes will have a more negative impact on growth than what the consensus is estimating.

Source: BCA, Bloomberg

Covid recession/recovery vs earlier episodes -1

Figure 38: GDP

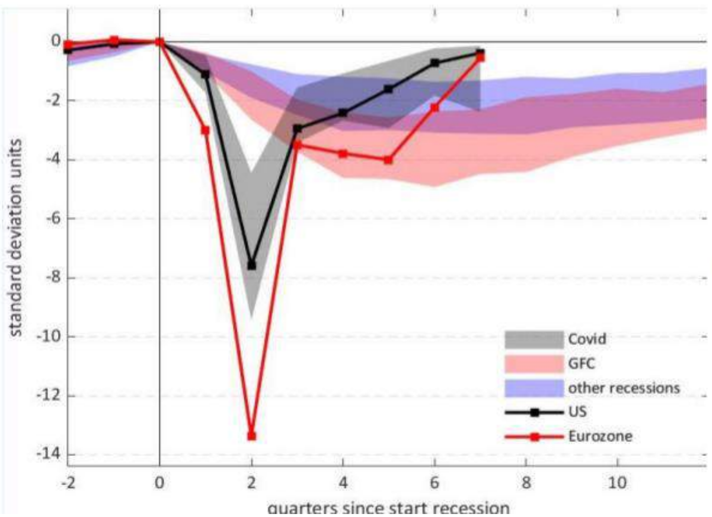


Figure 39: Consumption

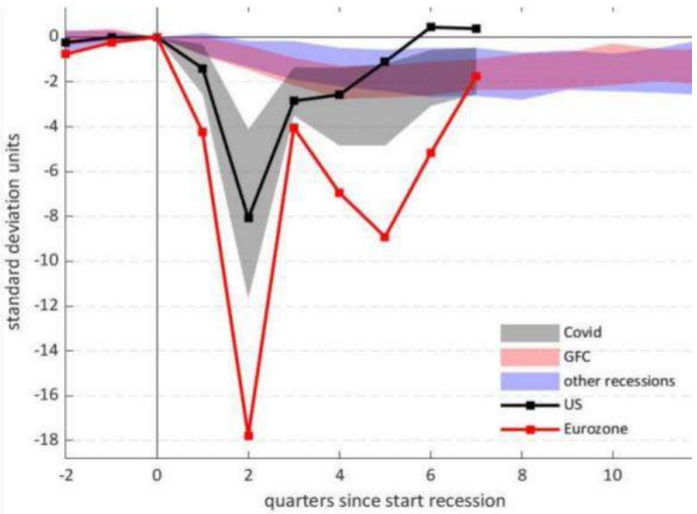


Figure 41: Investment

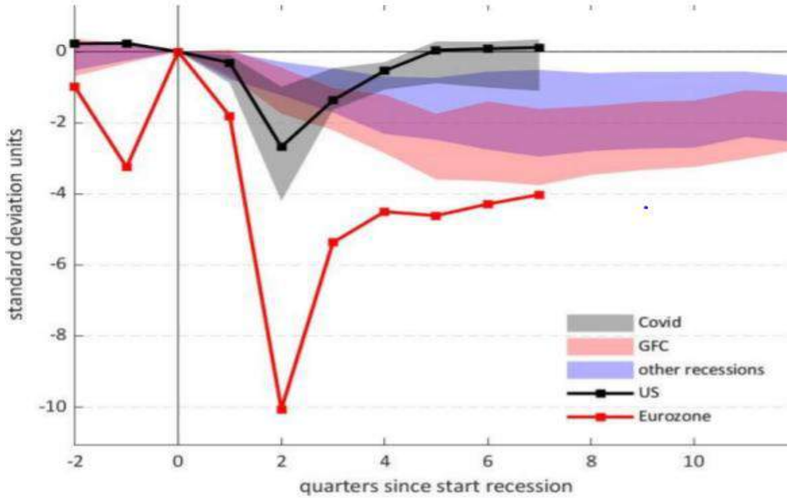
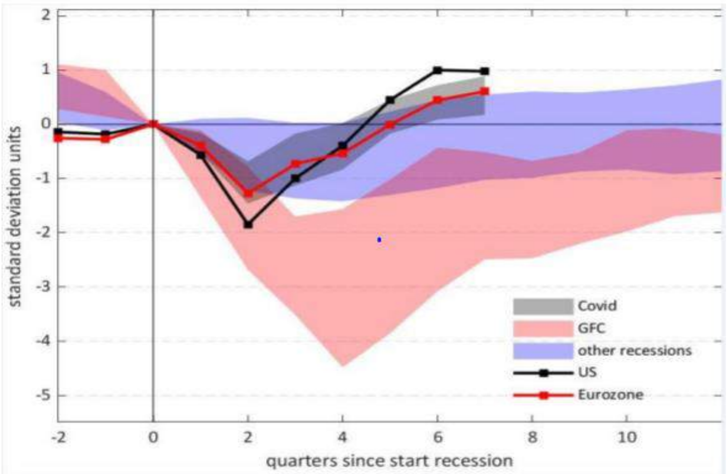


Figure 49: Equity markets



- ✓ Key difference is in how fast growth and relate indicators (consumption and investment) have recovered compared to earlier recessions. US consumption moving back to above pre-Covid is another notable phenomenon.
- ✓ The difference in equity market performance is also quite glaring, especially compared to GFC recession.

Source: UBS

Covid recession/recovery vs earlier episodes -2

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Figure 50: Steepness yield curve

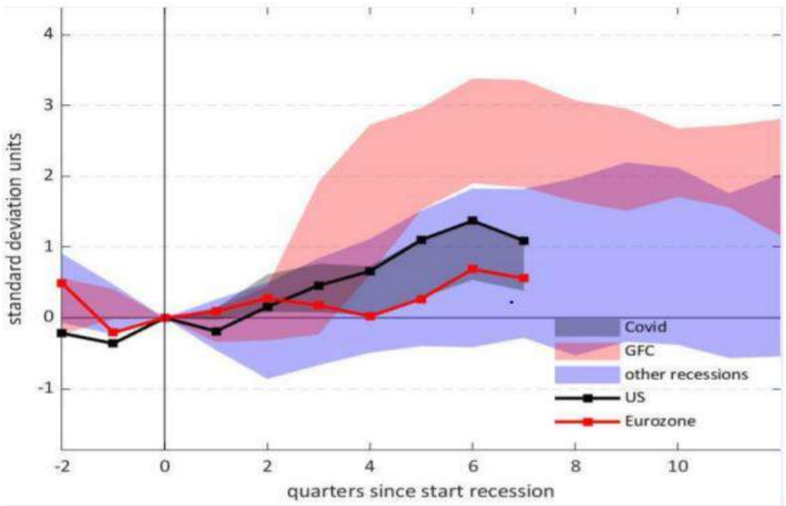


Figure 48: Core inflation

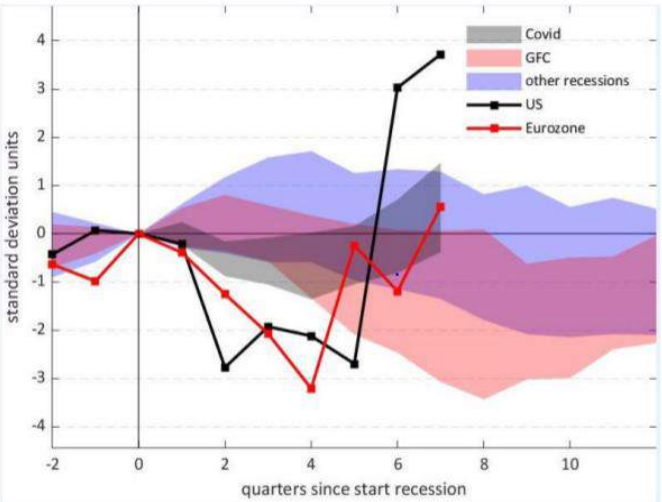


Figure 44: Employment

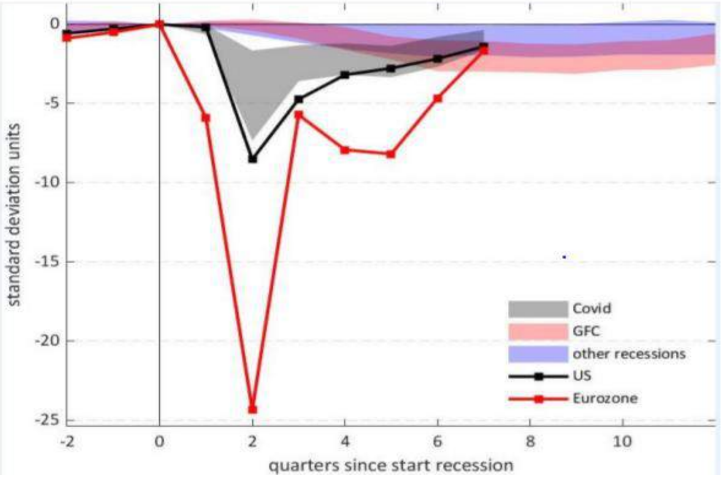


Figure 46: Goods inflation

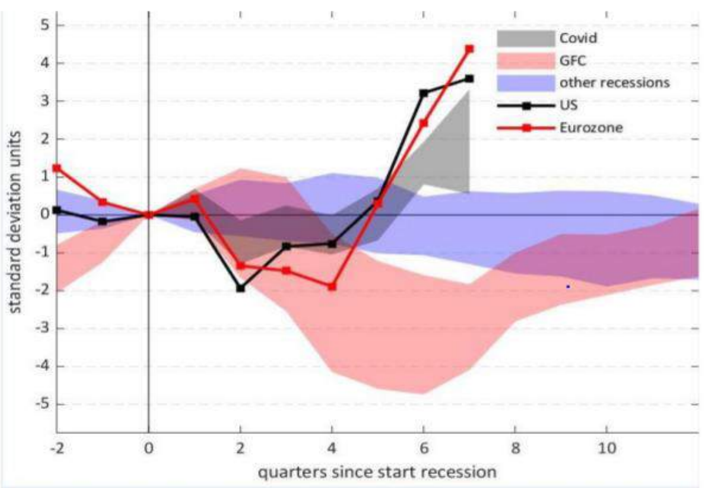
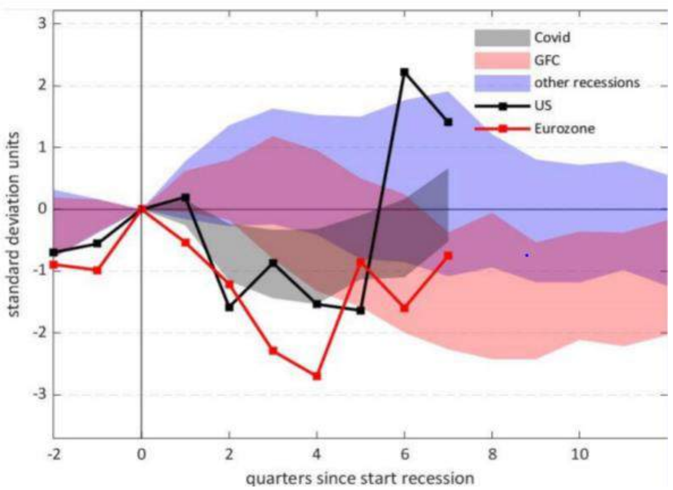


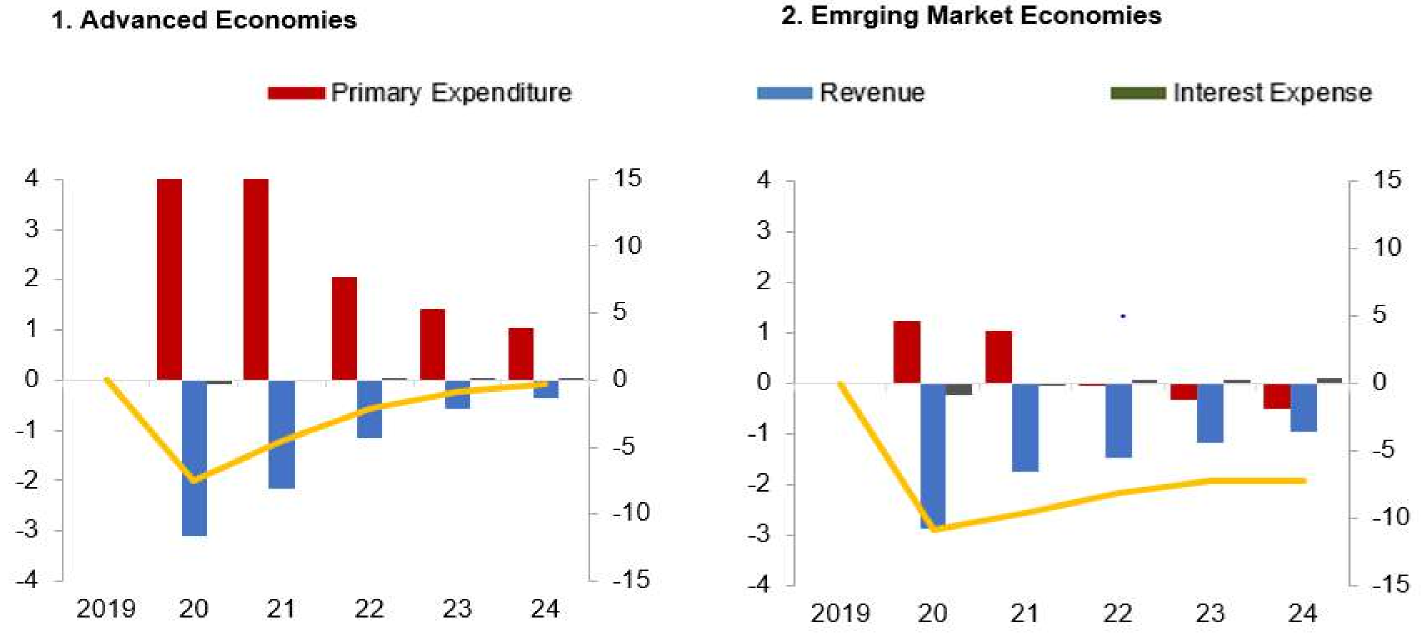
Figure 47: Services inflation

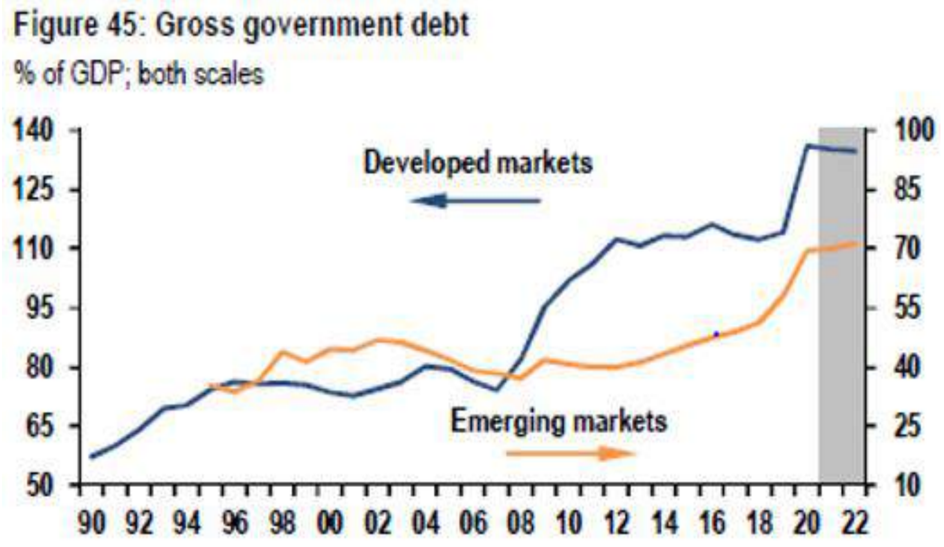


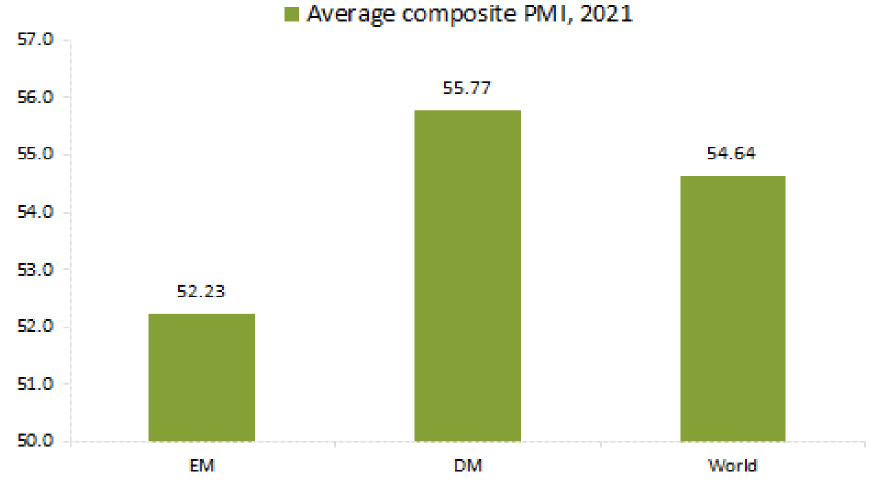
- ✓ Yield curve is much less steep compared to earlier recessions and goods inflation generally much higher.
- ✓ Higher growth is despite much lower employment levels, given the uniqueness of the recession and the policy response.

Source: UBS

Divergence in fiscal response important reason for EM/DM growth divergence



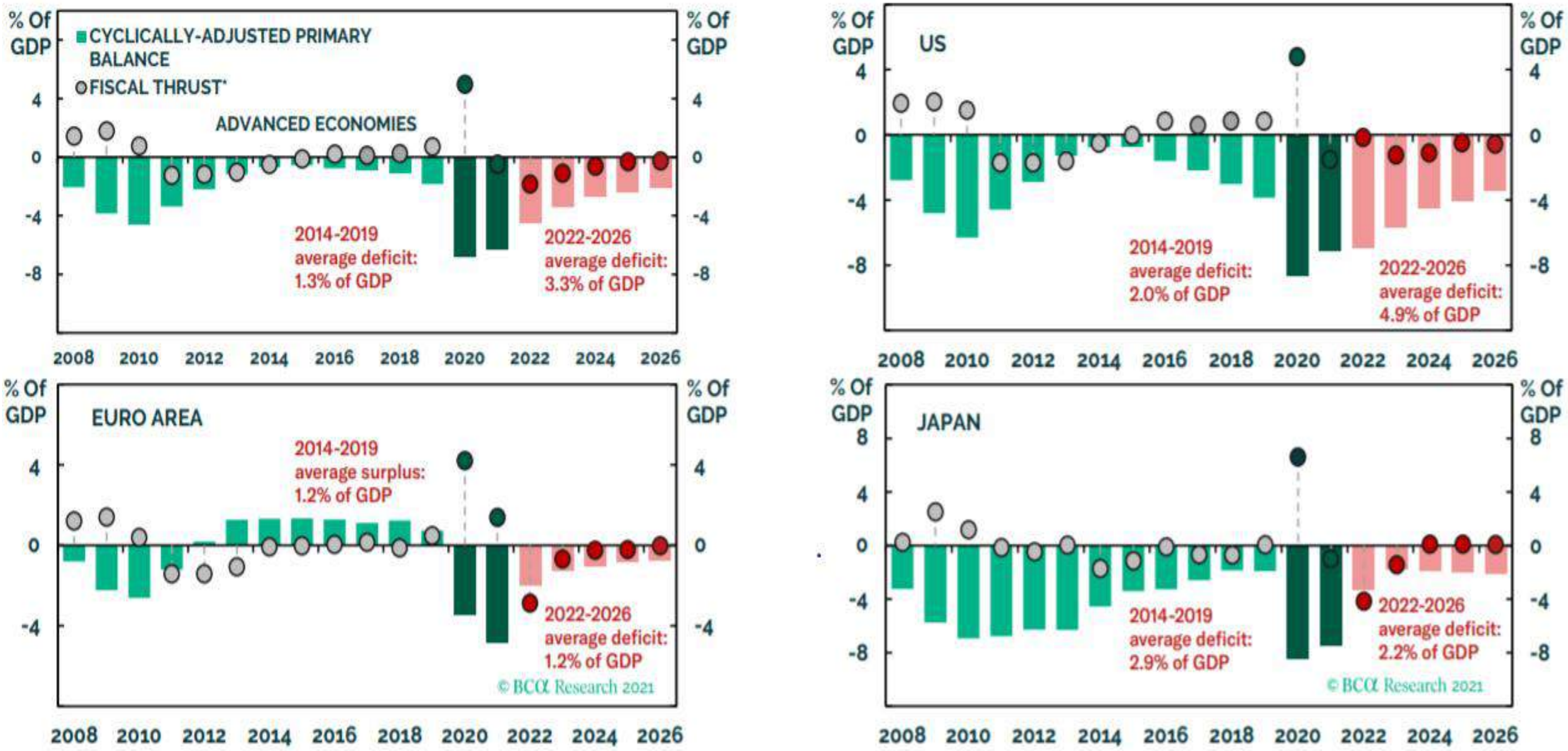




- ✓ Fiscal expansion to offset the impact of pandemic was not only much larger in DMs compared to EMs, but also the nature of fiscal expansion in DM was by way of actual expenditure to support incomes of household and firms. On the contrary, most of the EMs saw expansionary fiscal on account of shortfall in receipts due to collapse in economic activity. Multiplier impact of such expansion are limited and usually tends to wane out very quickly. The same reflected in different growth outcomes.

Source: IMF, Bloomberg, JP Morgan

Fiscal policy tighter but not tight

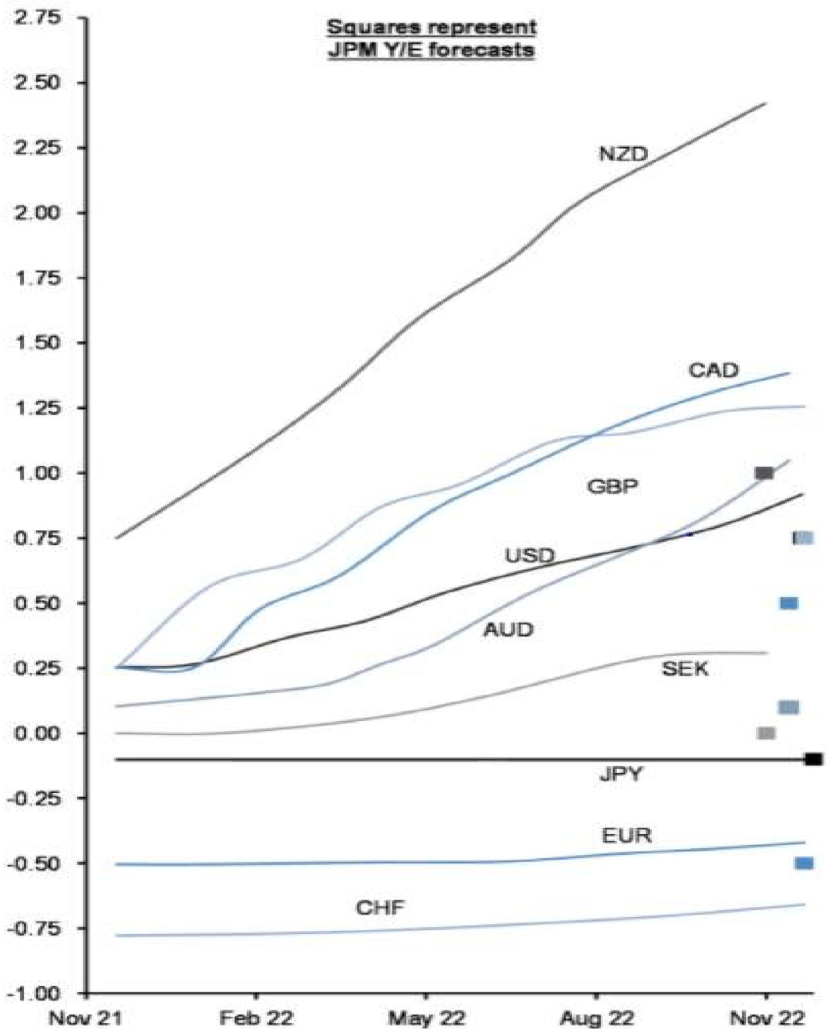


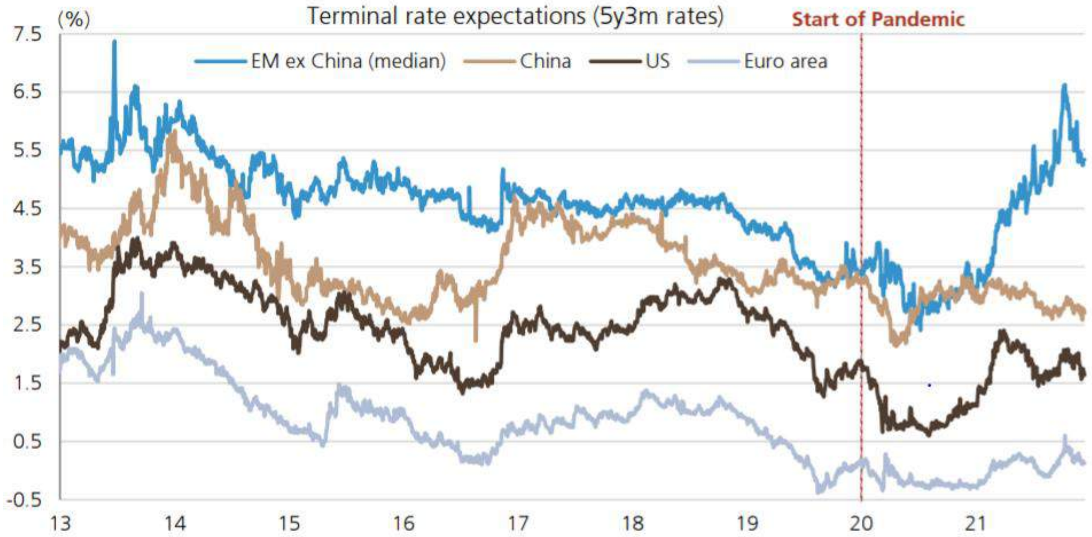
* NEGATIVE OF THE ANNUAL CHANGE IN THE GENERAL GOVERNMENT CYCLICALLY-ADJUSTED PRIMARY DEFICIT AS A PERCENTAGE OF POTENTIAL GDP.
NOTE: A POSITIVE FISCAL THRUST DENOTES EXPANSIONARY FISCAL POLICY.
RED BARS AND DOTS REPRESENT FORECASTS. 2021 IS AN ESTIMATE.

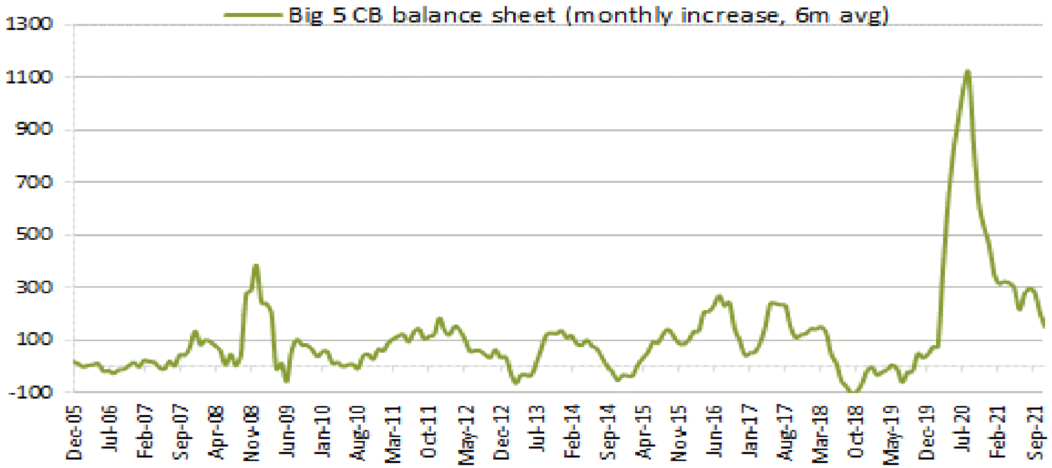
While fiscal policy is likely to get tighter in 2022 compared to 2021, we note that in DMs the fiscal policy will still remain relatively. easy and cyclically adjusted fiscal balance is likely to be close to neutral. We also need to remember that a large part of fiscal policy stimulus of developed economies is sitting in the household balance sheets in form of excess savings and should continue to support consumption.

Source: BCA

Monetary policy normalization with divergent paths; terminal rate expectations low





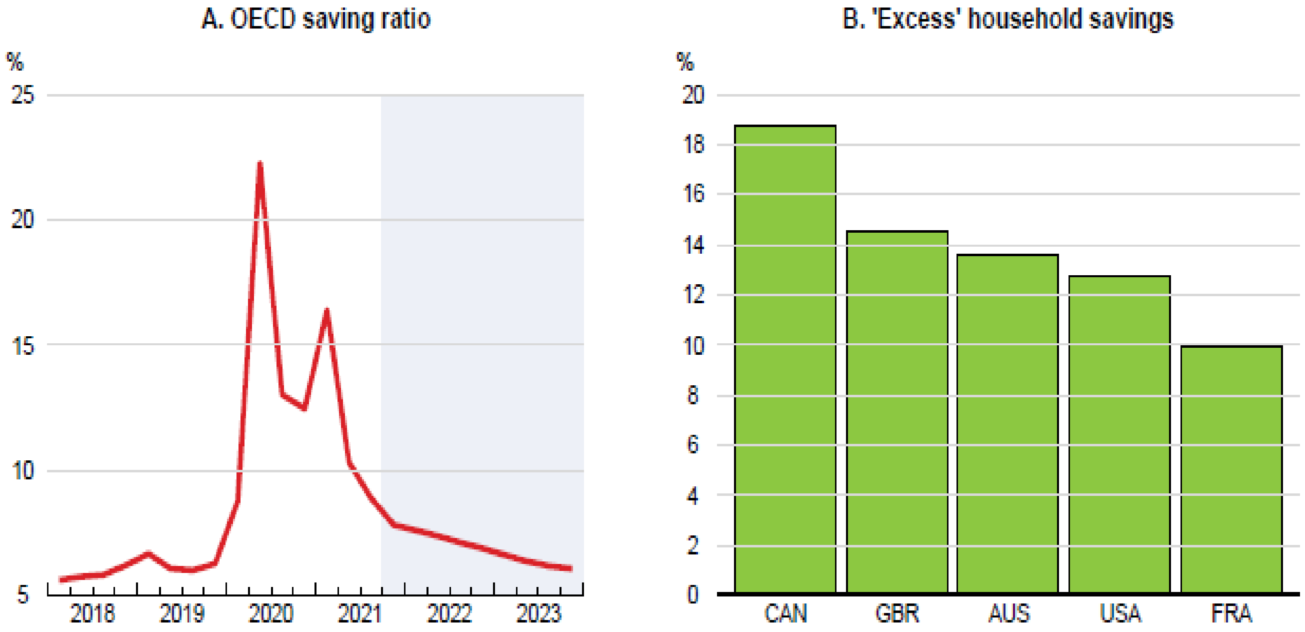


Source: JP Morgan, Bloomberg, UBS

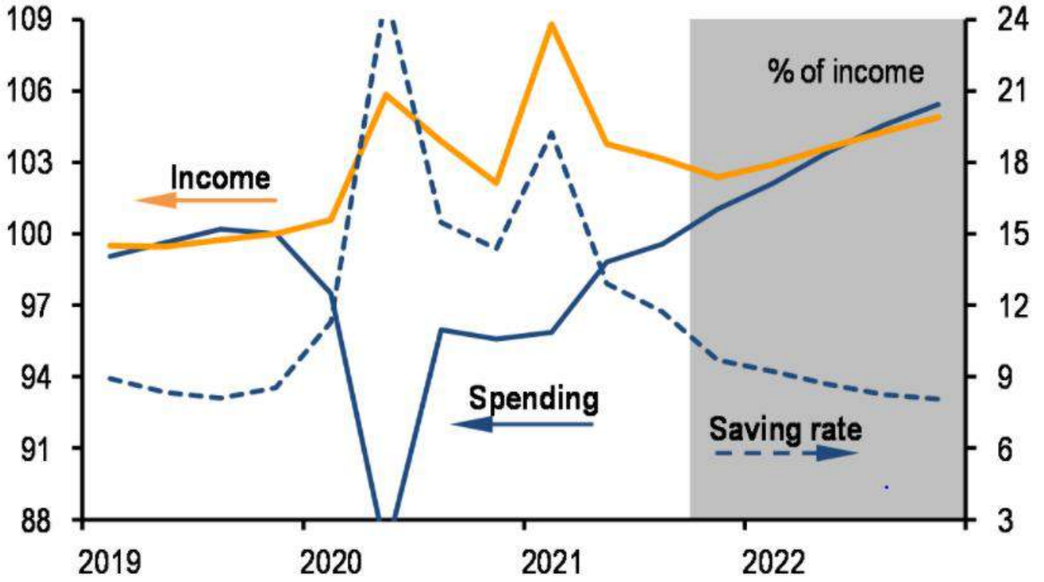
Monetary policy normalization is already underway, and we expect more CBs to join them in raising rates besides curtailing QEs (where still undergoing) in 2022. However, there is a clear divergence visible in CB reaction function expectation with ECB and BoJ likely to keep rates unchanged. Another notable theme is the declining terminal rate expectations despite rising inflation pressure.

Strong household balance sheet to cushion fiscal consolidation

India pre-Covid growth has been remarkably stable



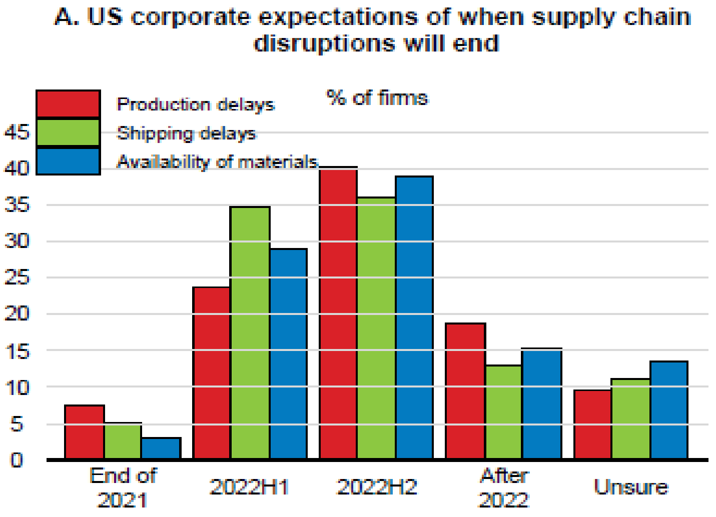
G4: Household income spending and saving

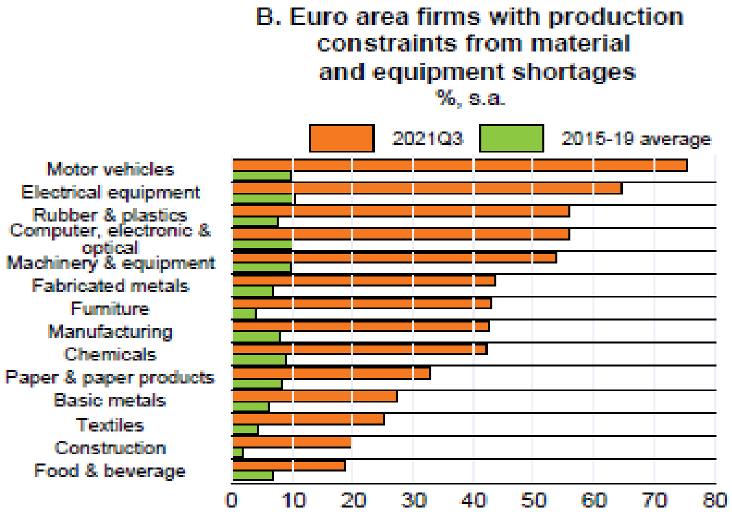


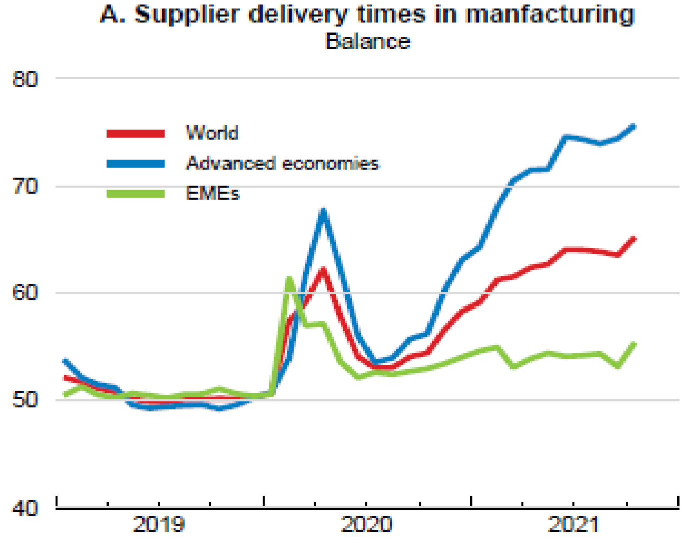
One interesting result of the pandemic policy response has been the sharp rise in household savings in developed economies due to aggressive government support to household and fall of consumption (particularly services) due to pandemic. Besides the government support, job markets and asset prices are now booming. Over the past two years, the net worth of US households was boosted by some $29 trillion—a record rise in a short period of time—as the prices of stocks and real estate surged by over 20%. Equally, labor market tightness will likely persist due to declining immigration, a COVID-driven surge in retirement and unfavorable demographics, and employers will have to pay more to attract workers. Unlike one-off stimulus checks, paychecks are recurring and so have a more lasting impact on consumption. The result is likely a positive wealth effect on demand and consumer spending for a while to come

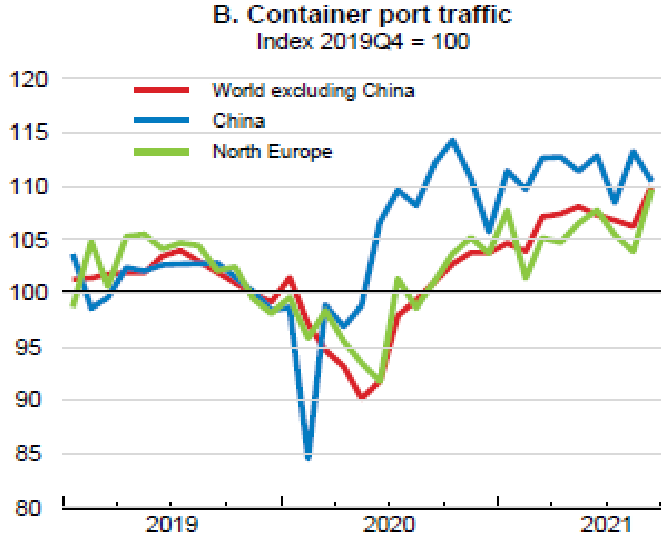
Source: JP Morgan, OECD

Elevated bottlenecks prevented full normalisation







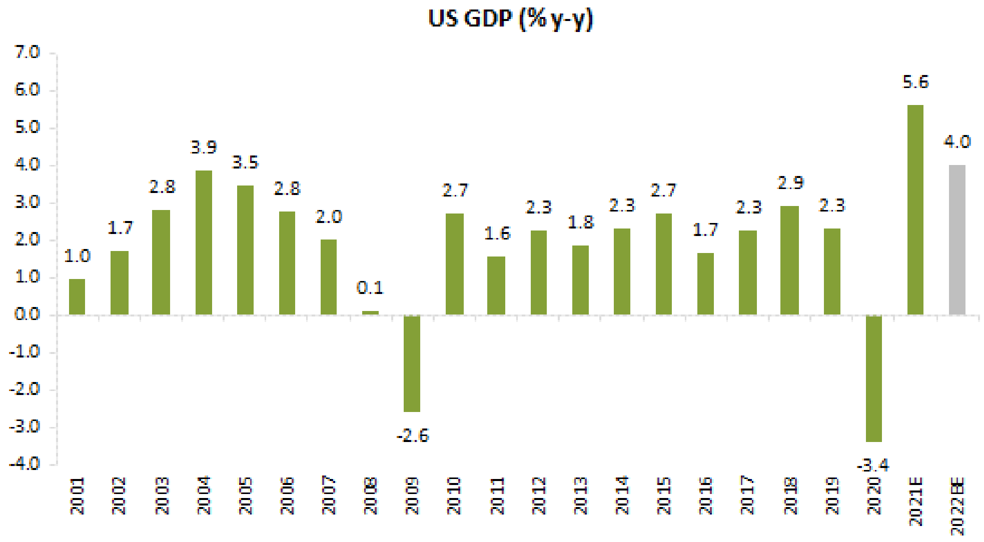


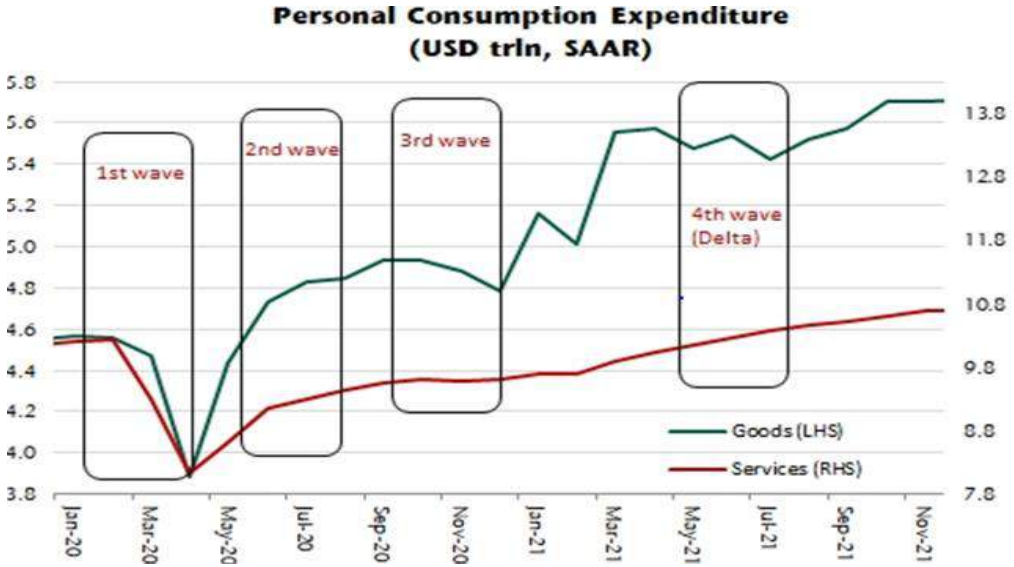
The rapid recovery in global demand over the past year and the slower recovery of production capacity in some sectors have generated supply shortages. While new COVID-19 infections and deaths have been reduced substantially in many advanced economies, outbreaks are continuing to occur in some parts of the world, including many European economies in recent weeks, extending some supply constraints and creating new ones. Such constraints appear to be a factor in the loss of momentum visible in recent economic indicators.

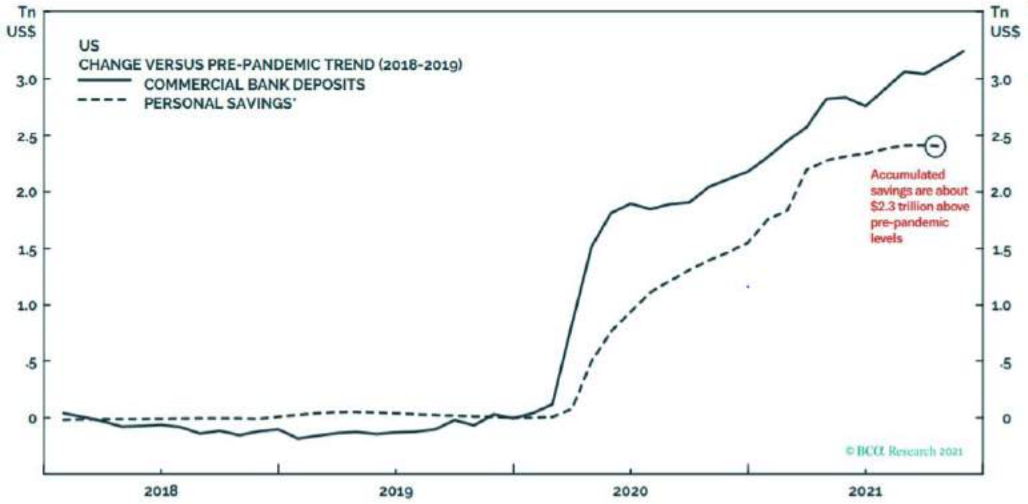
Series in bottom left chart is based on Manufacturing PMI and defined as 100 minus the proportion of PMI survey respondents reporting that delivery times have stayed the same or become faster.

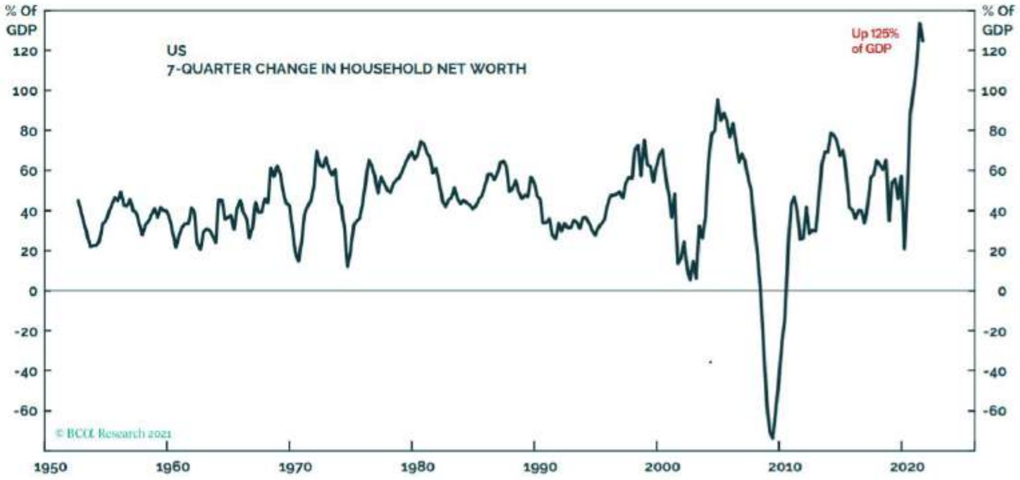
Source: OECD

US growth to normalize but stay above pre-Covid trend







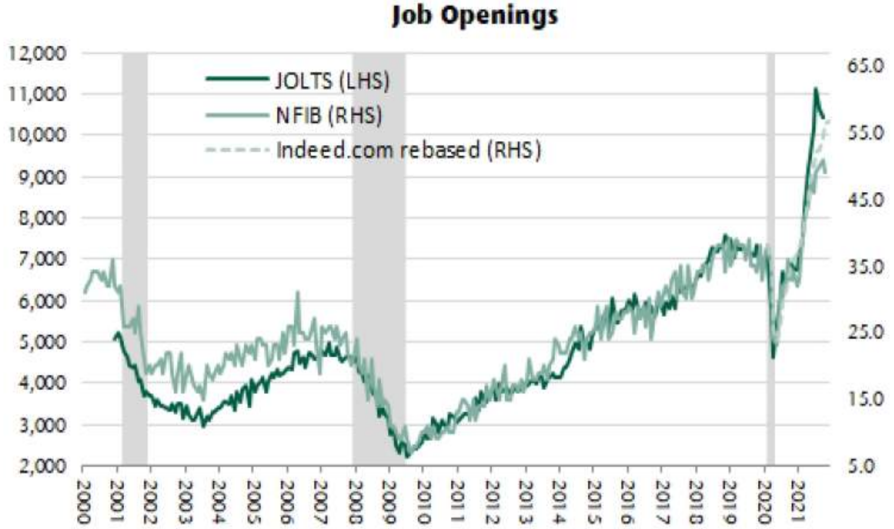


We see US growth to remain strong but weaken from the current super high levels due to reversal to mean from the current super high consumer demand and normalisation of policy stimulus, particularly from the fiscal side. However, we still see US growth to be significantly higher from the pre-Covid trend given the healthy household balance sheets, inventory rebuilding, strong labour market and still considerable, albeit declining policy stimulus.

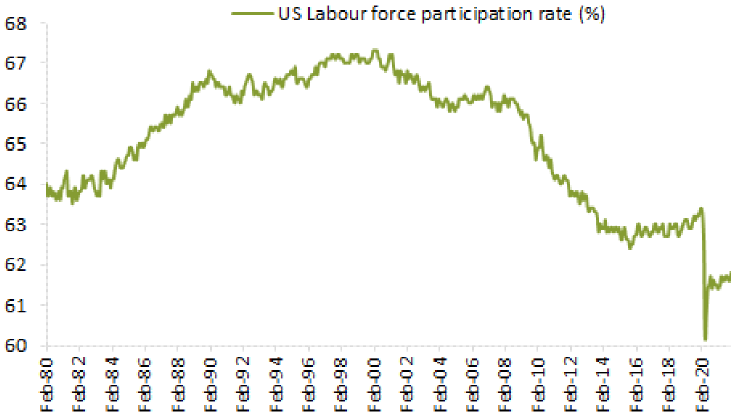
Source: CEIC, BCA, Jefferies

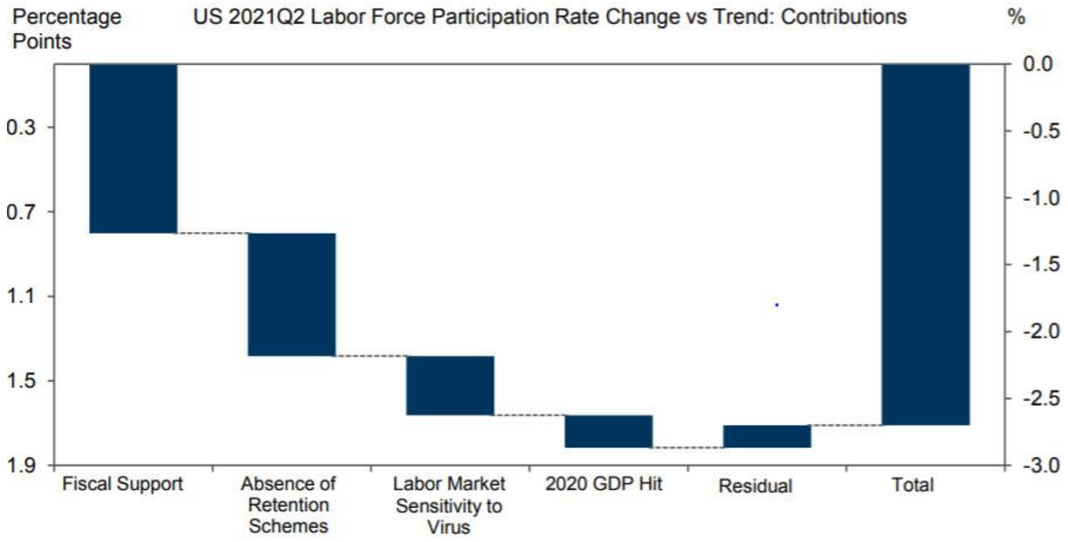
US: Tight labour market feeding wage pressure; labour force participation holds the key

Job opening at record high



Labour force participation still low

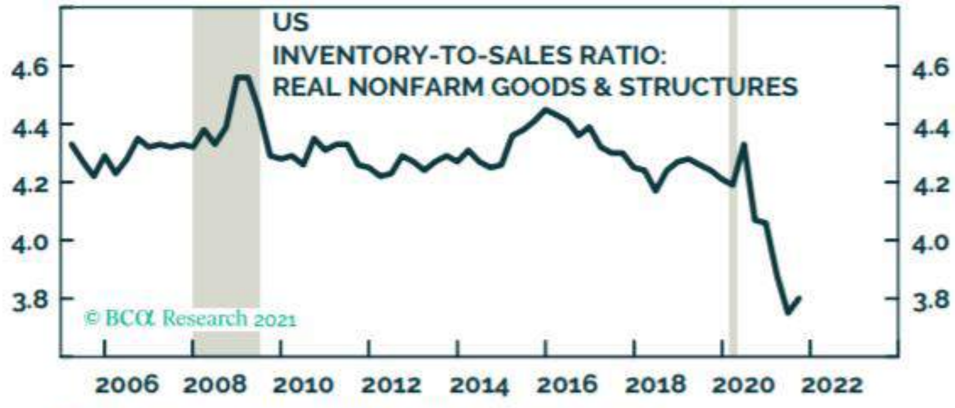


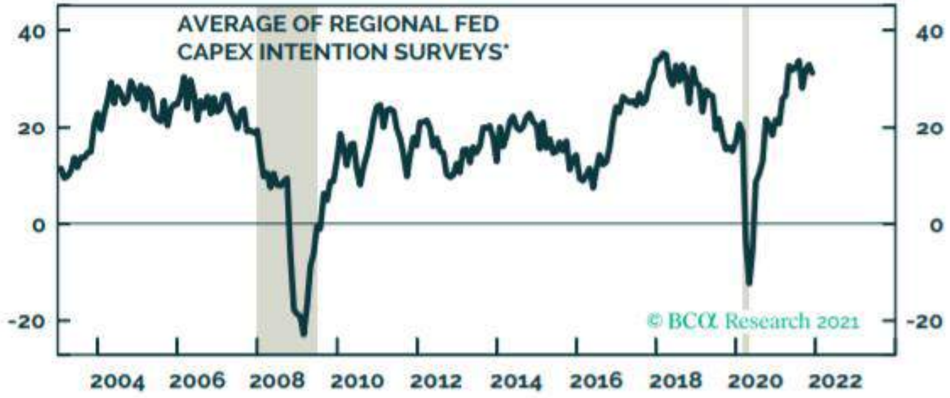


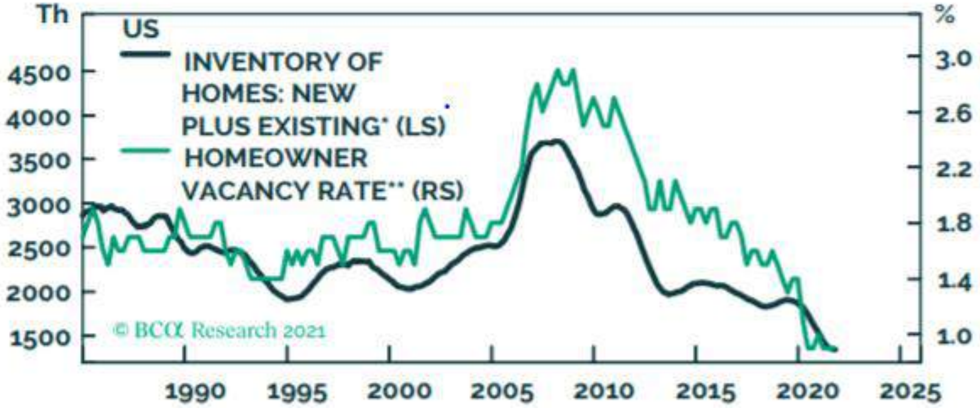
US labour market is exceptionally tight and fuelling wage pressures. An important reason for tight labour market is the low labour force participation due to a variety of reasons, but which appears to be "transitory"

Source: Jefferies, Nomura

US: Investment outlook looks robust







Super hot demand and falling inventories level has probably to increase US investment appetite as visible in the data and surveys

Source: BCA Research

China economic growth is slowing down

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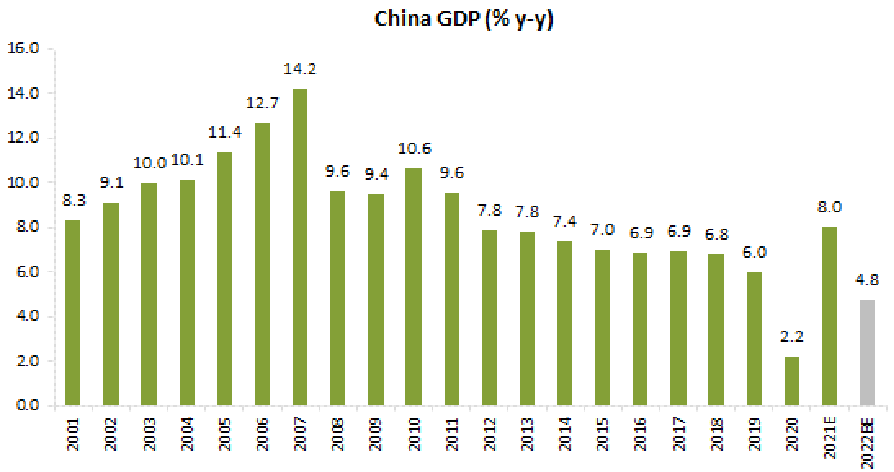


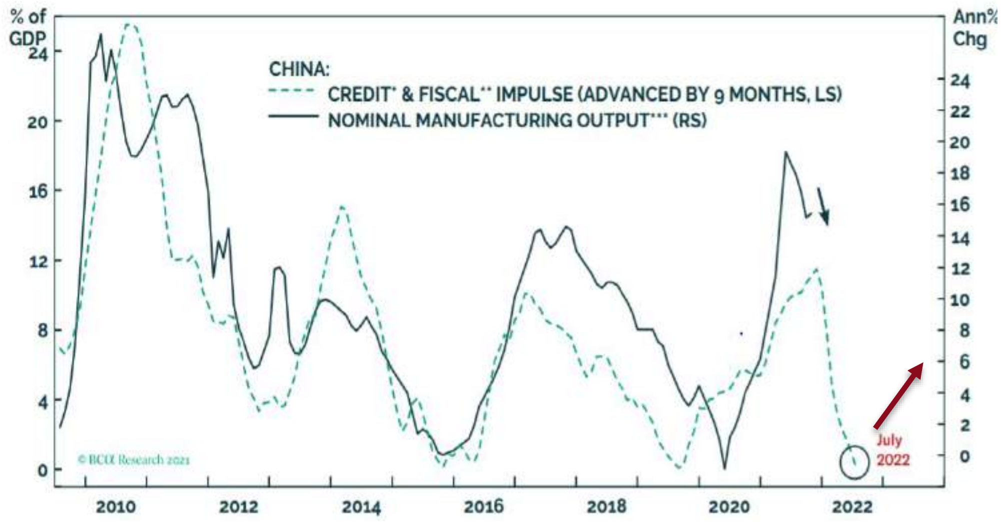


Exhibit 4: China has undergone aggressive deleveraging this year...

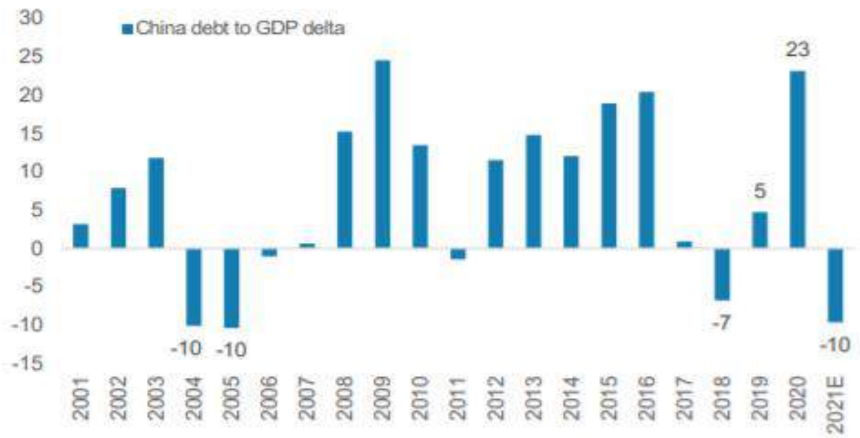
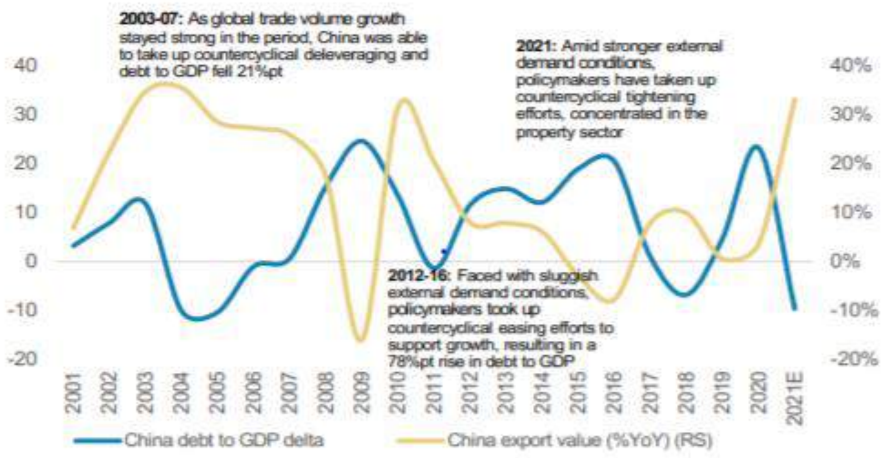


Exhibit 5: ...amid strong external demand as part of its countercyclical growth model...



We expect downside risk to Chinese growth in 2022 due to weakness in credit and fiscal stimulus, aggressive deleveraging in Chinese economy, zero Covid tolerance policy and weakness in property sector which has been a key growth driver in past two decades. While we expect policy easing to stem the downside, such responses work with a lag and should be measured and just putting a floor on growth.

Source: CEIC, Morgan Stanley, BCA

Property sector has been a key growth driver in China

Figure 74: Property was a key growth engine

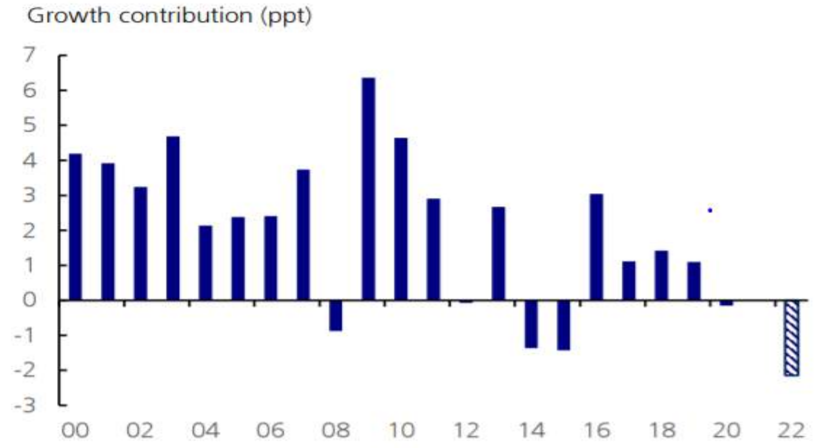
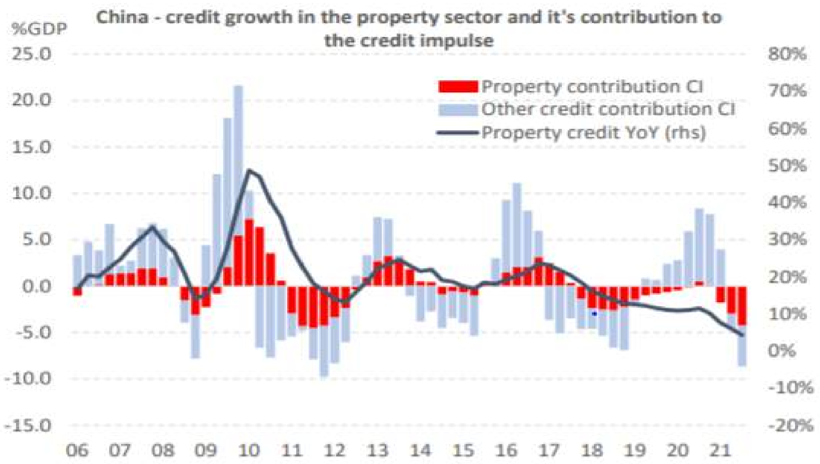


Figure 75: And a large part of China's credit cycles



Property sector which has been a key growth driver in last two decades is facing strong regulatory headwinds which should create downside risk to Chinese growth. The stringent regulations to rein in real estate investment (the so-called three red lines related to financial ratios as well as caps on real estate lending by bank type) and deflate the bubble that was forming tightened liquidity conditions for property companies and even pushed some large ones to default on their debt.

Source: OECD, Capital Economics, Refinitiv

Europe growth outlook benign-1

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Figure 3. Euro Area: Household Consumption, Real (1Q-17 =100)

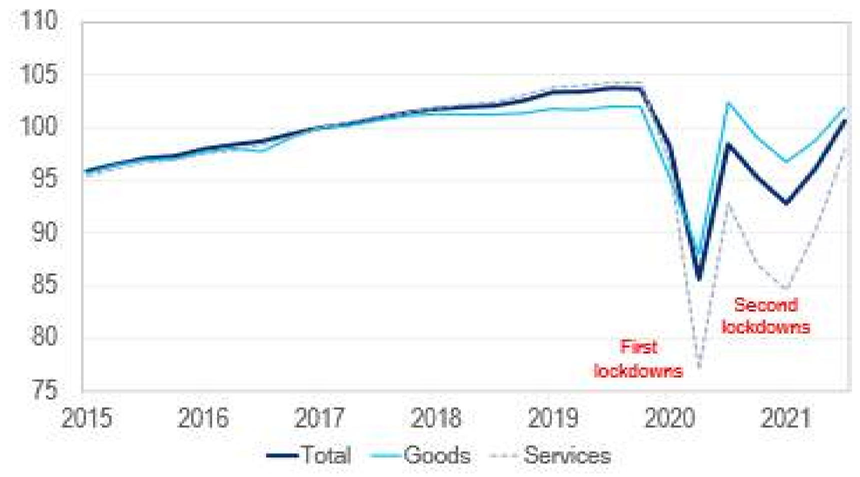
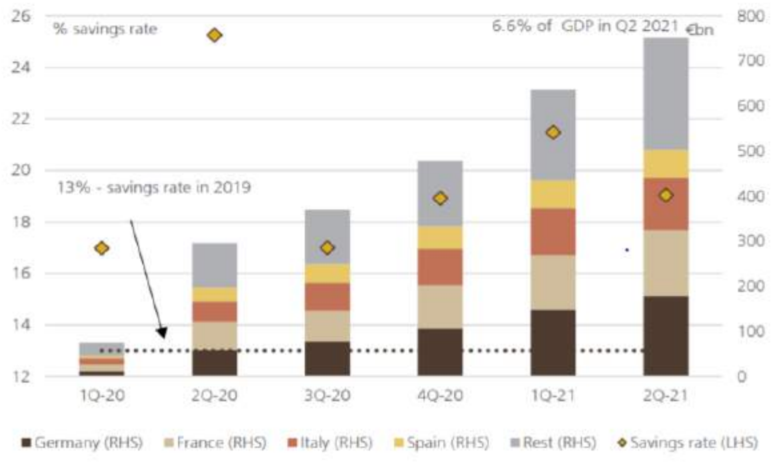
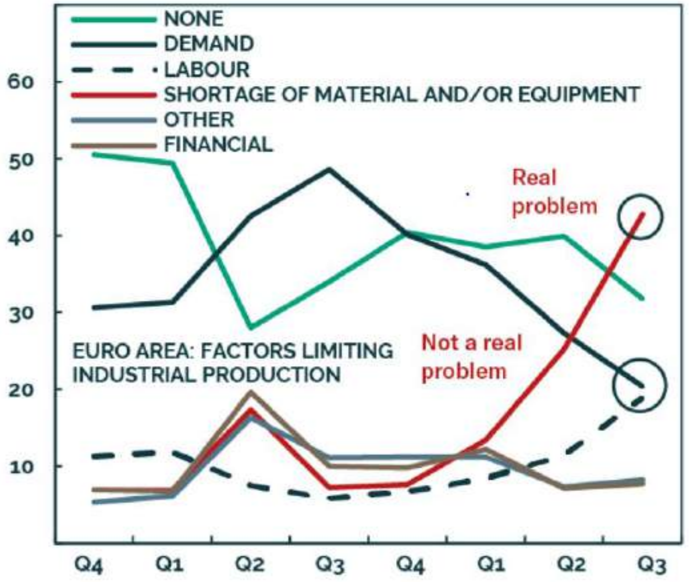
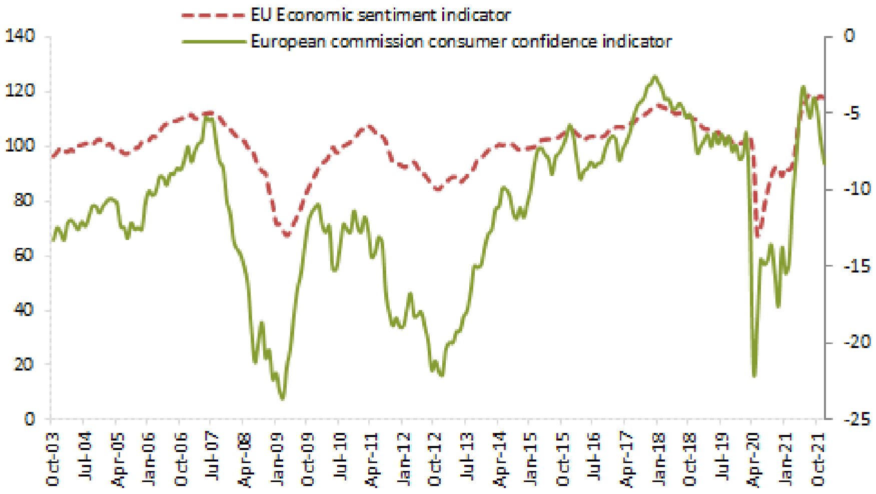
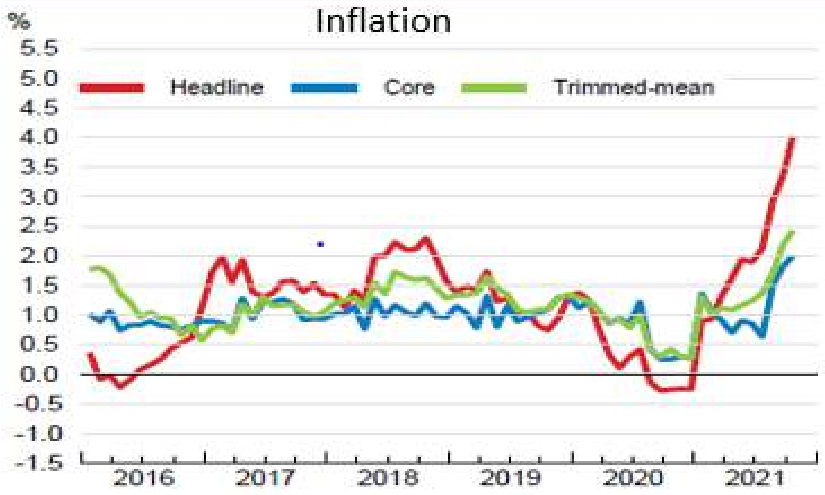


Figure 293: Eurozone household excess savings









European growth outlook for 2022 is benign given high consumer confidence, excess savings, low inflation and continuation of easy monetary and fiscal policy. Moreover, should Covid subside it should be positive for European tourism industry.

Source: OECD, Citi, Capital Economics, BCA

Europe growth outlook benign-2

European Banks Have Cleaned Up Their Act

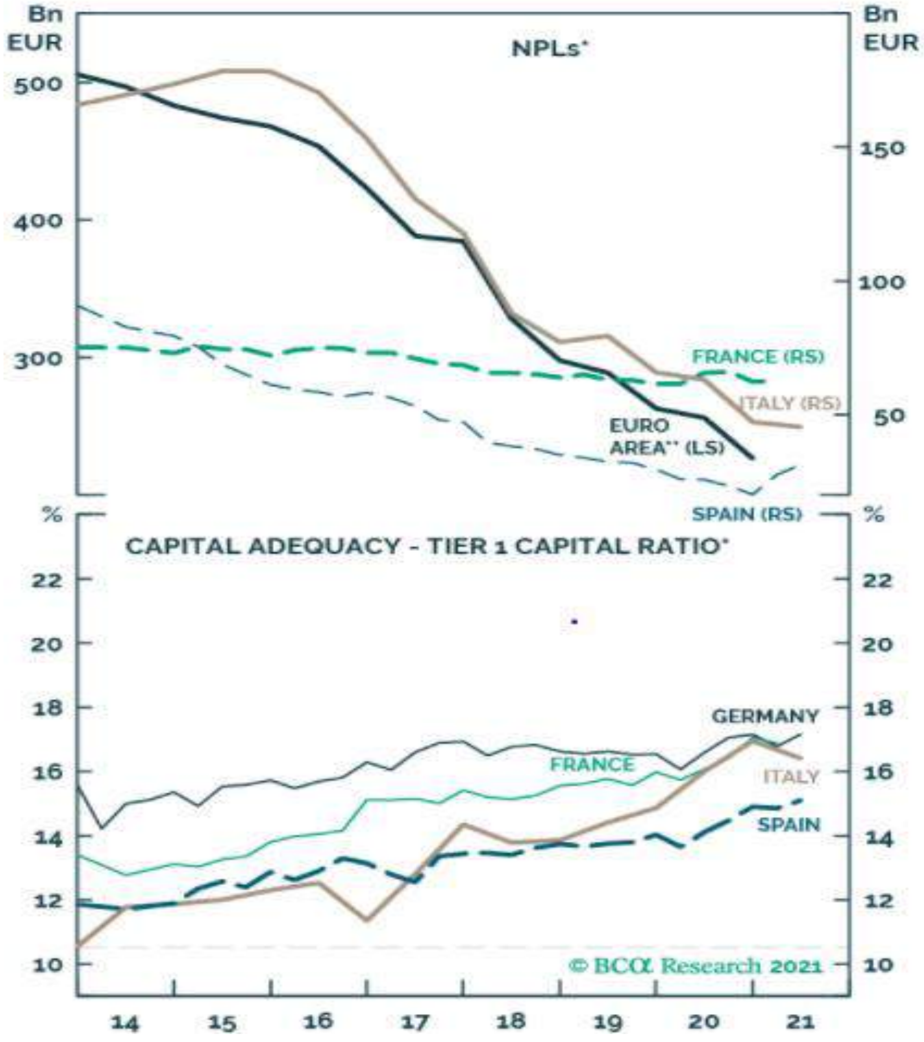
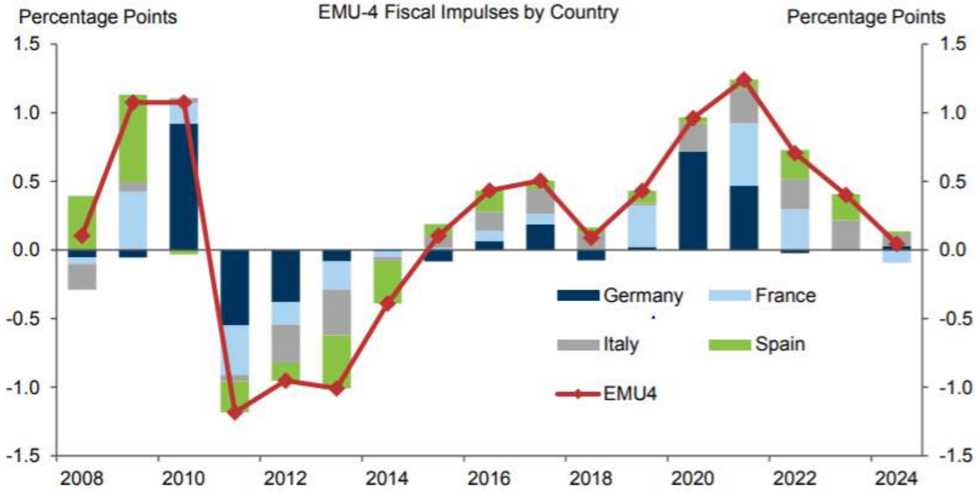
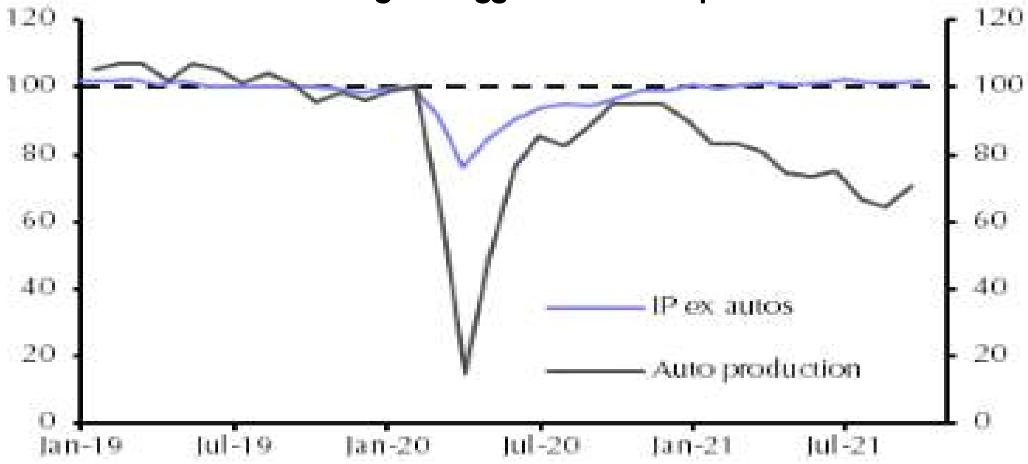


Exhibit 12: The Fiscal Impulse Remains Expansionary in the Euro Area



Semi-conductor shortages dragged down auto production

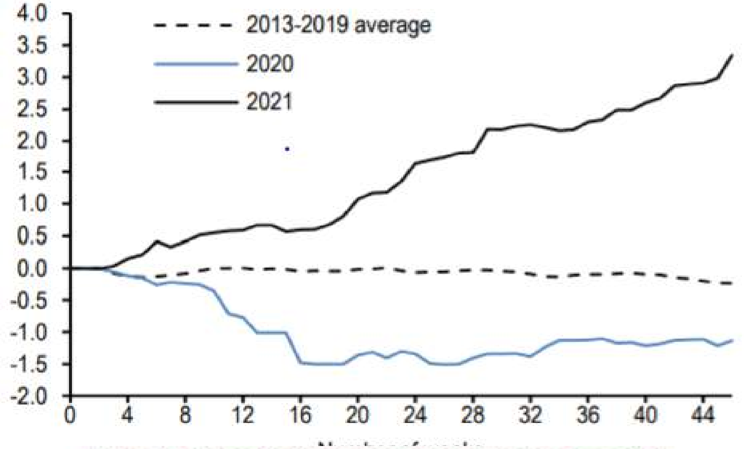


Unlike in most other economies, fiscal impulse is expansionary in Euro Area. European banks cleaned up their balance sheets, Euro area manufacturers' investment expectations is high and semi-conductor shortage which has constrained auto production should subside in 2022

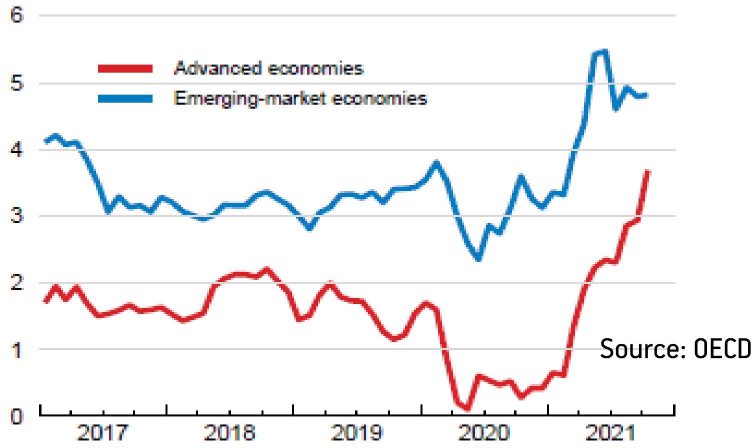
Source: BCA research, GS, Capital Economics

Inflation has surprised on the upside-1

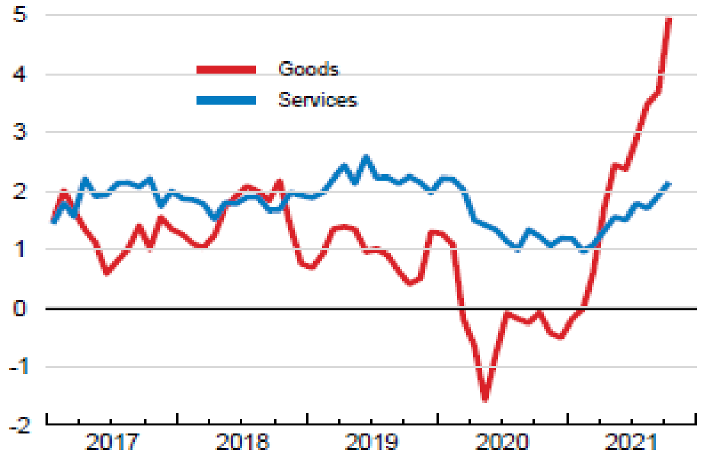
Cumulative change in the JP Morgan Developed Markets Forecast Revision Index*, rolling 4-qtr (q-1, q, q+1, q+2); number of weeks since the beginning fo the year;



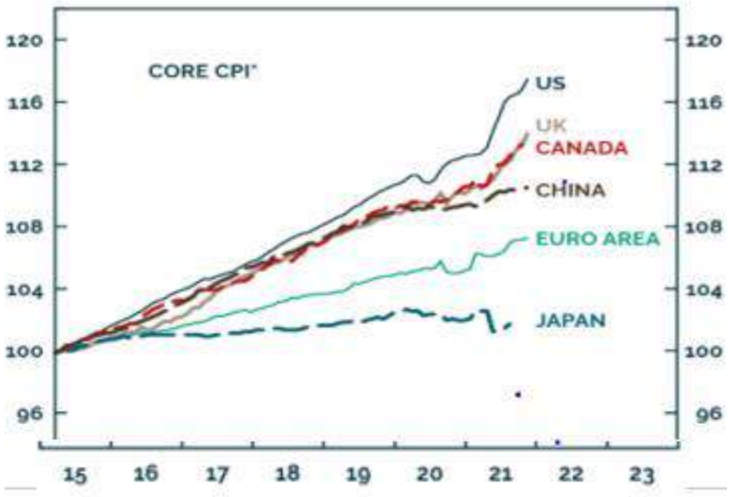
A. Headline consumer price inflation in median economy
Y-o-y % changes



B. Sectoral consumer price inflation in median advanced economy
Y-o-y % changes



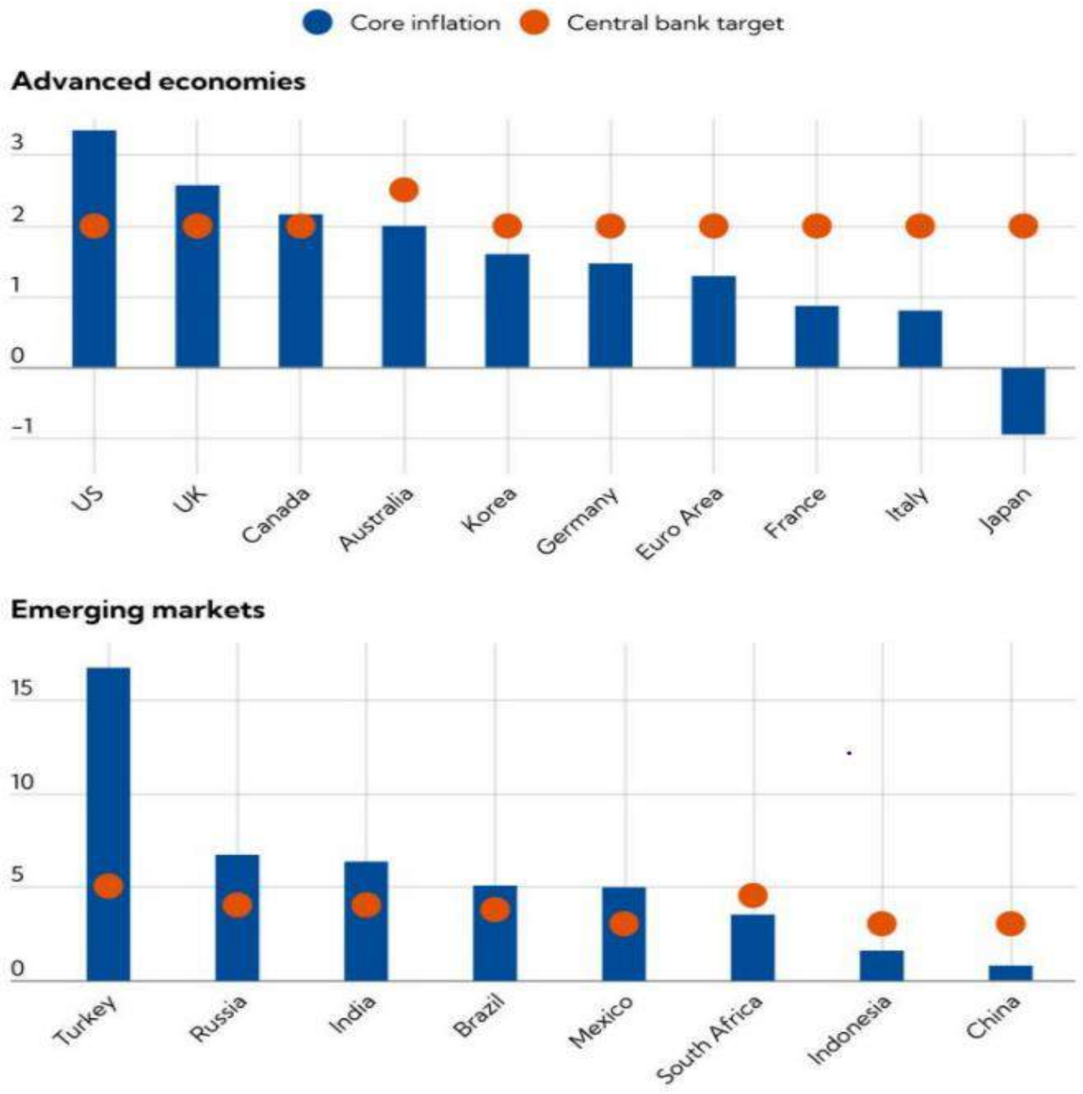
The US Stands Out As The Inflation Leader

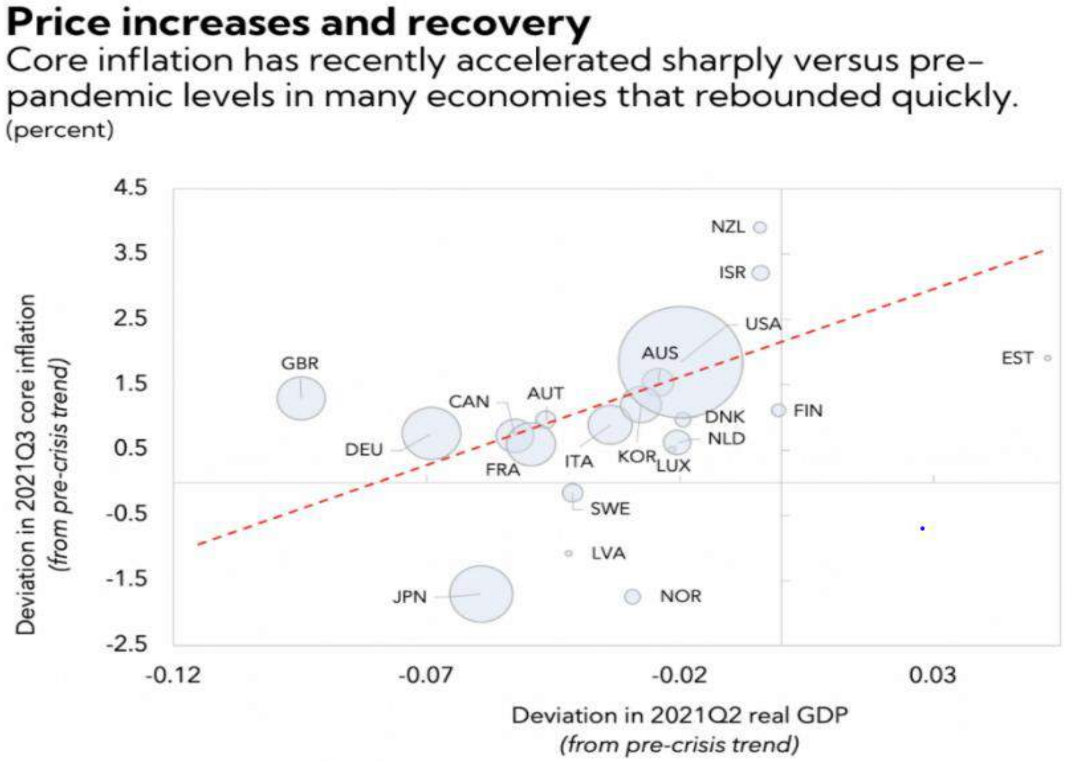


High inflation was the dominant theme in 2021 with numbers surprising consistently on the upside. Headline inflation and, to a lesser extent, core consumer price inflation have risen markedly in most countries over the past year. Among large advanced economies, this is particularly the case for the United States, as well as, to a lesser extent, the United Kingdom, Germany and Canada. Commodity prices have risen particularly sharply, as have prices in many durable goods sectors, especially in the United States.

Source: OECD, JP Morgan, BCA

Inflation has surprised on the upside-2





Cross country analysis shows the good correlation between inflation and speed of recovery. Also we can see core inflation above Central Bank targets in DMs have been confined in US, UK and Canada, countries which received the maximum policy stimulus.

Source: IMF

Supply bottlenecks have been key contributor to high inflation

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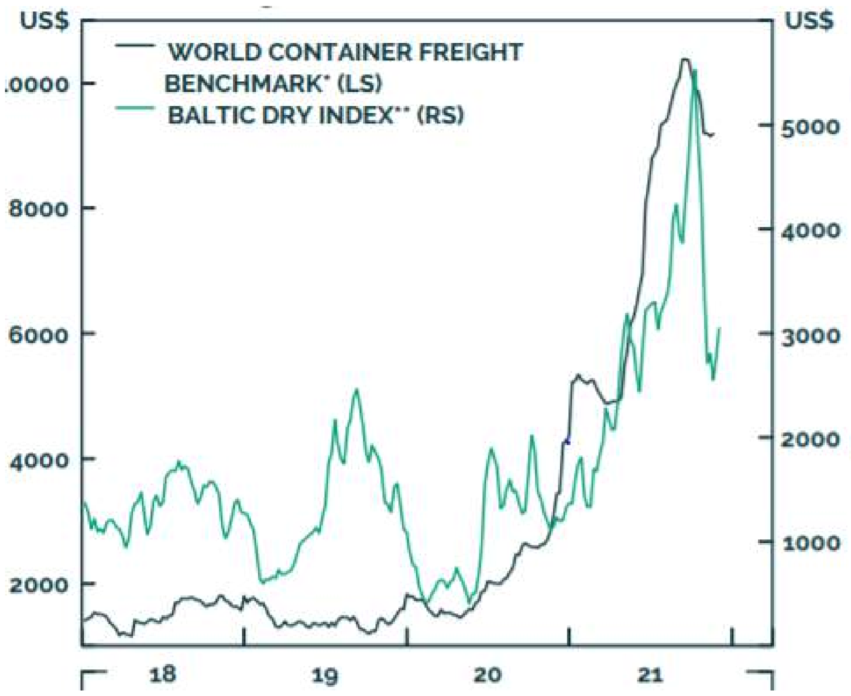
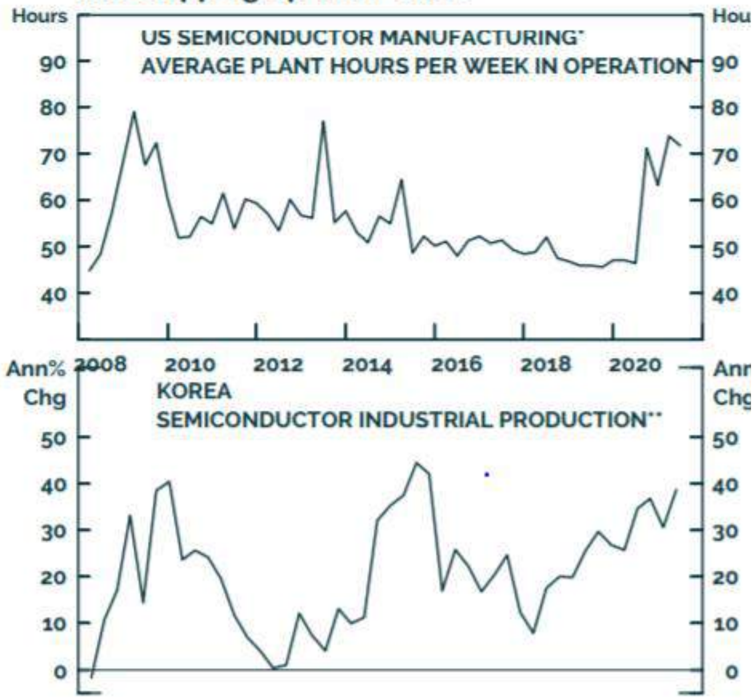


Semiconductor Manufacturers Are Stepping Up Their Game



4 types of supply constraints were key contributor to high inflation: Crude and energy prices, logistical bottlenecks, semi-conductors and labour supply. Good news is that most of these except probably energy should ease in 2022.

Figure 17: Reports of labour shortages in business surveys have increased

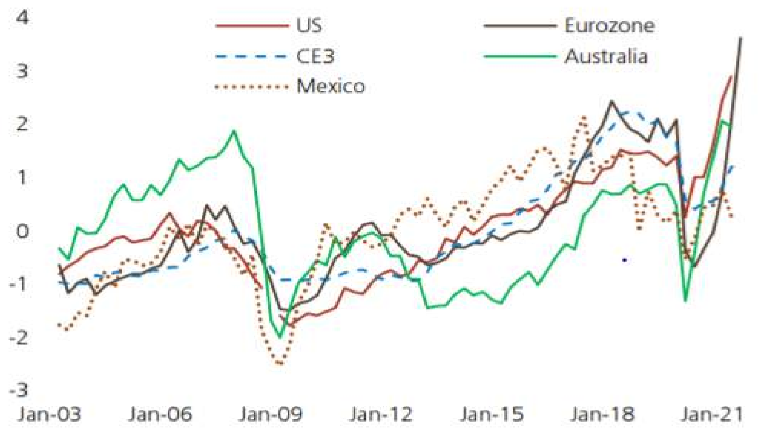
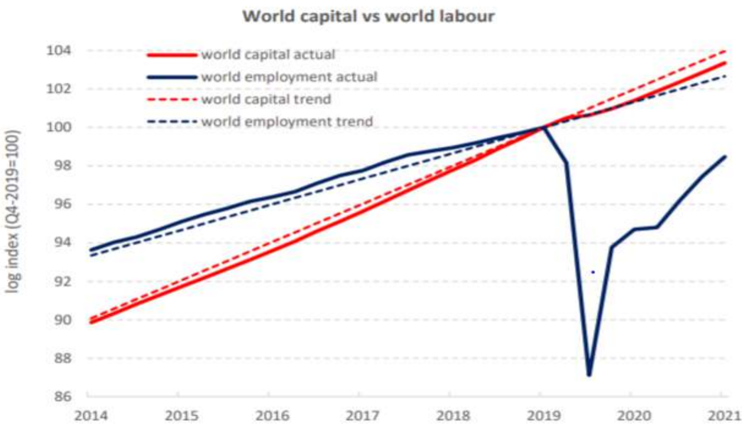


Figure 87: Global capital and labour growth vs trend



Source: OECD, BCA

US inflation rises to highest in 4 decades, but long-term expectations anchored

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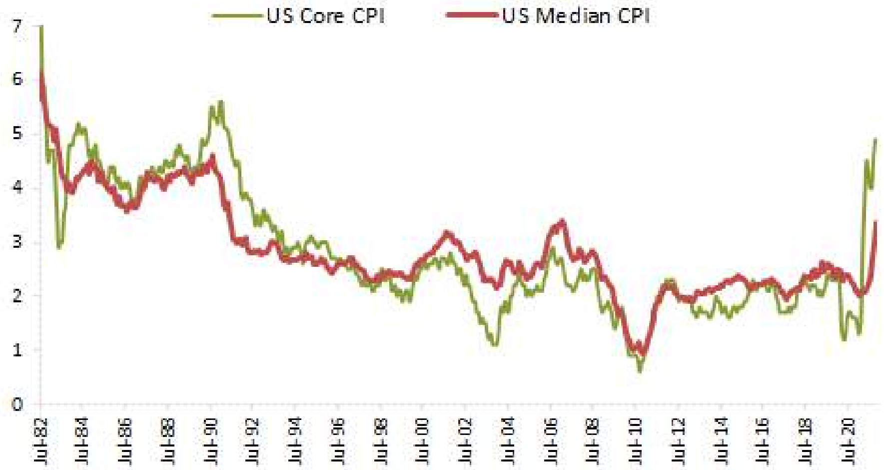
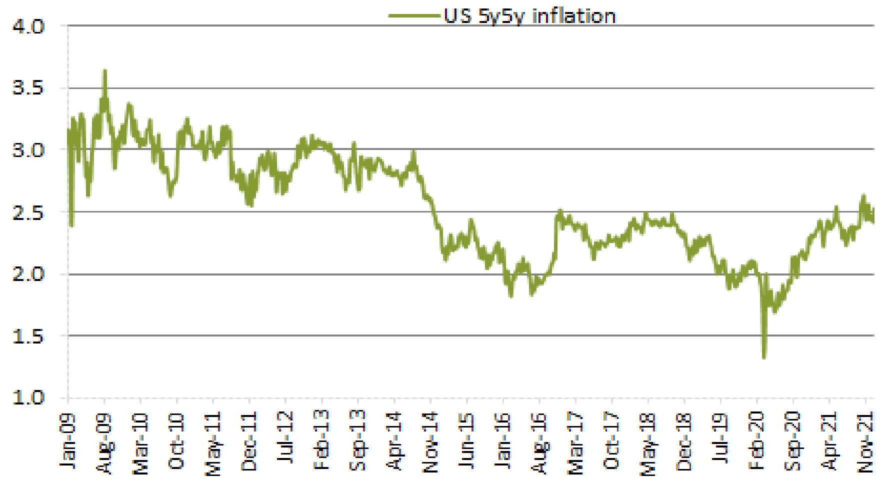
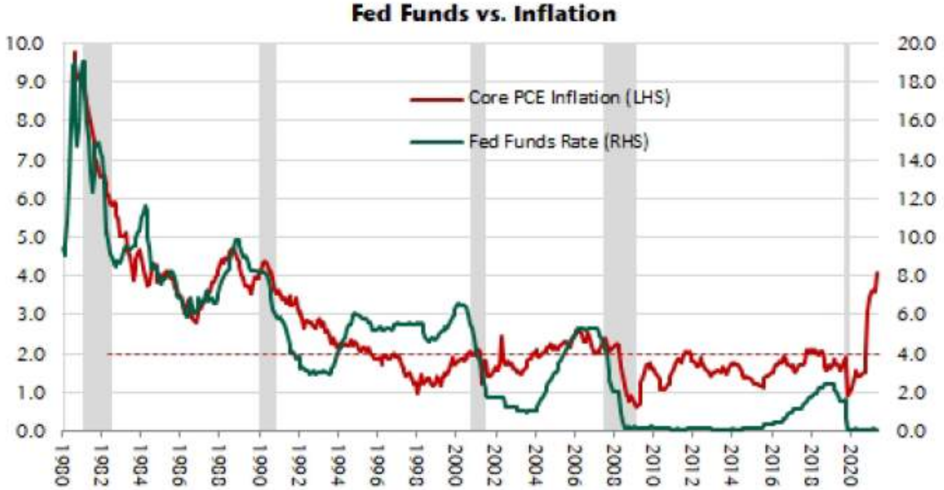
US core inflation has risen to multi-decade high



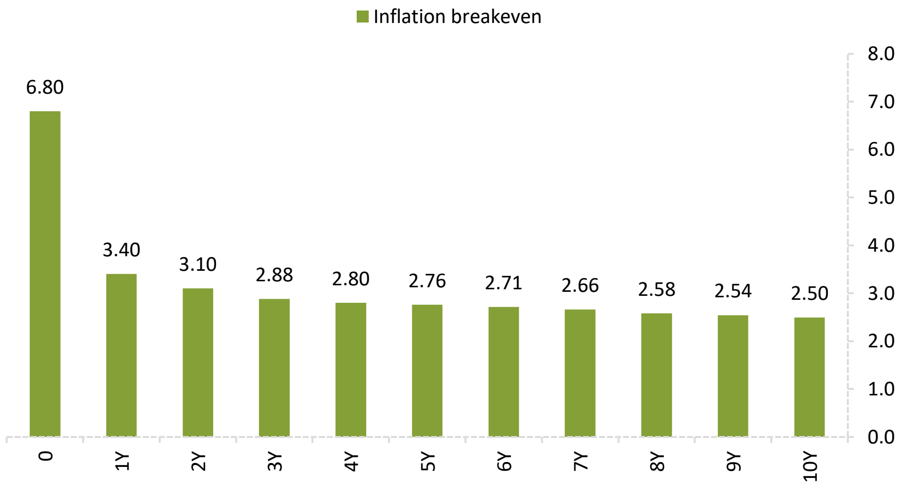
Market expectation of long-term inflation remain anchored



Fed funds rate much lower than the inflation



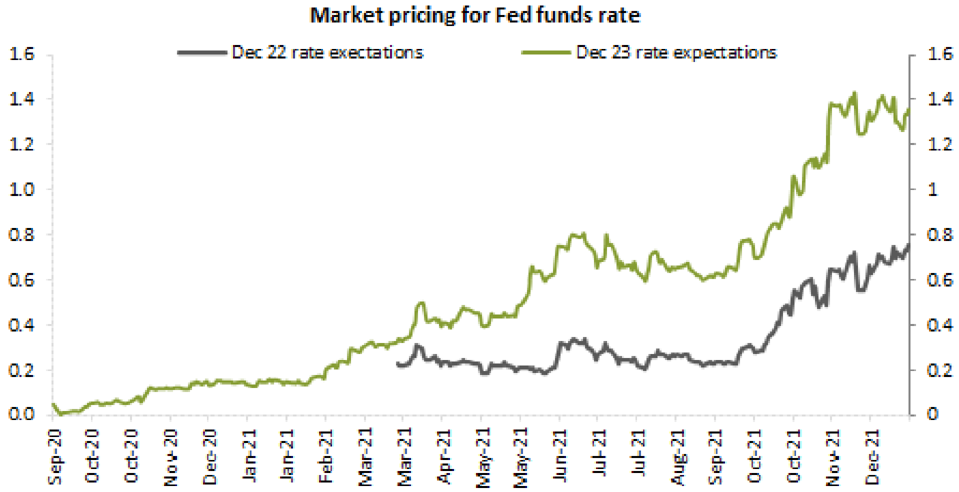
Market expectation is that inflation will ease going ahead

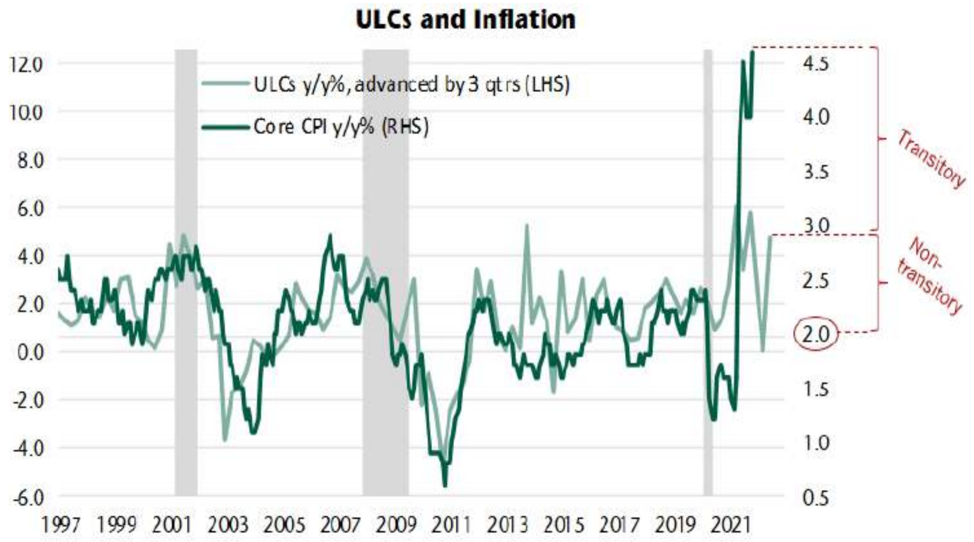


Given the reserve currency status of dollar, high US inflation and the resultant prospects of Fed rates rise will be the dominant theme in markets in 2022. We note that while US policy rates are very low compared to historical standard and likely to rise, longer term inflation expectations are anchored which are probably keeping longer end of yield curve anchored.

Source: Bloomberg, Jefferies

Markets and FOMC forecasting 3 rate hikes in 2022





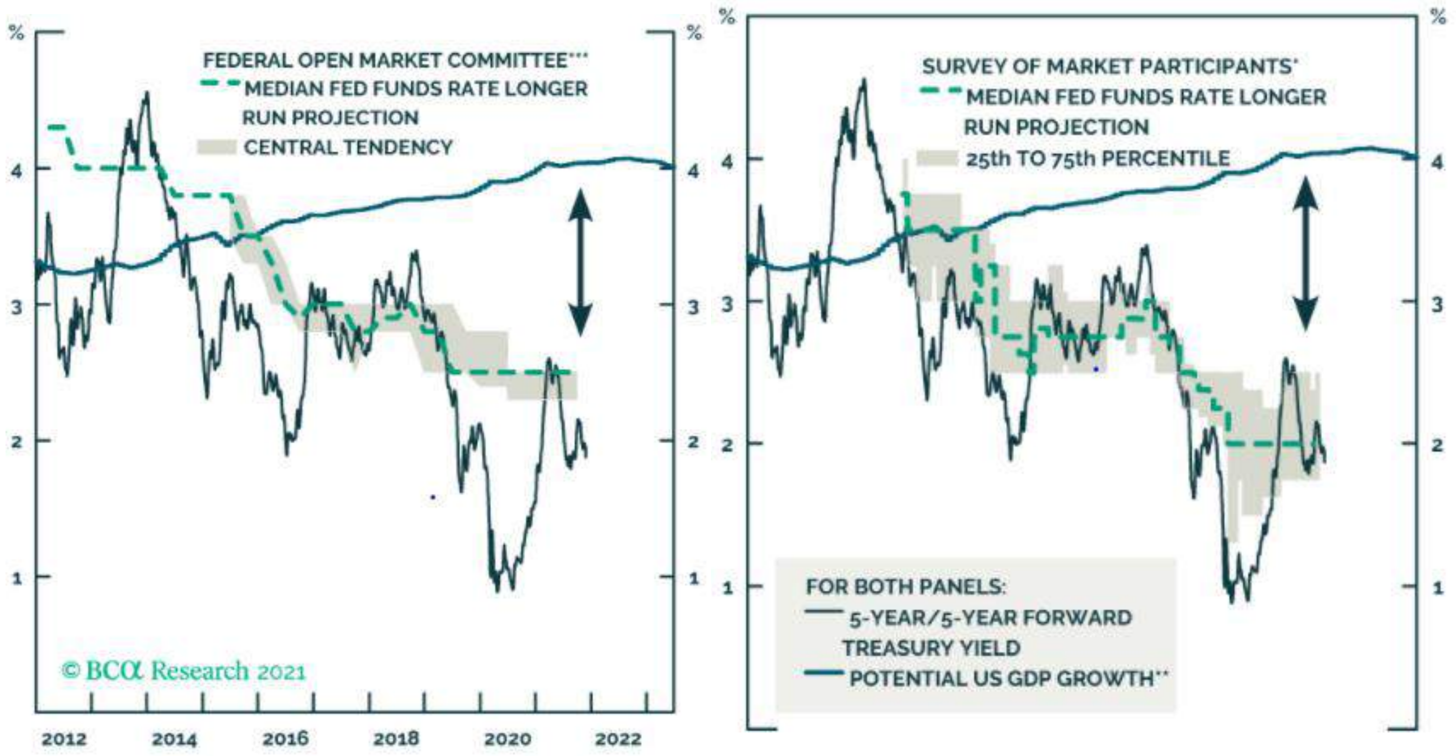
FOMC projections

Variable	Median[1] 2021	2022	2023	2024	Longer run
Change in real GDP	5.5	4.0	2.2	2.0	1.8
September projection	5.9	3.8	2.5	2.0	1.8
Unemployment rate	4.3	3.5	3.5	3.5	4.0
September projection	4.8	3.8	3.5	3.5	4.0
PCE inflation	5.3	2.6	2.3	2.1	2.0
September projection	4.2	2.2	2.2	2.1	2.0
Core PCE inflation[4]	4.4	2.7	2.3	2.1	
September projection	3.7	2.3	2.2	2.1	
Memo: Projected appropriate policy path					
Federal funds rate	0.1	0.9	1.6	2.1	2.5
September projection	0.1	0.3	1.0	1.8	2.5

Given high inflation and high growth, markets and Fed are both forecasting 3 rate hikes in 2022

Source: Bloomberg, Jefferies

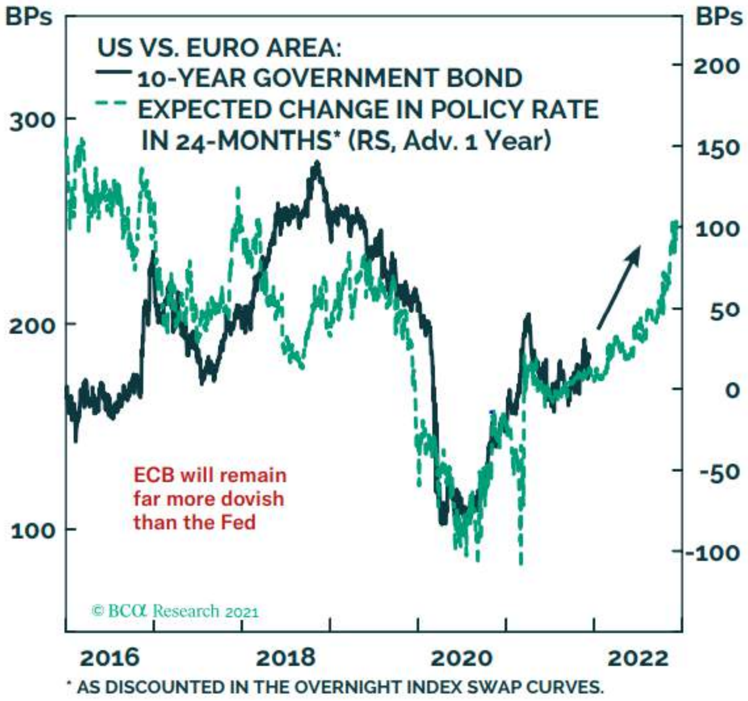
US real rates at record low, terminal rates anchored

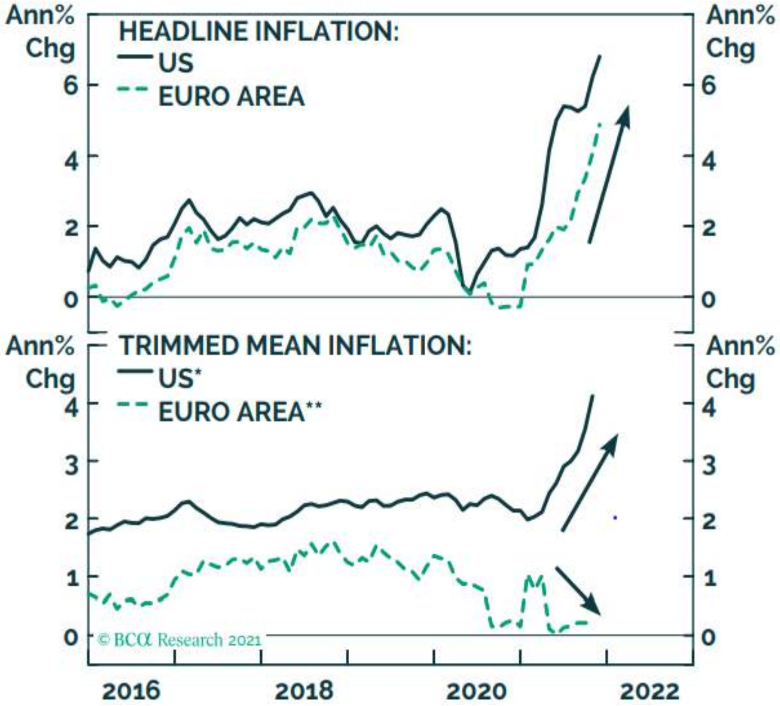


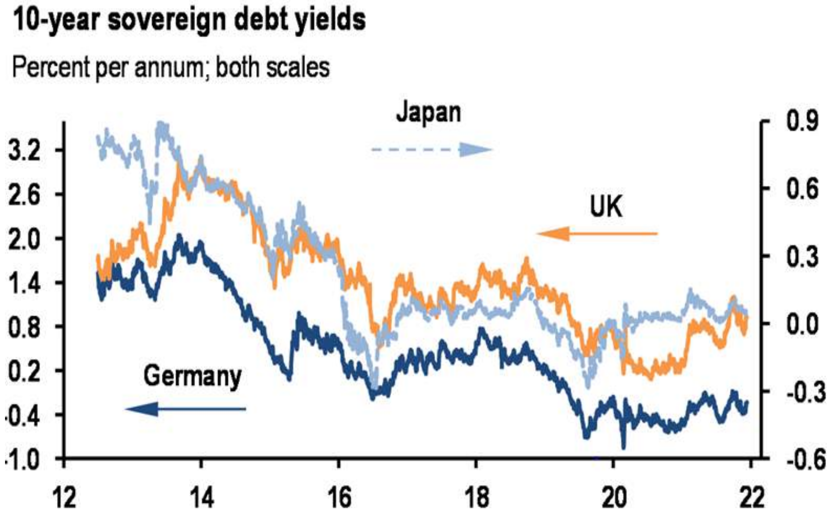
US real rates have fallen to record lows and the rising inflationary expectations have kept the longer end anchored. Another reason for US long end remaining relatively stable in face of high inflation and rising short end is that longer end terminal rate expectations has remained well anchored.

Source: BCA, Bloomberg, ABSLAMC Research

Spread between US and other DMs to stay elevated







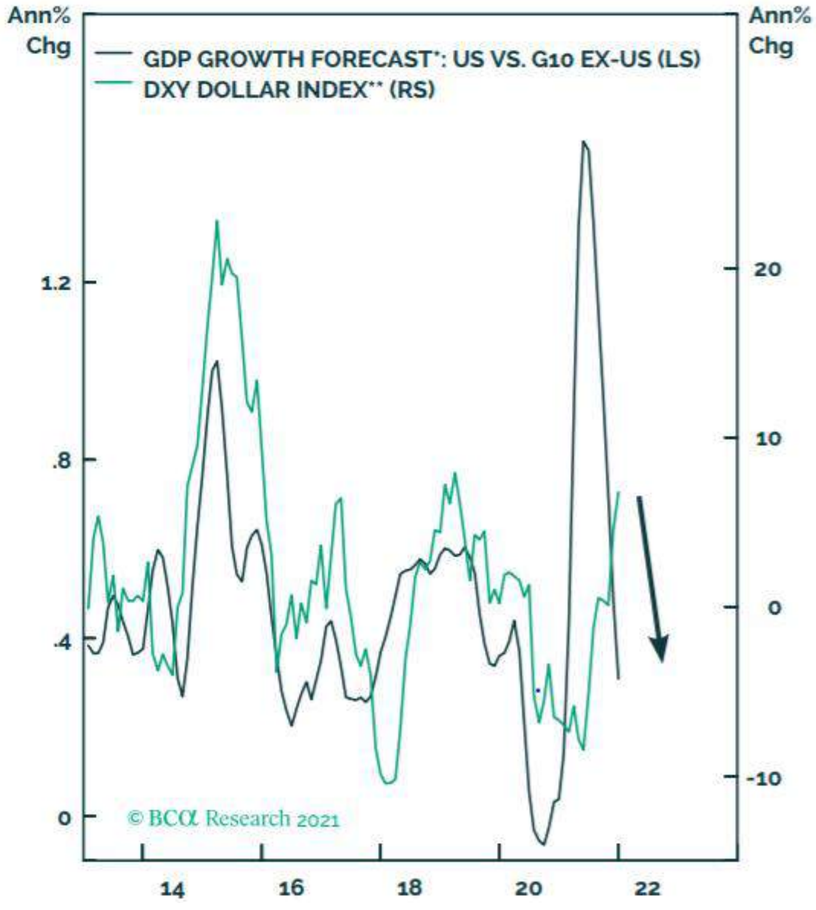
Given the different inflation outlook and rate hike expectations the divergence between US and European and other DM sovereign rates can stay elevated.

Source: BCA, JP Morgan, ABSLAMC Research

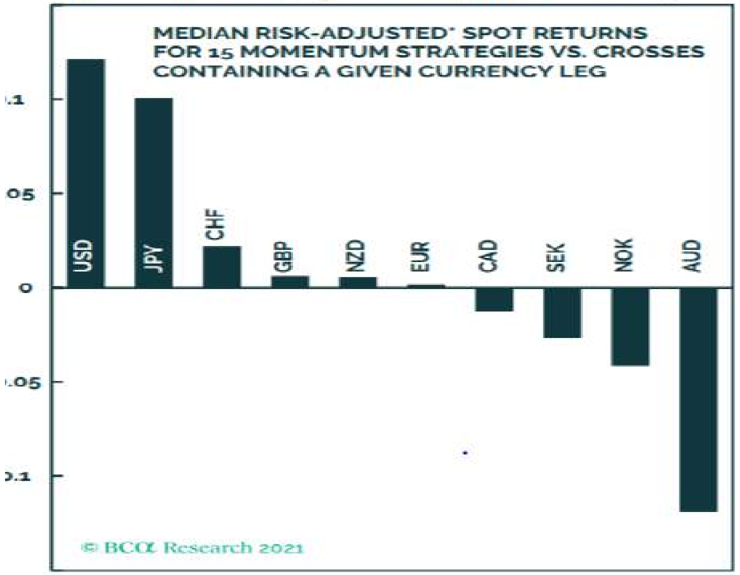
Strong growth, bullish market and Interest rate differential drive dollar strength in 2021

Interest Rates Have Played A Major Role On The Dollar's Performance This Year

US growth differential also drove dollar strength in 2021 and should cause dollar weakness in 2022

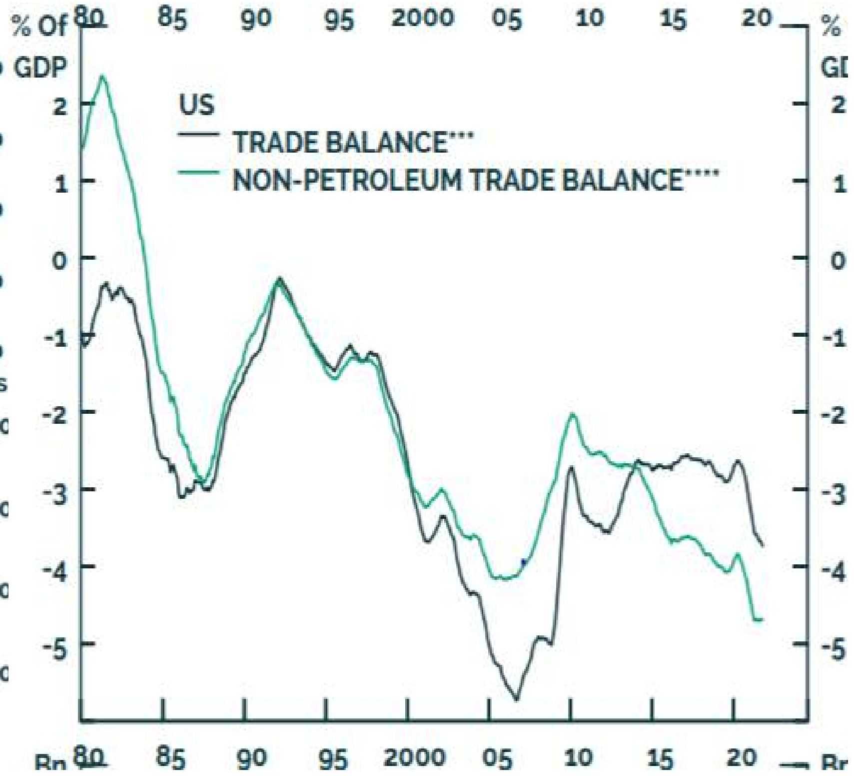


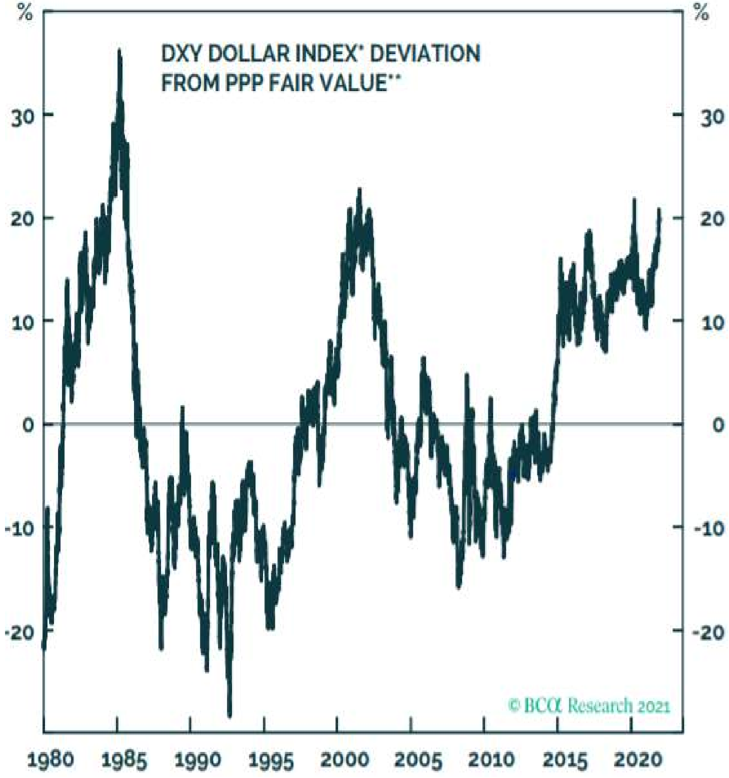
The Dollar Is A High Momentum Currency



Source: BCA

But headwinds ahead in 2022



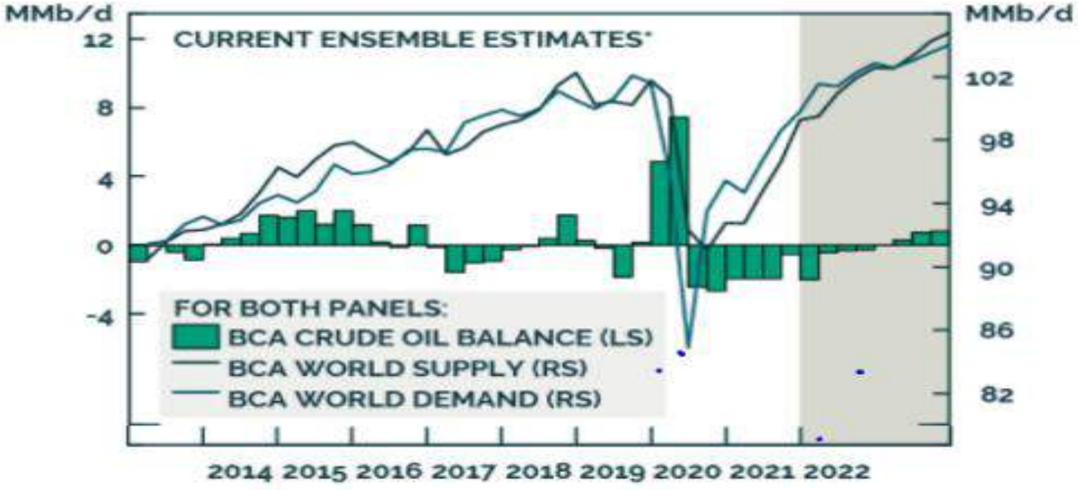


We are bearish on dollar in 2022 given the rising US real rates differential, weakening current account balance and PPP over-valuation. However, dollar is a high momentum currency, and the current strength can persist for some more time.

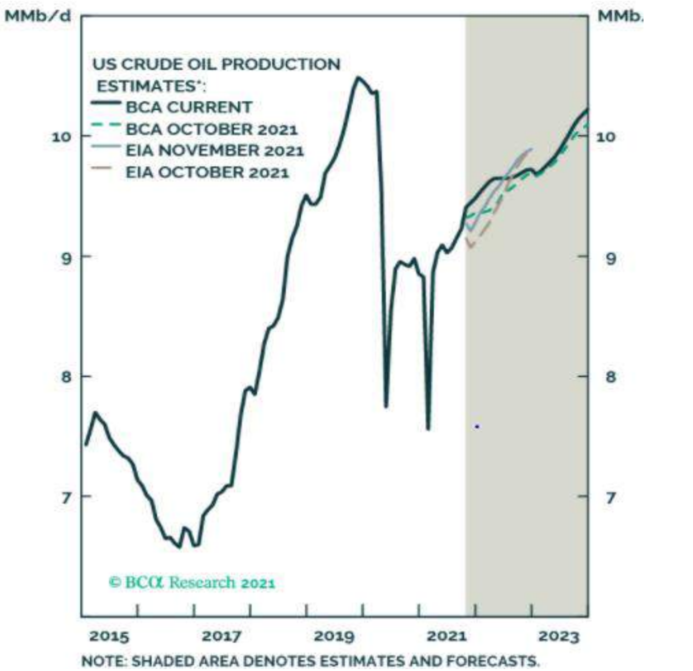
Source: BCA

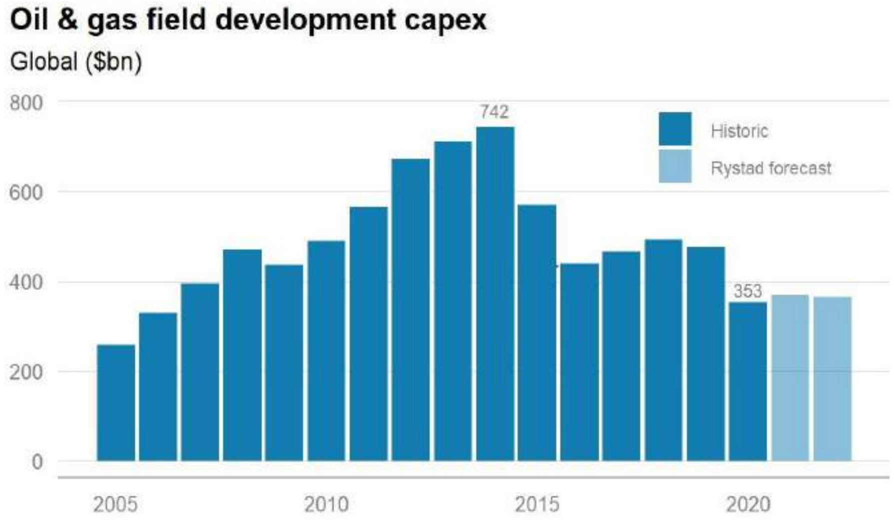
Crude price can stay elevated on OPEC-2 supply management and lower capex

Supply management and rising demand likely to keep supply demand balance in negative



OPEC-2 and US shale output running well below pre-pandemic levels even as demand is fast normalising

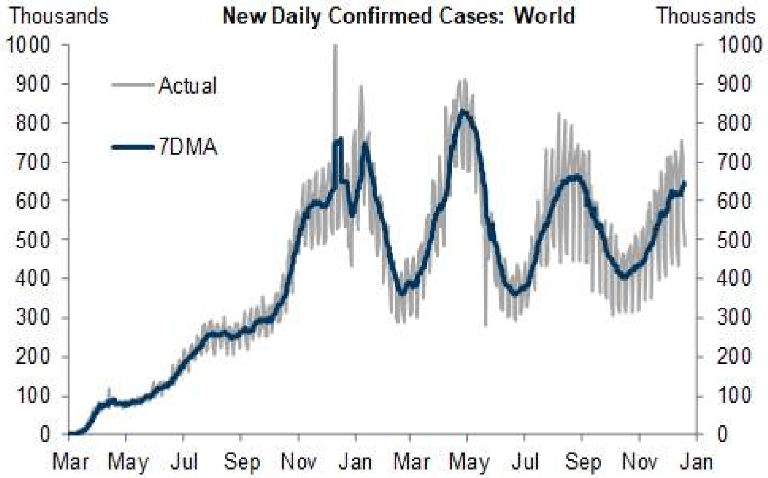


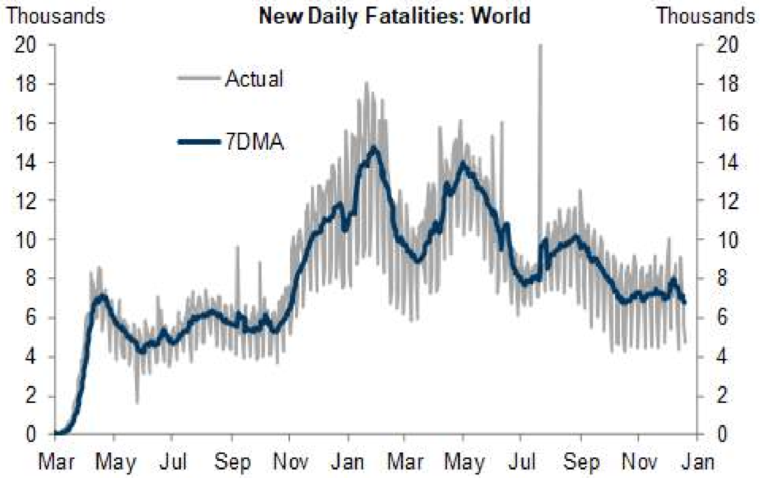


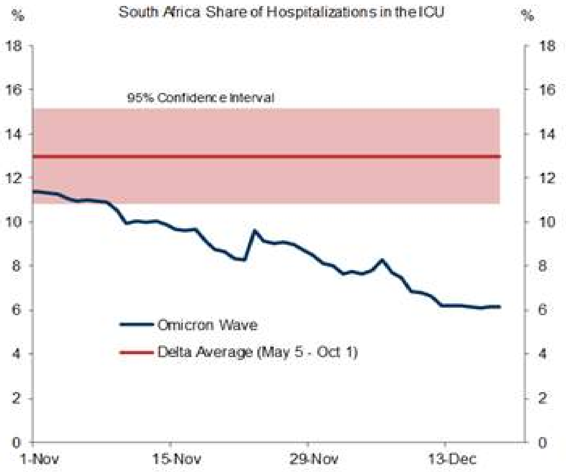
Supply discipline by OPEC-2, slow recovery of shale output and 7-8 years of low capex would constrain supply recovery and keep crude price elevated

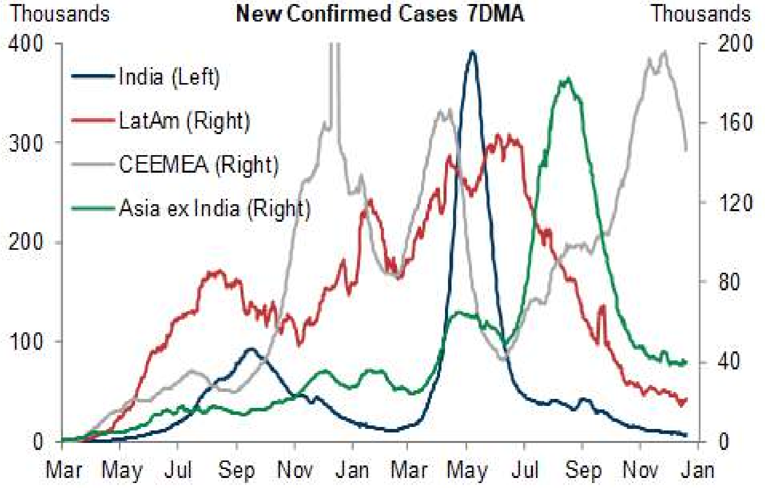
Source: BCA, Morgan Stanley Research

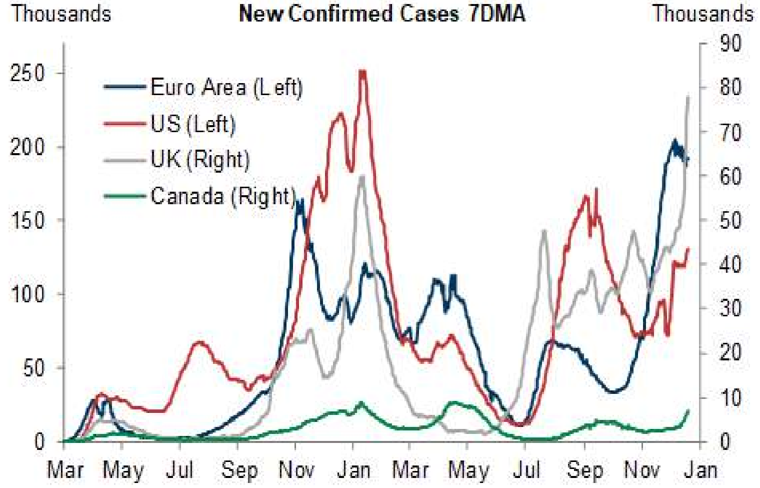
Omicron variant poses downside risks to growth

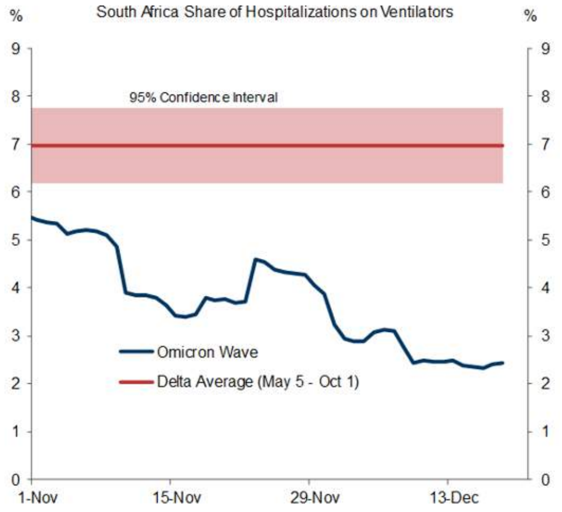












Source: GS

Omicron variant poses downside risks

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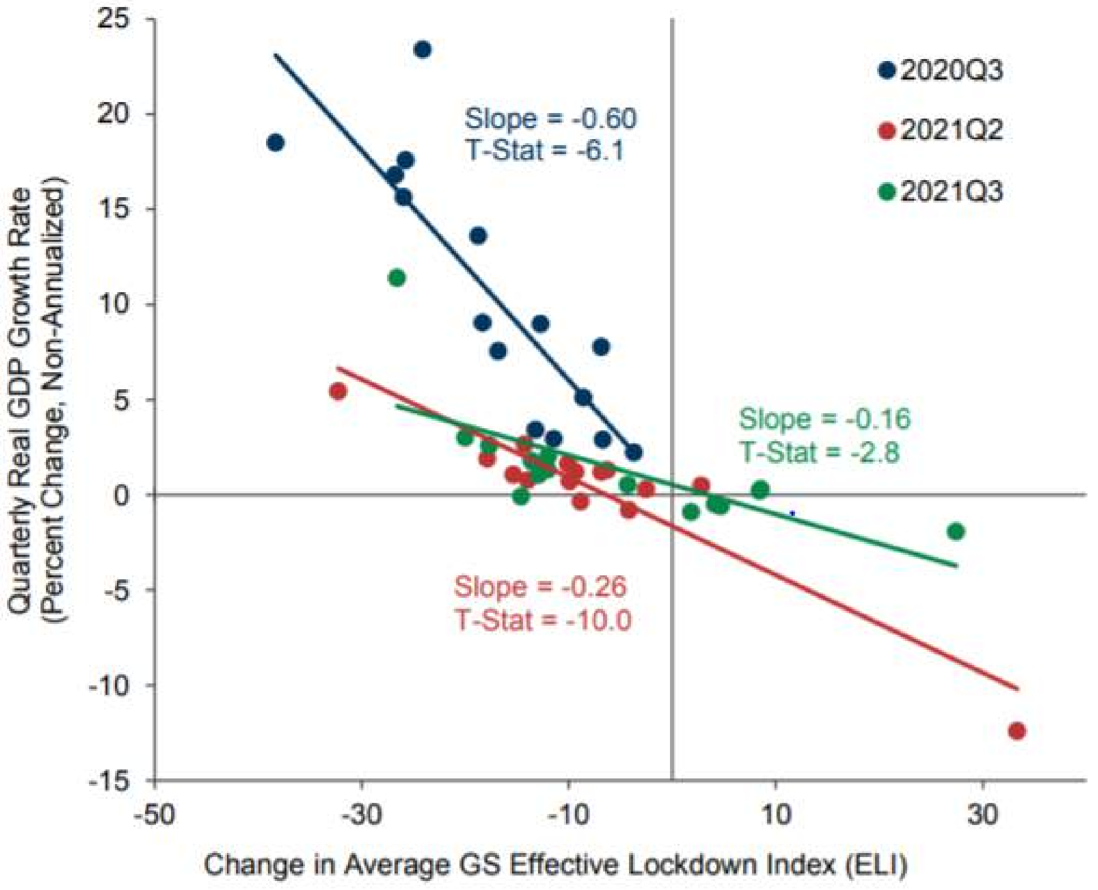
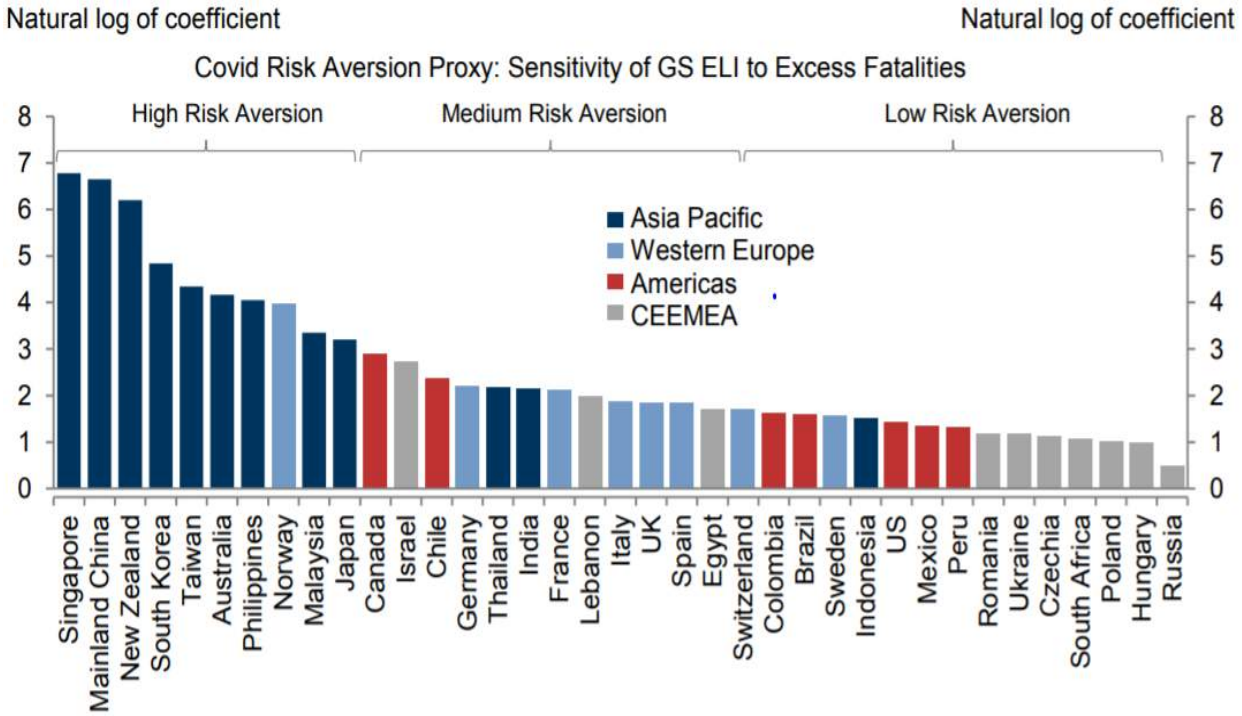
Economy's sensitivity to Covid is steadily falling, even though is there is a lot of divergence among economies in risk aversion. China's zero Covid policy is a risk to global growth and inflation outlook in 2022





Source: Jefferies

India

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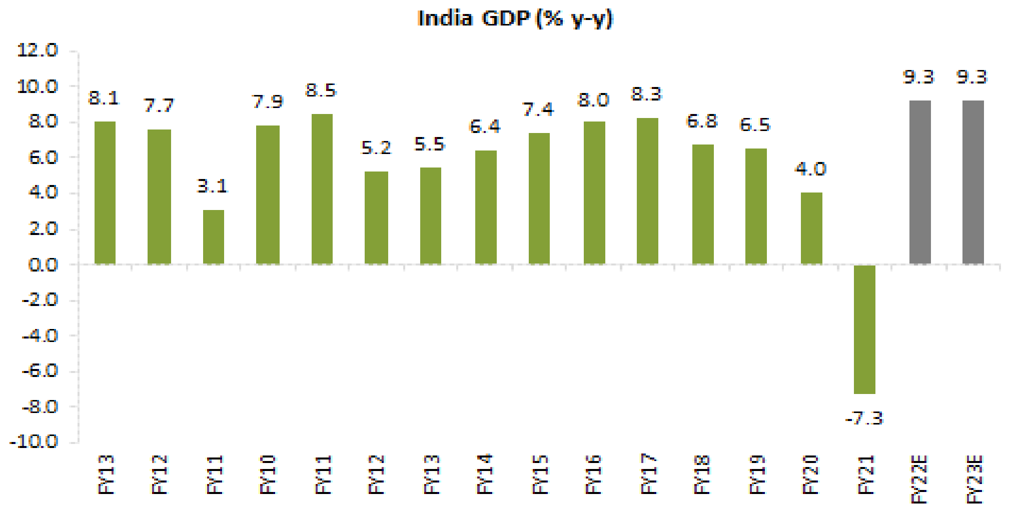
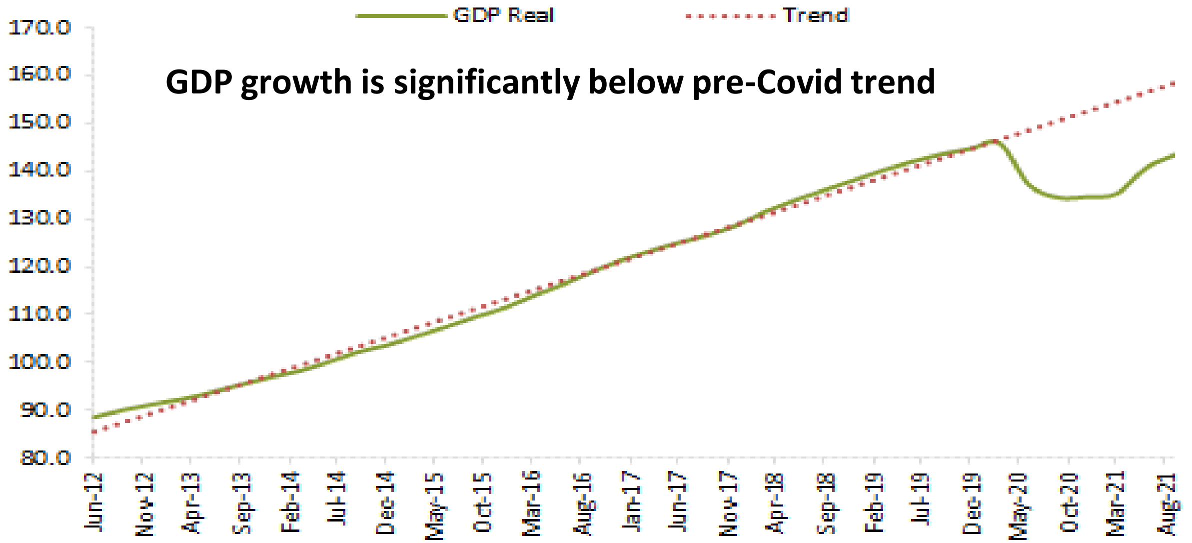
India: Recovery in growth, but significantly below trend



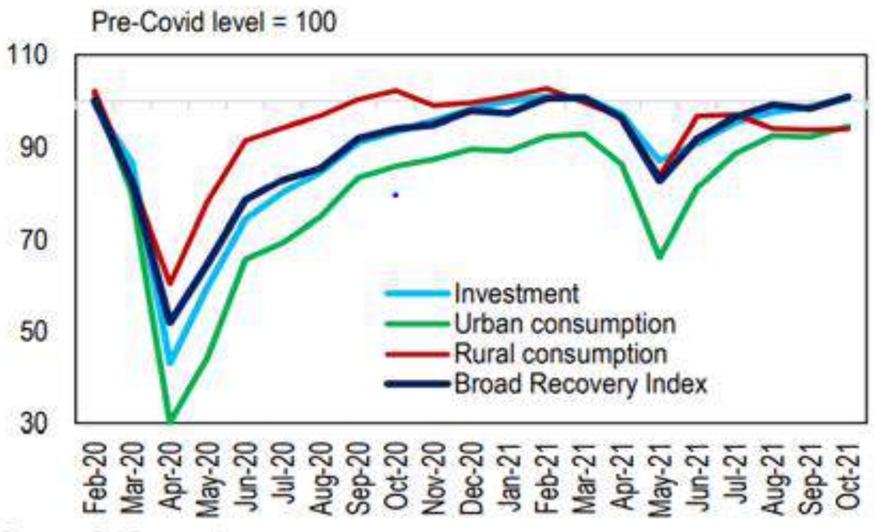


2yr CAGR	GDP (% y-y)	FCE	GFCE	PFCE	GFCF (% y-y)	Exports	Imports
09-2021	0.2	-3.0	-8.8	-1.8	0.8	8.3	7.5
06-2021	-4.7	-4.5	3.6	-6.1	-8.9	4.3	-2.7
03-2021	2.3	4.8	19.9	2.3	6.6	-0.4	4.6
12-2020	1.9	2.0	3.8	1.7	2.5	-4.5	-6.2
09-2020	-1.6	-3.7	-8.4	-2.7	-2.5	-1.7	-10.2
06-2020	-10.8	-7.6	7.1	-10.9	-22.2	-10.3	-19.6
03-2020	4.4	5.0	10.1	4.2	3.5	0.9	-1.0
12-2019	4.8	7.0	5.9	7.2	6.9	4.6	1.8
09-2019	5.5	7.9	8.6	7.8	7.6	5.4	7.6

We expect growth to be 9.25% both in FY22 and FY23, but corresponding run rate of growth is closer to 4% once you adjust for Covid base of FY22. We are witnessing steady economic recovery in India from the troughs of delta wave, but the recovery is far from complete, and it is a K shaped recovery with segments most impacted like trade, hotel, transport and other high contact services still running below pre-pandemic levels. Private final consumption expenditure and consumption sentiment survey have ben weak. However, recovery has moved much further in industrial sector, construction and exports.

Source: Citi, CEIC

India: Covid drag receding



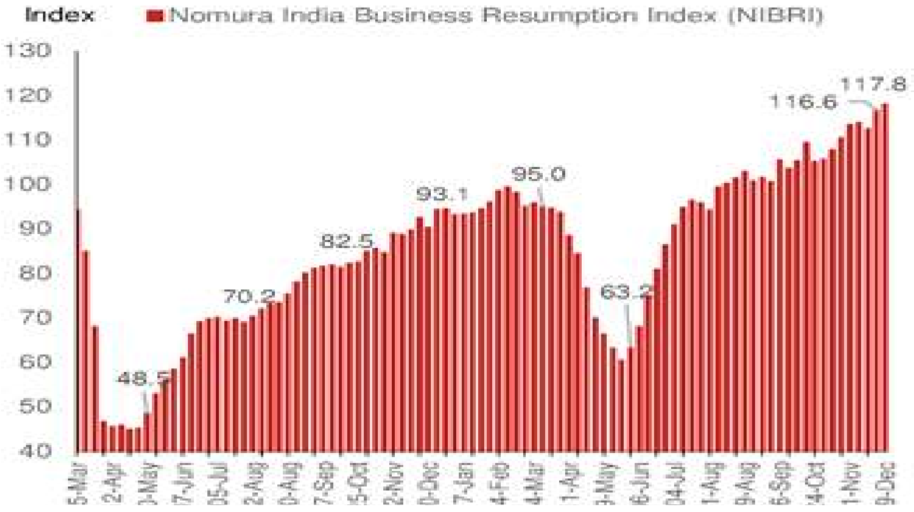
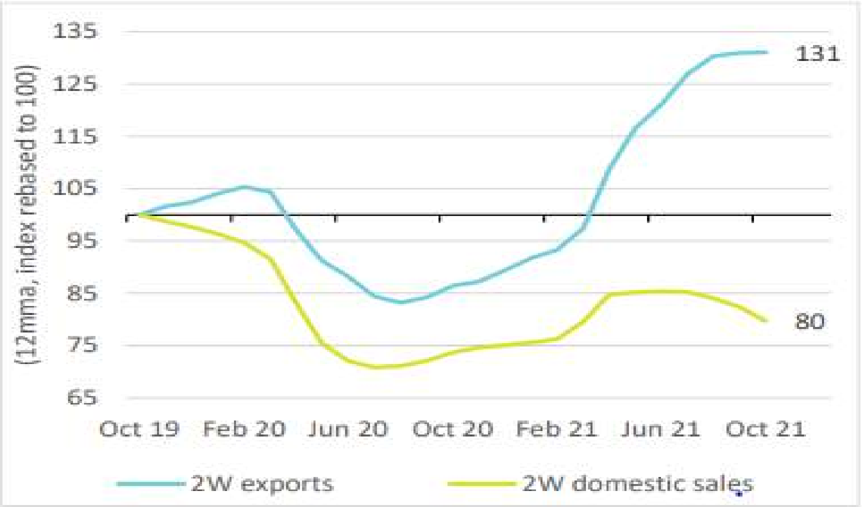
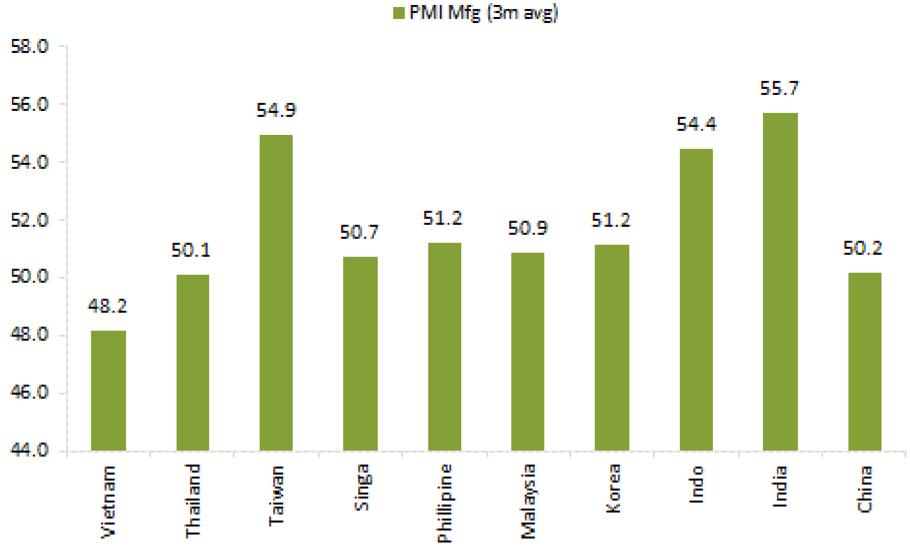


Exhibit 6: Exports have outpaced domestic demand





Source: Citi, Nomura, Edelweiss, Refinitiv

Consumer confidence remains low

Aditya Birla Sun Life AMC Ltd.
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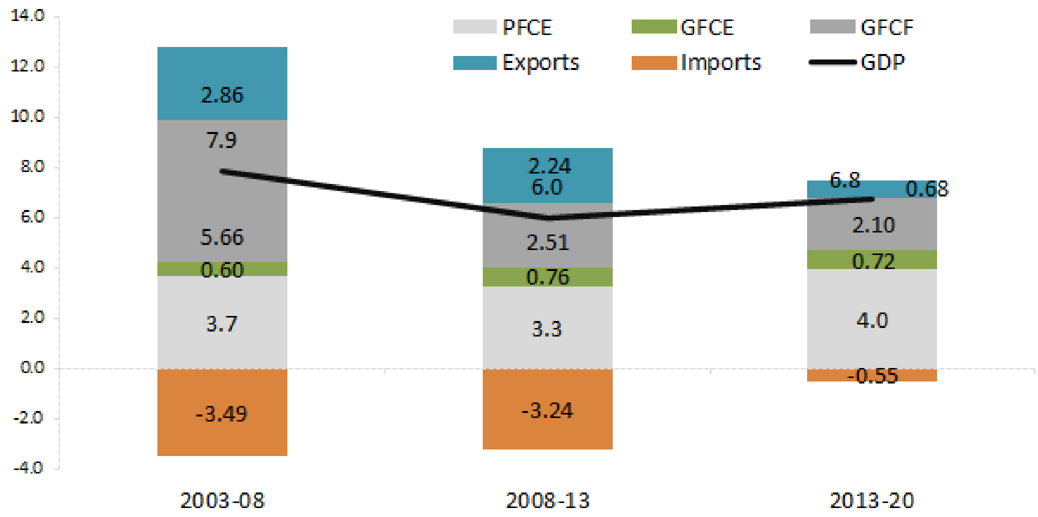
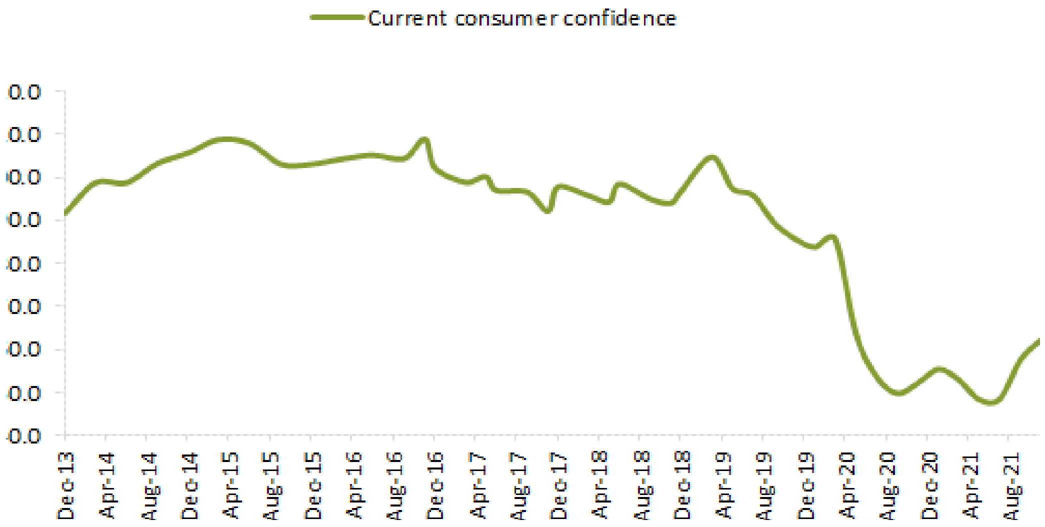
ADITYA BIRLA CAPITAL

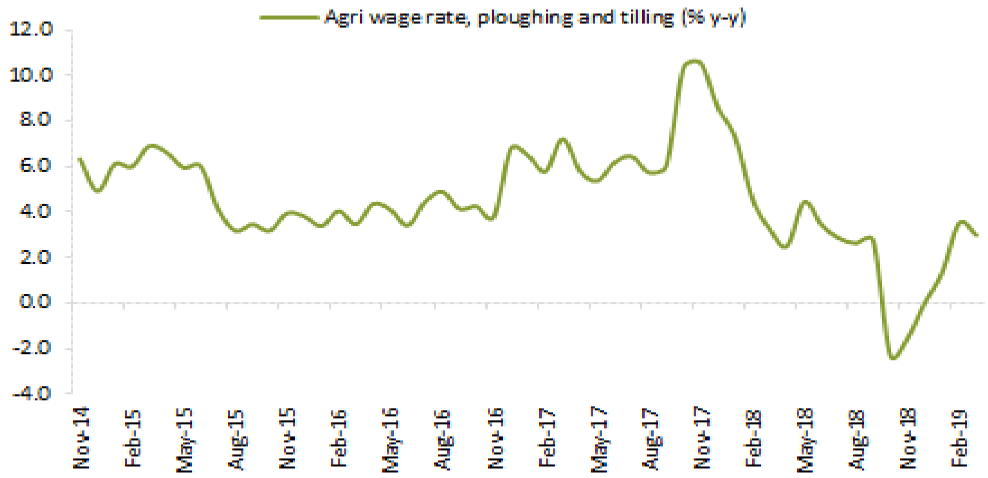
GDP growth contribution (%)



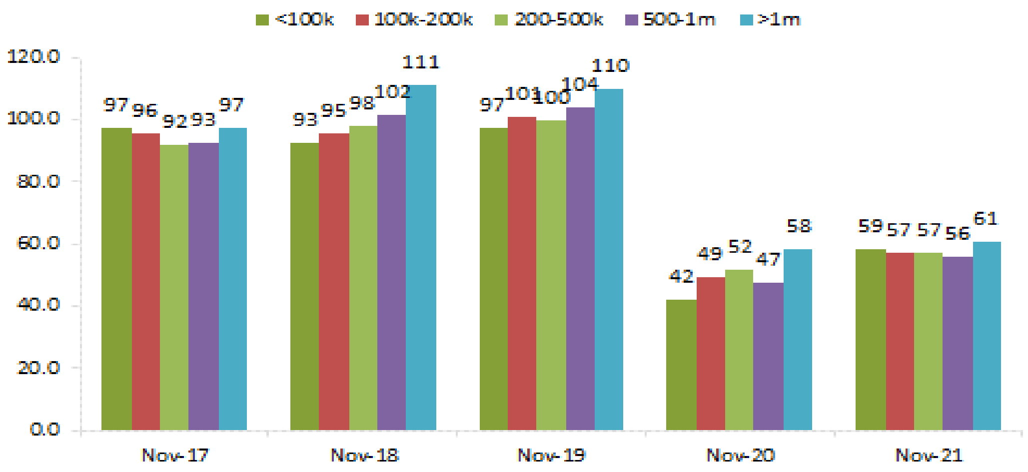
Consumer confidence very weak



Private consumption has been the key growth driver in pre-Covid years. Weakness in consumption augurs ill for near term growth momentum.



Index of consumer sentiments across income groups



Source: CEIC, CMIE

Conditions good for a capex revival, but low capacity utilization will delay recovery

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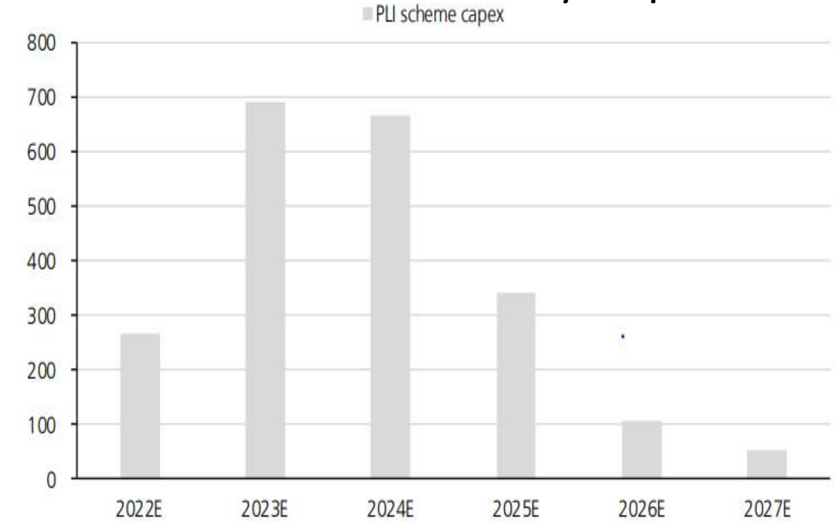
PLI scheme can contribute considerably to capex



Industries have deleveraged

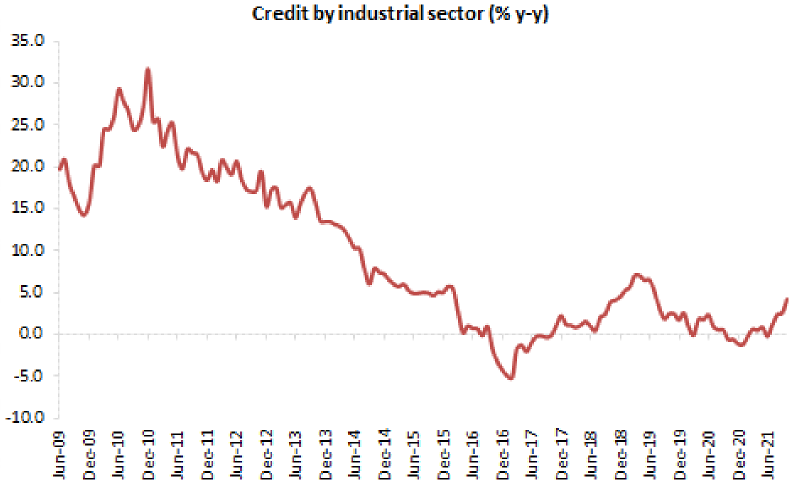


Figure 3: Substantial fund-raising to help in growth revival

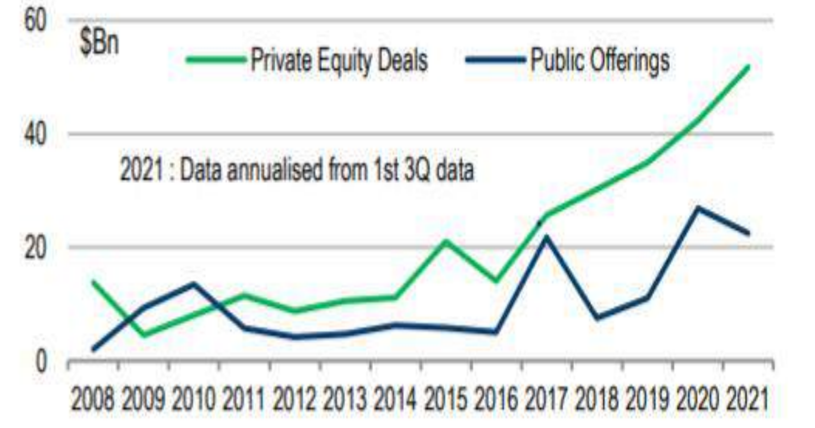


Figure 29. Rising NPAs had stretched bank balance sheets causing funding squeeze, but stressed assets have fallen now

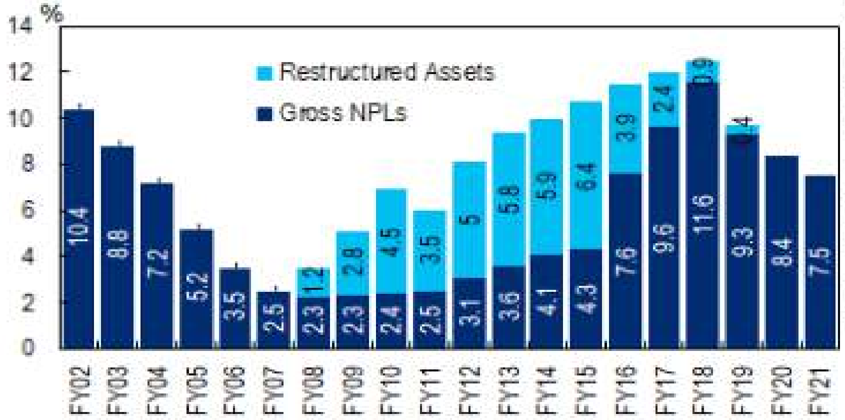
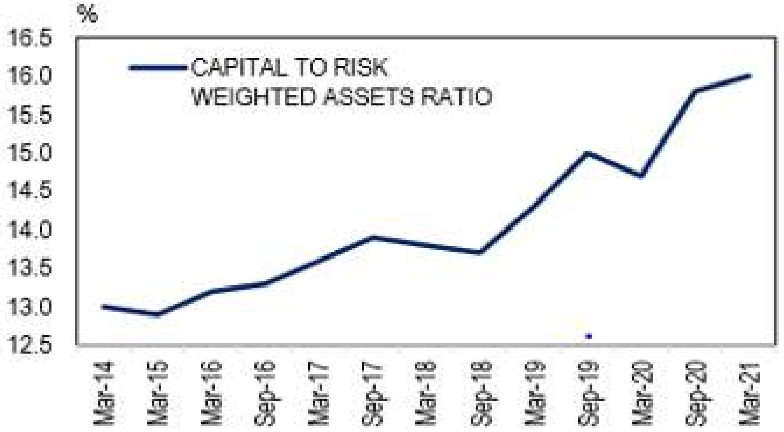
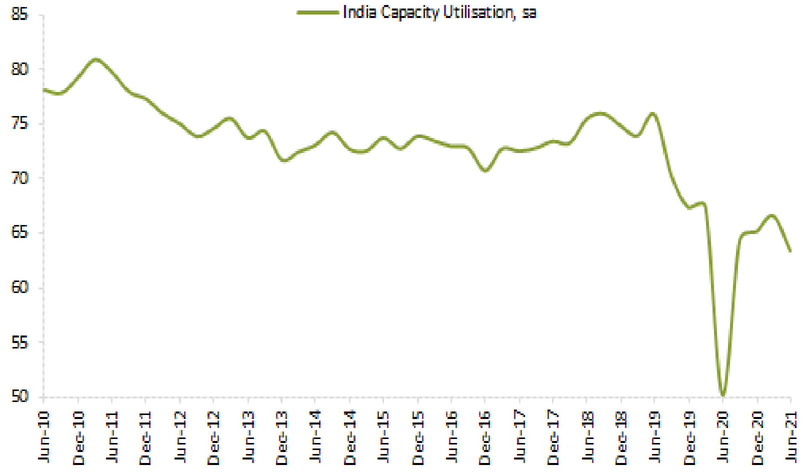


Figure 30. Capital adequacy ratio





Source: Citi, Kotak, Credit Suisse

India: EBITDA growth of listed corporates still below pre-COVID levels

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ADITYA BIRLA CAPITAL

Performance of 2,716 listed non-government non-financial companies

EBITDA in Crores					2 Year CAGR			
Quarter	All	Ex Telecom	Ex Telecom and Metals	Ex Tele, mining and Metals	All	Ex Telecom	Ex Telecom and Metals	Ex Tele, mining and Metals
Q1FY19	1,73,009	1,68,248	1,45,504	1,43,104	7.99%	10.54%	8.22%	8.24%
Q2FY19	1,78,018	1,74,828	1,51,535	1,49,591	9.80%	12.93%	10.66%	10.95%
Q3FY19	1,71,980	1,68,874	1,47,349	1,40,425	8.24%	10.59%	10.16%	8.95%
Q4FY19	1,72,548	1,68,967	1,47,967	1,46,271	7.34%	8.91%	9.50%	13.60%
Q1FY20	1,77,885	1,72,878	1,53,452	1,52,020	13.96%	15.38%	15.45%	16.00%
Q2FY20	1,47,616	1,68,428	1,52,543	1,49,197	-1.84%	7.08%	8.38%	7.96%
Q3FY20	1,71,128	1,62,850	1,44,129	1,43,912	5.71%	5.38%	6.59%	7.63%
Q4FY20	1,55,931	1,45,706	1,26,712	1,26,712	-2.89%	-4.39%	-3.97%	-2.24%
Q1FY21	1,23,726	1,12,022	95,961	94,812	-15.43%	-18.40%	-18.79%	-18.60%
Q2FY21	1,86,518	1,74,343	1,50,453	1,48,695	2.36%	-0.14%	-0.36%	-0.30%
Q3FY21	2,15,878	2,03,424	1,65,336	1,63,661	12.04%	9.75%	5.93%	7.96%
Q4FY21	2,16,920	2,03,137	1,60,603	1,59,304	12.12%	9.65%	4.18%	4.36%
Q1FY22	2,08,136	1,94,963	1,47,714	1,46,049	8.17%	6.20%	-1.89%	-1.98%
Q2FY22	2,37,657	2,24,665	1,73,644	1,71,667	26.88%	15.49%	6.69%	7.27%
	37,38,161	35,81,481	30,64,994	30,08,521				

Source: RBI, ABSLAMC Research

Real estate revival can be key positive

Real estate has been key reason of Capex slowdown since 2012

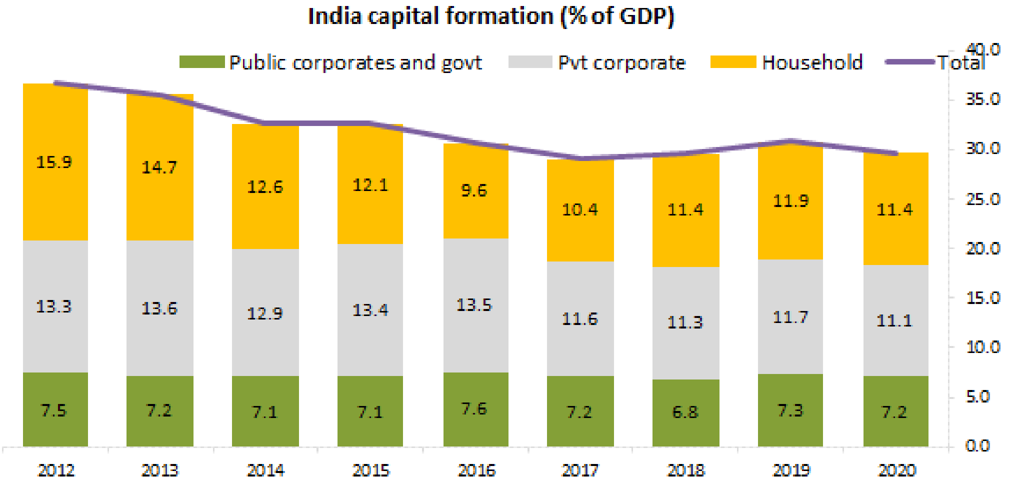


Exhibit 144: Mortgage rates are at all-time low

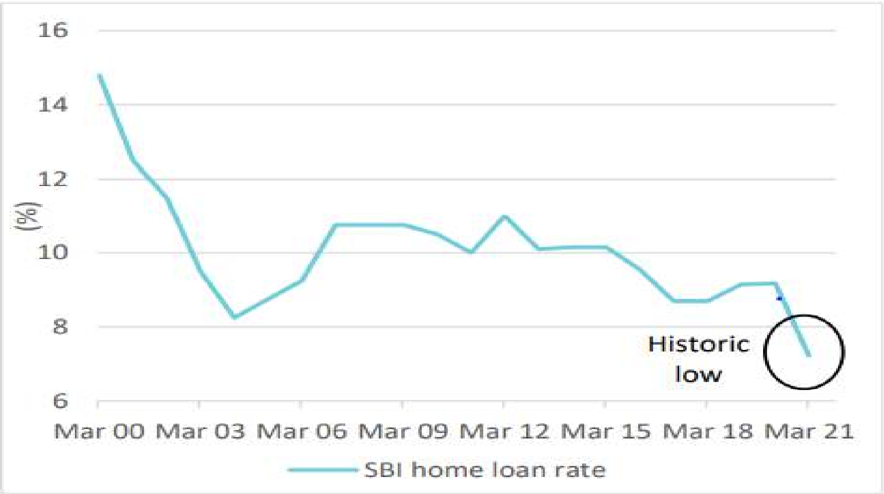
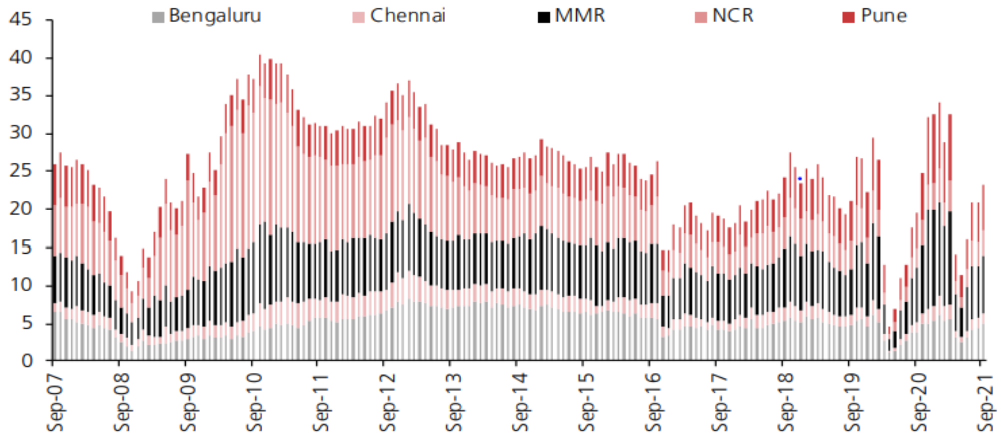
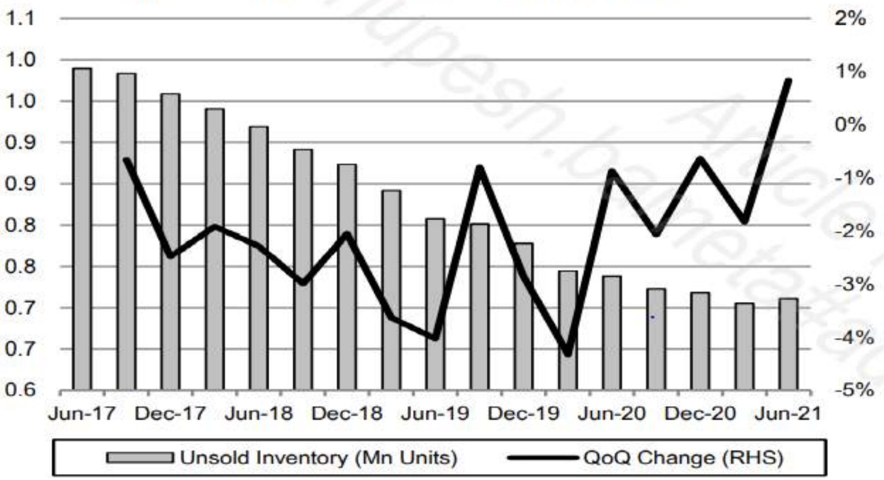


Exhibit 18: Residential real estate sales volume have increased recently
Absorption trend, residential, calendar year-ends (mn sq. ft)



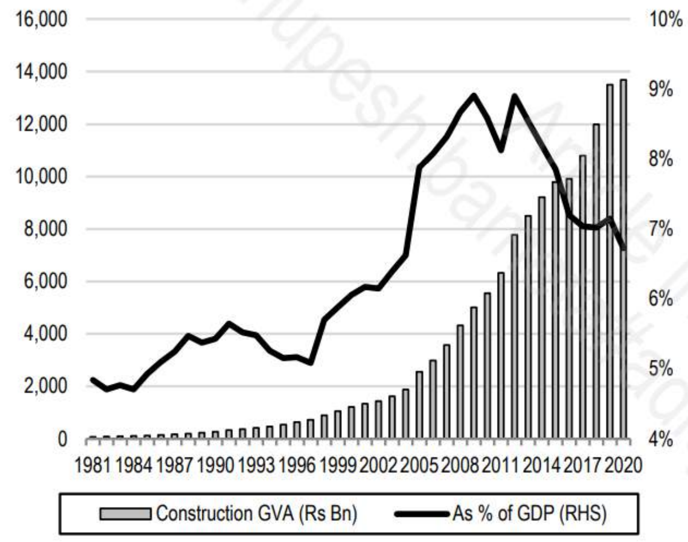
Unsold inventory in Top 8 cities down 30%



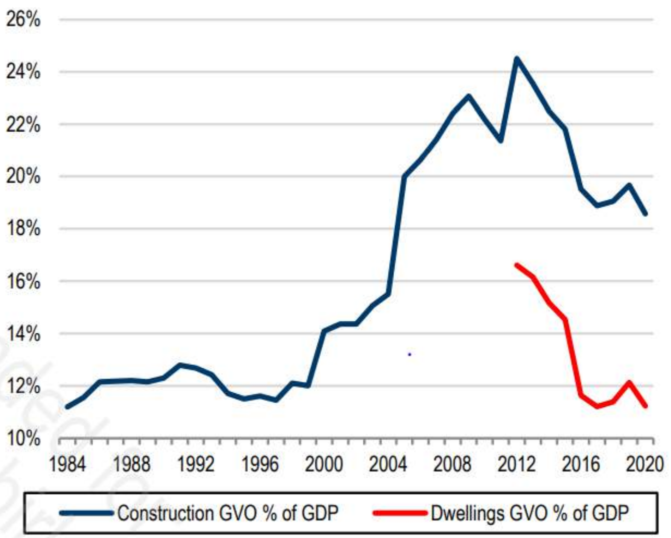
Source: Kotak, Credit Suisse, JP Morgan, Refinitiv

India: Housing sector revival can add significantly to growth momentum

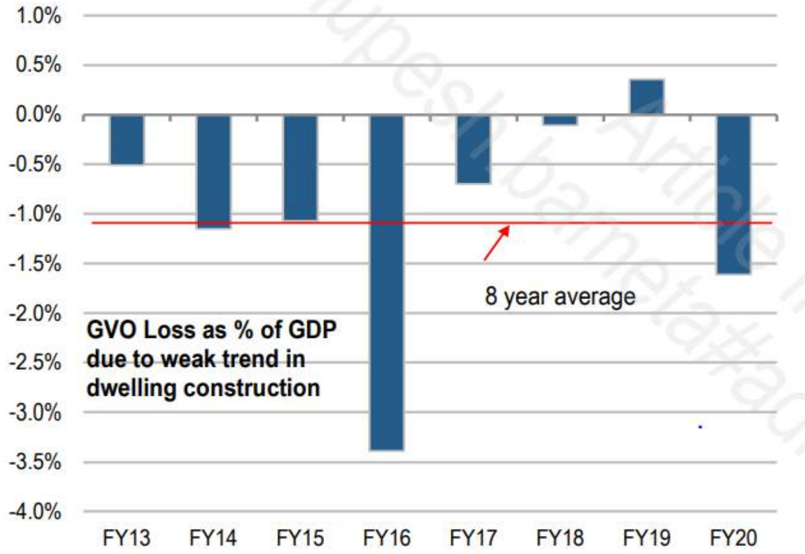
Construction GVA as % of GDP slowed FY12-20



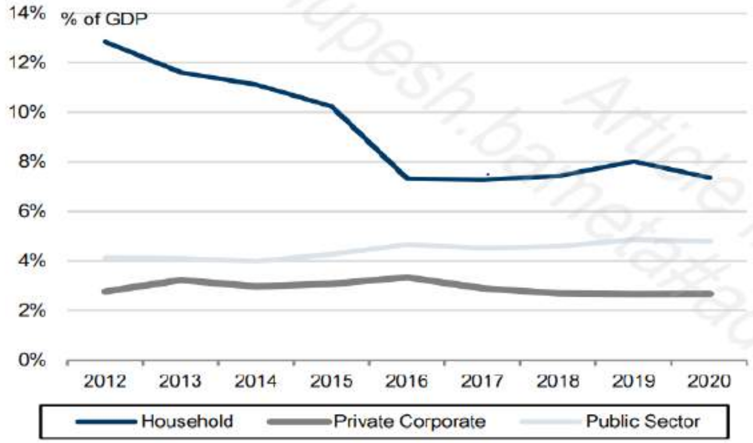
Construction GVO as % of GDP fell 5pp due to dwellings



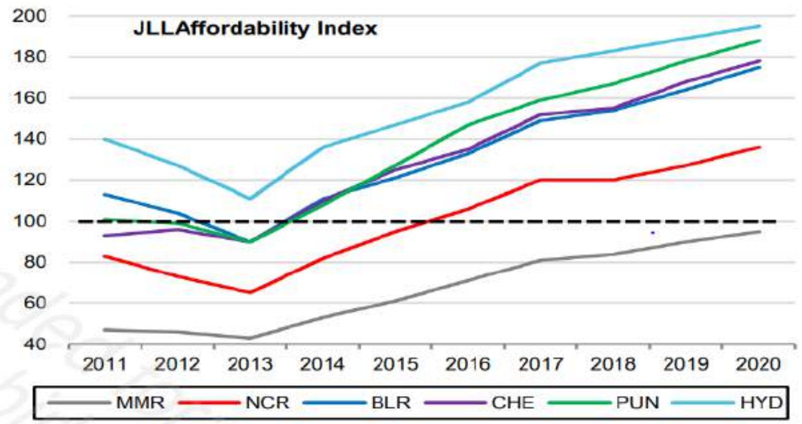
Dwelling GVO loss vs trend as % of GDP



Household capex on dwellings fell as % of GDP



Affordability has improved across cities (JLL)

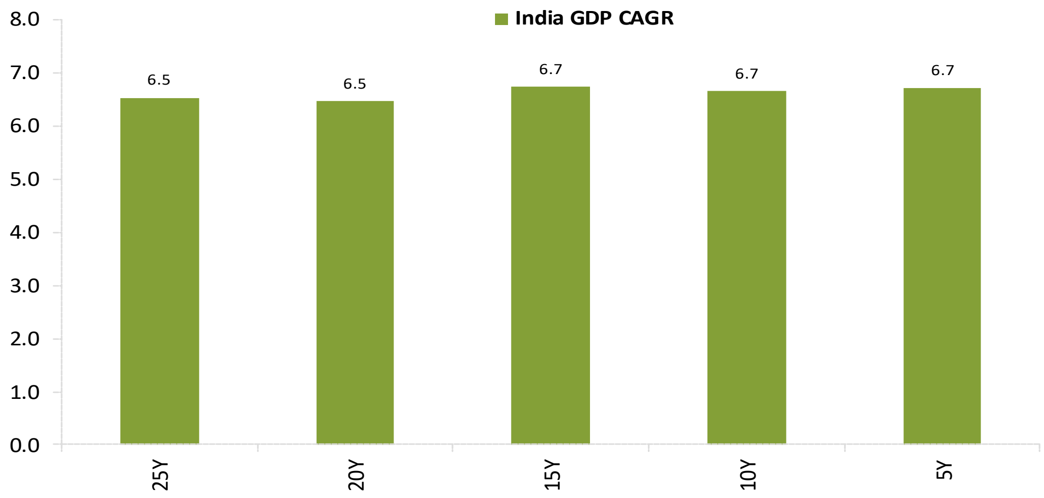


Housing sector contribution to overall GDP is much larger if we include the multiple linkages. Housing GVO as % of GDP is about 20%.

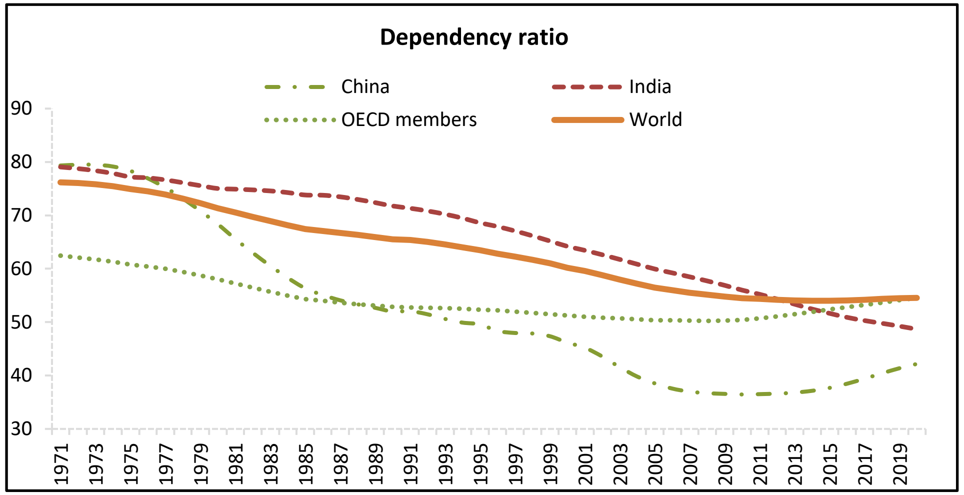
Source: Credit Suisse

Long term growth story remains bullish-1

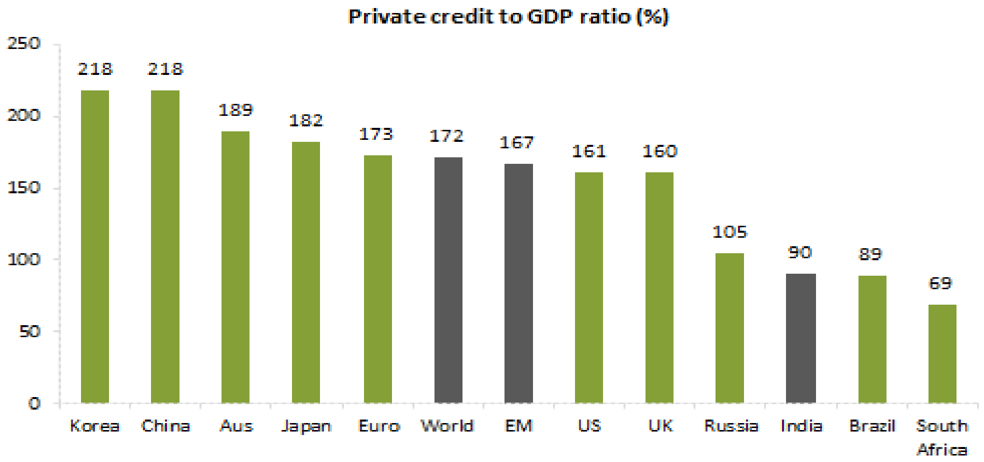
India CAGR growth pre-Covid: growth has been remarkably stable



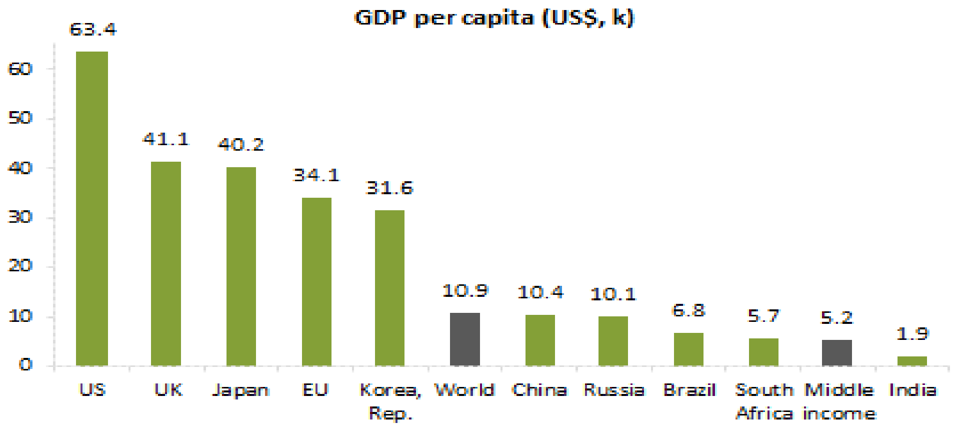
Demographic dividend in full bloom



India's debt level is still low and there is substantial room to leverage



India still low-income country and far away from 'middle income trap



India's long term growth factors remains strong. Our "natural growth momentum" since the economic reforms have been pretty steady at ~6.5%, we will stay in the best phase of demographic dividend for next few decades, our debt levels are low, and we are far away from middle income trap.

Source: Bloomberg, ABSLAMC Research

Long term growth story remains bullish-2

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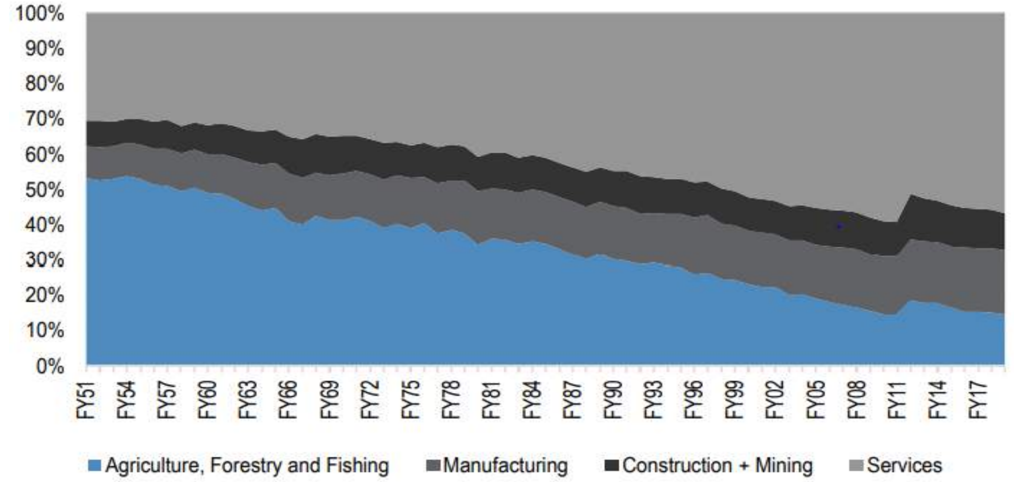
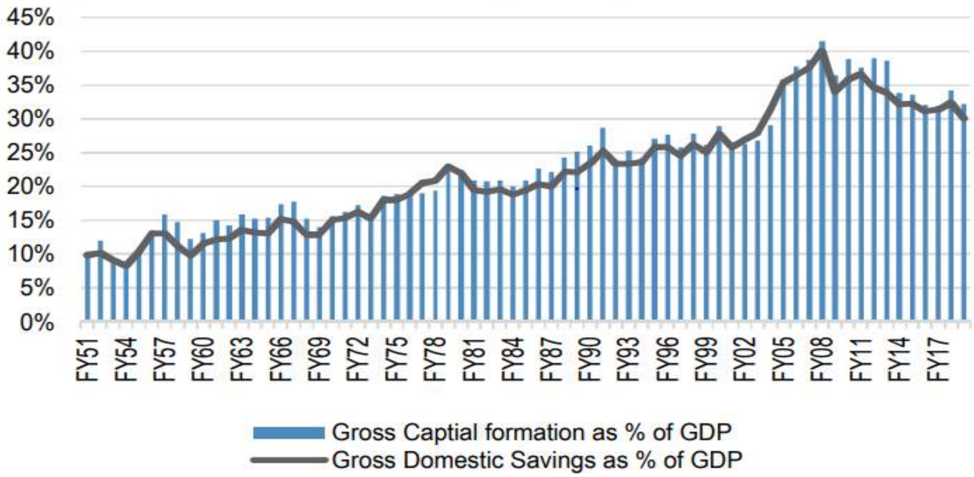
Shift from low productivity agri to industries and services



High savings and capital formation



Rising labour productivity with workers shifting out from agriculture, high savings rate, and rising education levels is a long term structural growth positive.

Figure 39: India - Per capita consumption (USD) – Education. Rapid increase since 2010

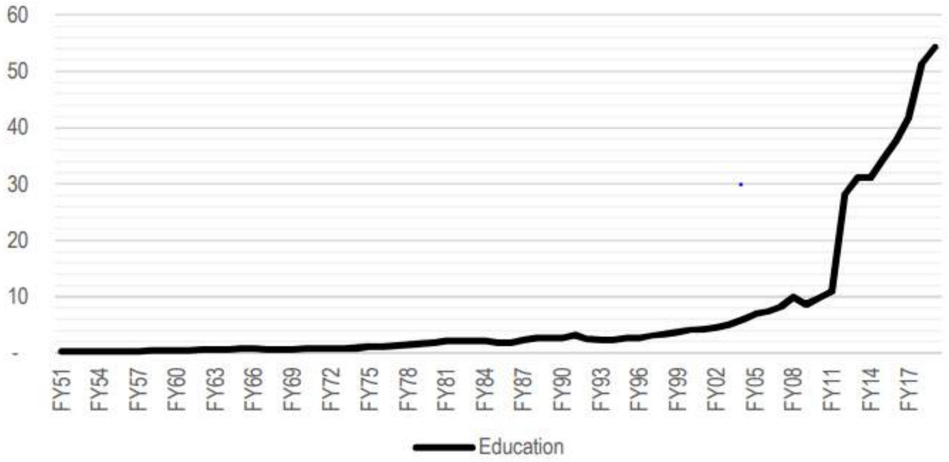
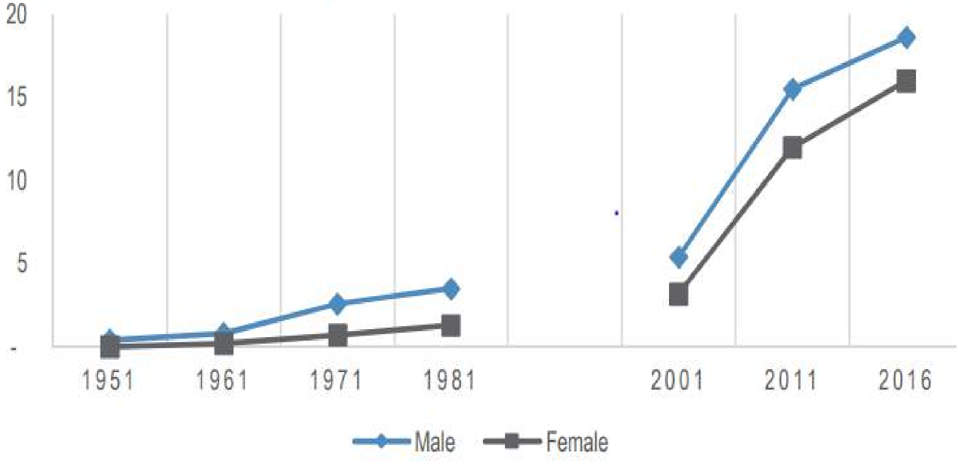


Figure 94: Number between ages 15-24 enrolled in higher education (post Grade XII). The proportion of this cohort in college has increased from 4% in 2001 to 14% in 2016

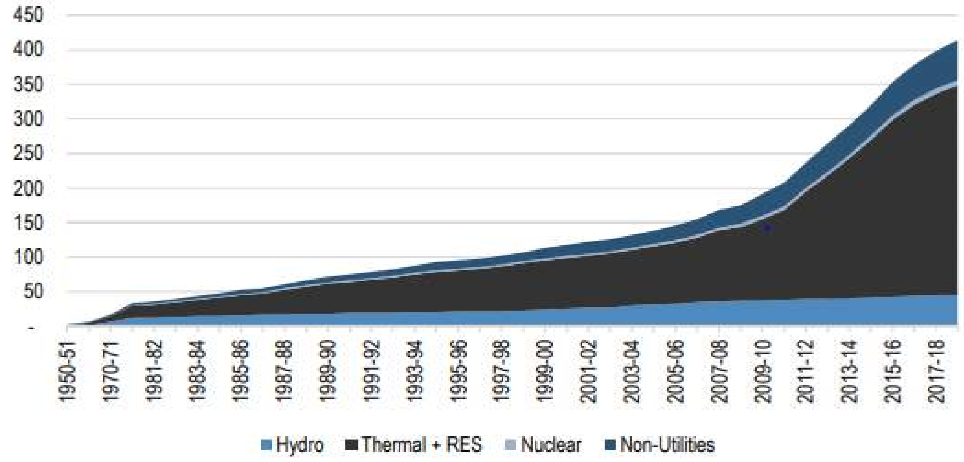


Source: Bloomberg, ABSLAMC Research

Long term growth story remains bullish-3

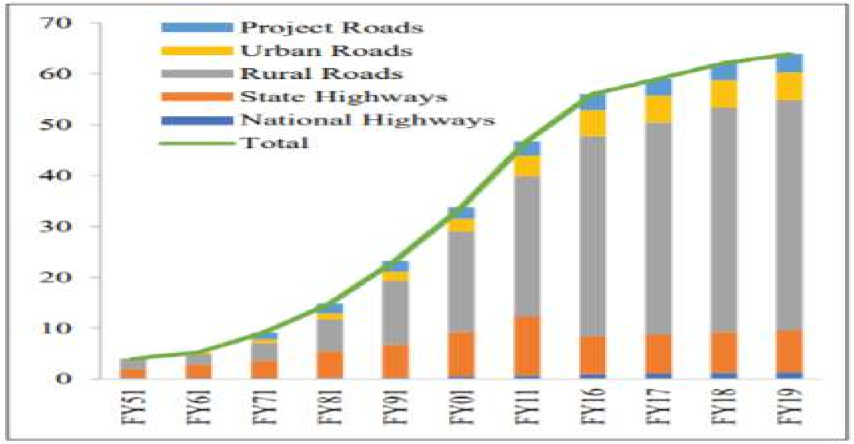
Figure 111: India's Doing Business Ranks have improved steadily

Figure 85: Total installed power capacity in India has increased rapidly over the last 10 years

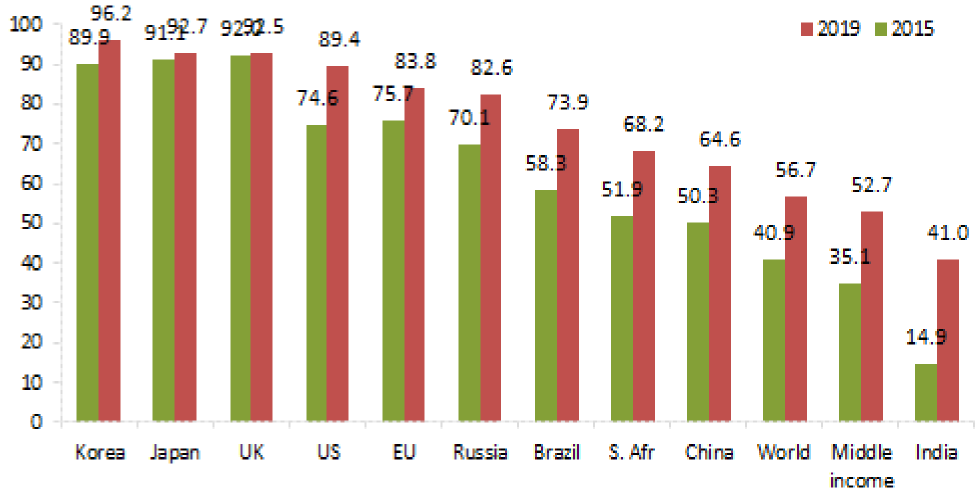


Rising power capacity, improving business confidence, rising road network and rising internet penetration should all increase per capita productivity and entrepreneurship.

Figure 26: Road Network in India (Lakh Km)



Internet Penetration (% of population)



Source: Bloomberg, ABSLAMC Research

Rates remain very low....

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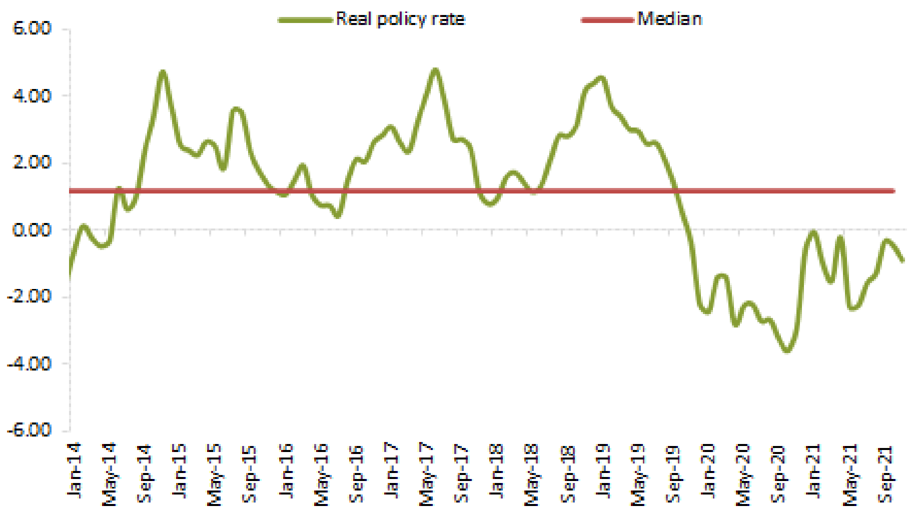
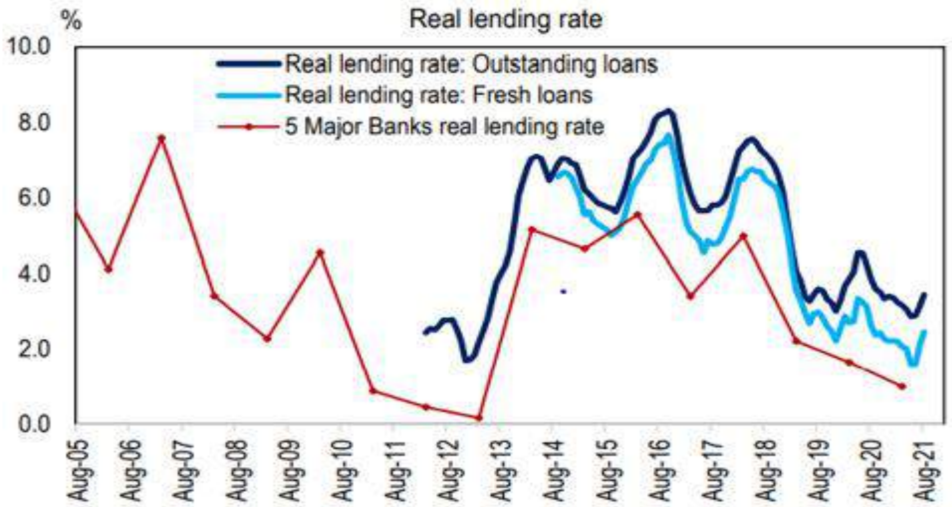
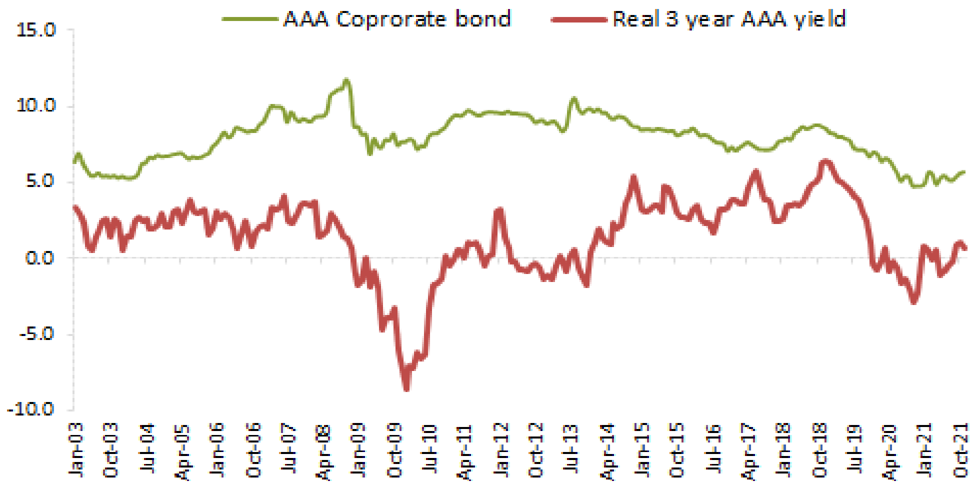
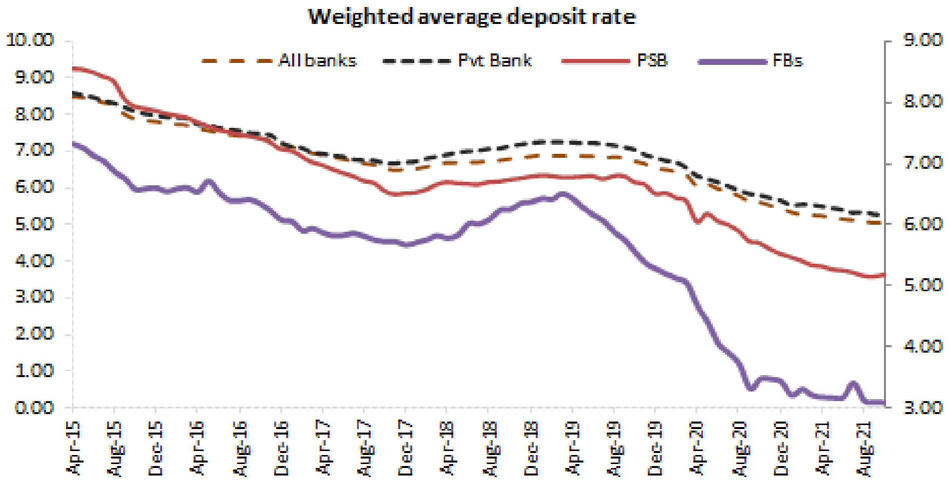


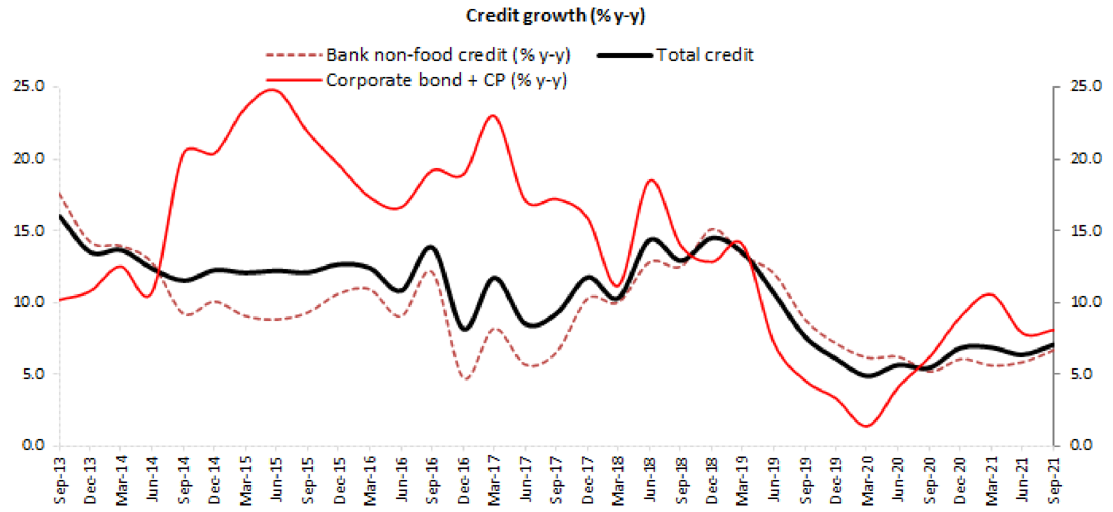






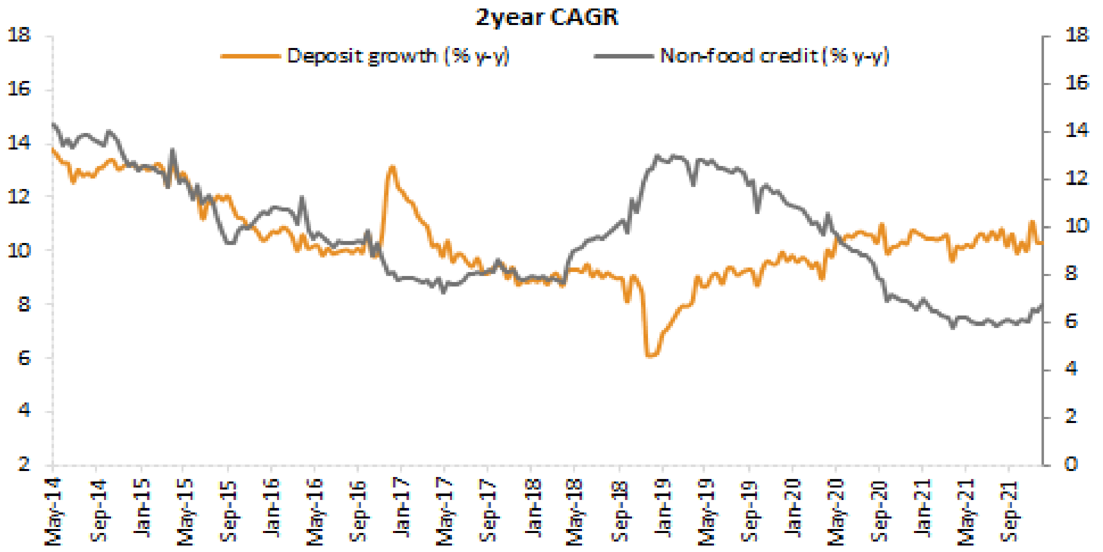
Source: Citi, Credit Suisse, Refinitv

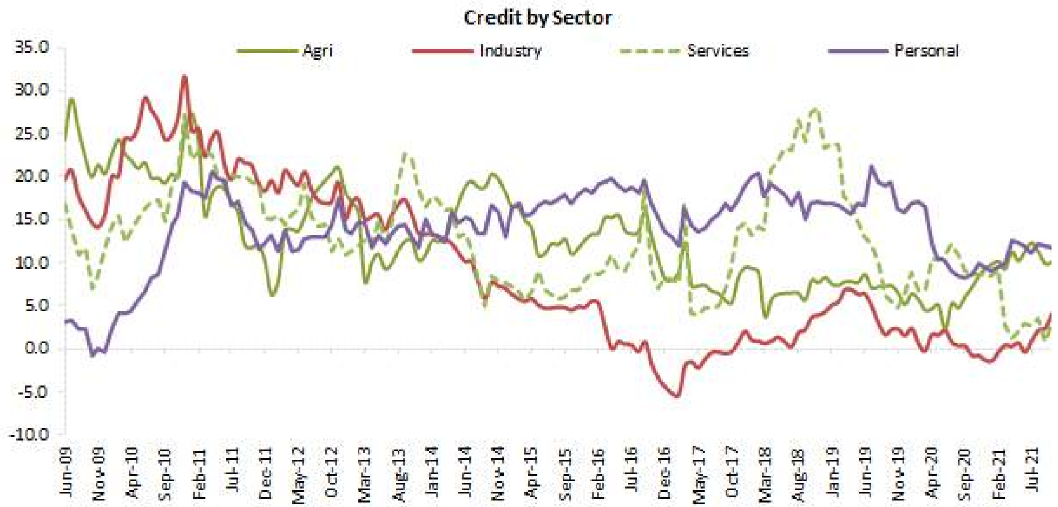
... but credit demand has so far been muted



Corporate bond issuances have been low

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Apri	84,807	41,079	63,819	66,399	70,064	54,639	32,010
May	20,692	59,801	33,389	10,539	43,577	84,573	21,242
Jun	36,125	33,576	75,337	23,733	49,072	70,214	42,051
Jul	27,920	36,774	49,033	31,952	46,082	47,962	30,081
Aug	46,564	71,165	51,552	36,916	40,309	58,419	49,848
Sep	26,612	67,952	50,821	31,802	48,629	64,389	92,727
Oct	43,931	70,396	44,146	31,894	47,318	62,331	46,845
Nov	24,618	38,645	50,855	55,215	48,732	45,545	47,654
Dec	30,152	59,587	41,108	84,925	56,158	88,130	
Jan	39,393	45,957	27,703	83,587	69,296	55,624	
Feb	33,810	30,151	46,467	39,298	80,058	45,685	
Mar	43,450	85,633	64,916	1,14,057	75,409	94,330	
Total	4,58,073	6,40,716	5,99,147	6,10,318	6,74,703	7,71,840	
1H	2,42,720	3,10,347	3,23,951	2,01,341	2,97,733	3,80,195	2,67,959





Source: Credit Suisse, Refinitv

Regulatory Changes impacting willingness to lend

There have been a slew of changes to regulations for various lenders that have impacted the willingness to lend.
Regulatory changes introduced in recent years include:

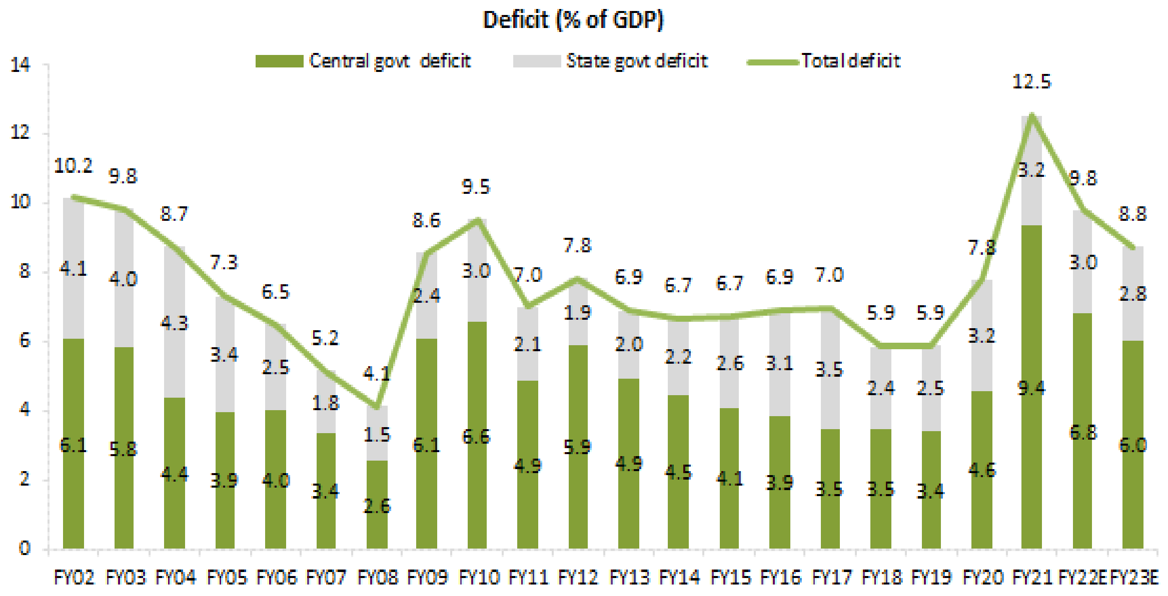
- **BANKS**
  - Prompt Corrective action framework imposed on many PSUs
  - Enquiries by CBC/CAG/ED/RBI on various loans gone bad and imprisonment of many senior bankers
  - Tighter capital to risk weighted asset ratio and liquidity norms
- **SHADOW BANKS**
  - Prompt Corrective Action Framework now applicable to NBFCs
  - NPA CLASSIFICATION – bad loan classification period tightened from 180 days to 90 days for small NBFCs
  - CBI/RBI/CAG/ED enquiries on certain promotors of shadow banks
  - Application of Expected Credit Loss model for provisioning and asset monitoring
- **MF INDUSTRY**
  - LIQUIDITY – Mandatory holdings of 10% in liquid assets (cash/T-Bills/G-Sec/repo)
  - CATEGORIZATION OF MF SCHEMES – MF house to have one scheme per category to streamline MF schemes
  - RISKOMETER – MF schemes are mandated to disclose risk classification
  - POTENTIAL RISK CLASS MATRIX – AMCs to disclose maximum credit risk, & interest rate risk any scheme can take
  - CLAWBACK RULES – Minimum 20% of employee compensation to be in MF units in which they have oversight
  - BINDING CONSTRAINTS – Some AMCs have additional internal binding constraints for each scheme which limit maneuverability

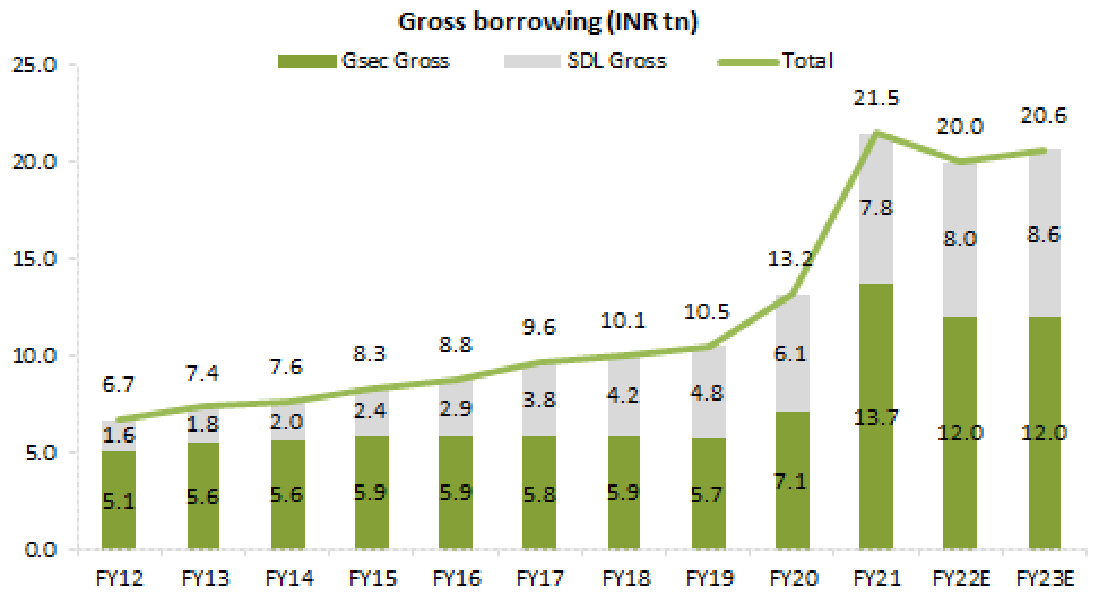
Additionally, on the borrowing side, there have been loss of willingness to take credit.

- Promotors have lost companies due to debt-fueled expansions and acquisitions under the IBC framework
- Some promotors have been brought in for questioning and imprisoned for alleged flouting of various norms
- Capacity utilization levels of various industries are still on lower levels that do not warrant a debt-fueled expansion as of now
- General level of debts in equity markets have gone down and higher debt impacts equity valuations of listed companies

Source: ABSLAMC research

Fiscal consolidation to be gradual, keeping borrowing elevated



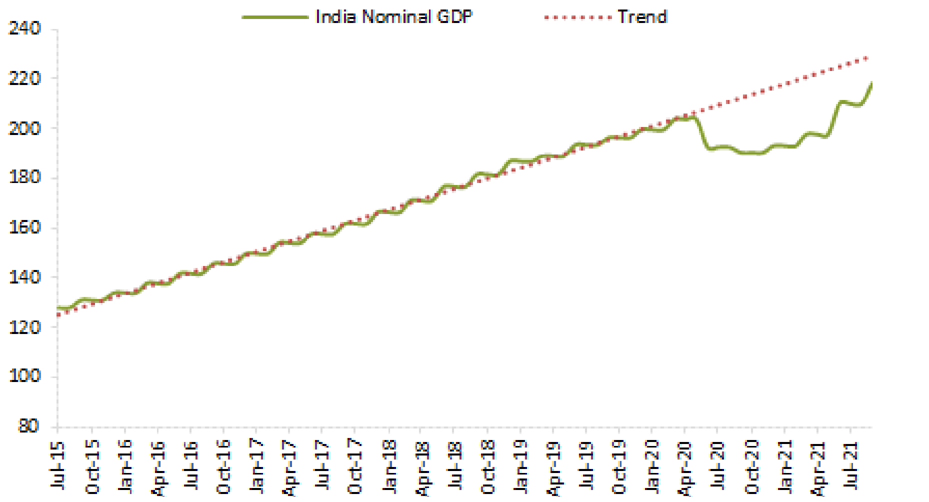


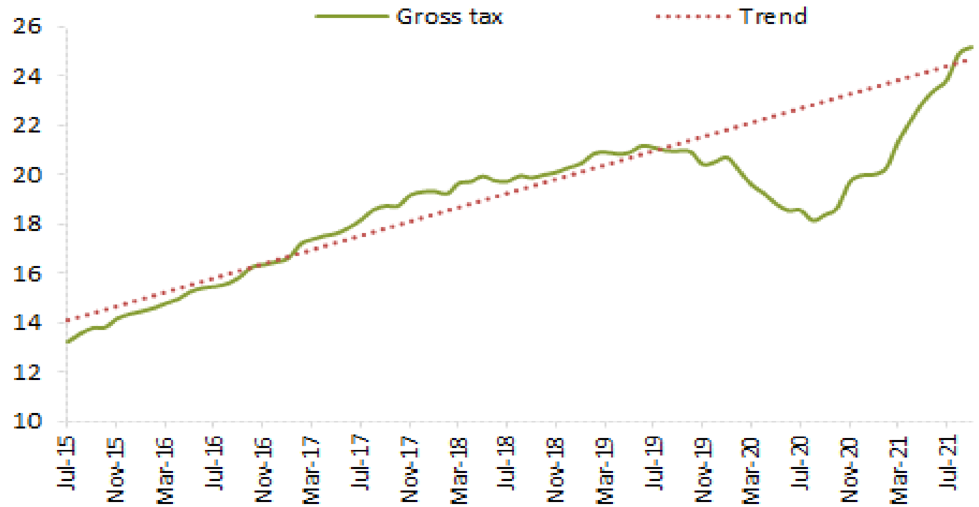
- We expect central and state fiscal deficit to decline to 6% and 2.8% in FY23 from 6.8/3% in FY22
- This is in line with government's own indication in last year's budget to reduce FD gradually to below 4.5% by FY26.
- Given the high maturities in FY23 and high financing of FD by off-market sources we think gross borrowing would be about 12tn for central and 8.6 tn for state governments.
- The supply is large given the likely pick-up in credit growth and lower RBI inclination to do OMOs.

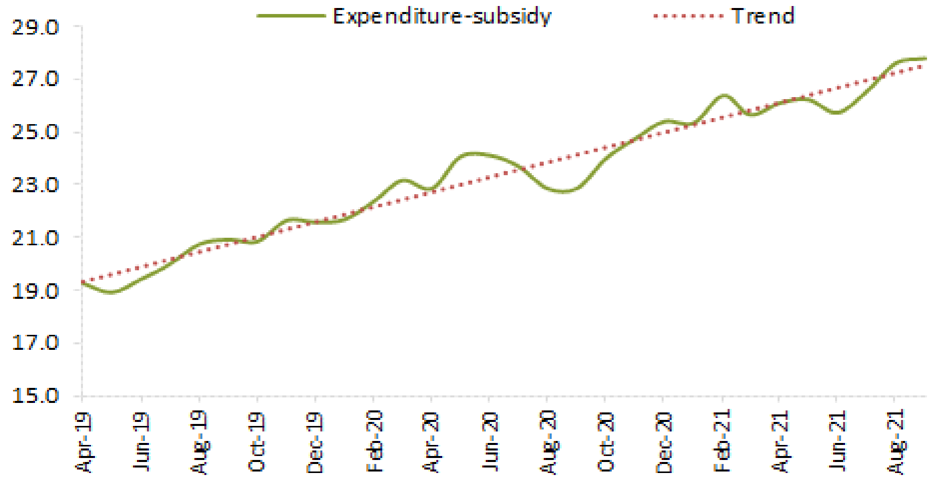
Source: CEIC, ABSLAMC research

Tax growth positive, fiscal stimulus largely on subsidies

While nominal growth is lower than the pre-Covid trend, tax growth







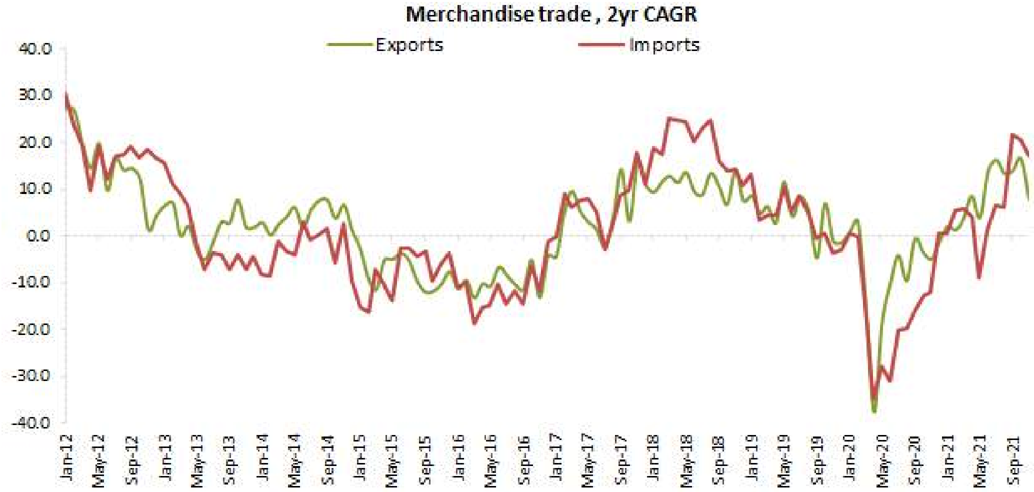
FY21	INR cr	% of GDP
Total extra FD	10,25,124	5.2
Revenue shortfall	3,88,832	2.0
Capital shortfall	1,67,341	0.8
Extra Expenditure	4,68,951	2.4
Extra subsidy	4,64,000	2.3

Tax growth has surprised on the upside and are running significantly ahead of budget expectations and in line with pre-Covid trend.

Another interesting point to note is that most of fiscal stimulus given in wake of Covid has largely been in subsidy payments and expenditure growth ex-subsidy is largely in line with pre-Covid rate

Source: CEIC, ABSLAMC research

Strong recovery in both exports and imports; trade deficit has shot up



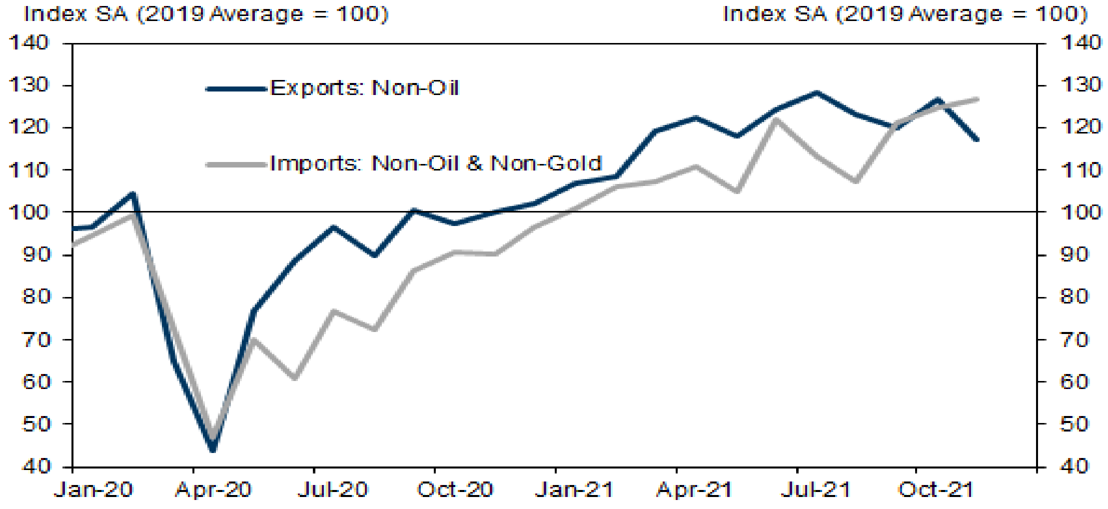
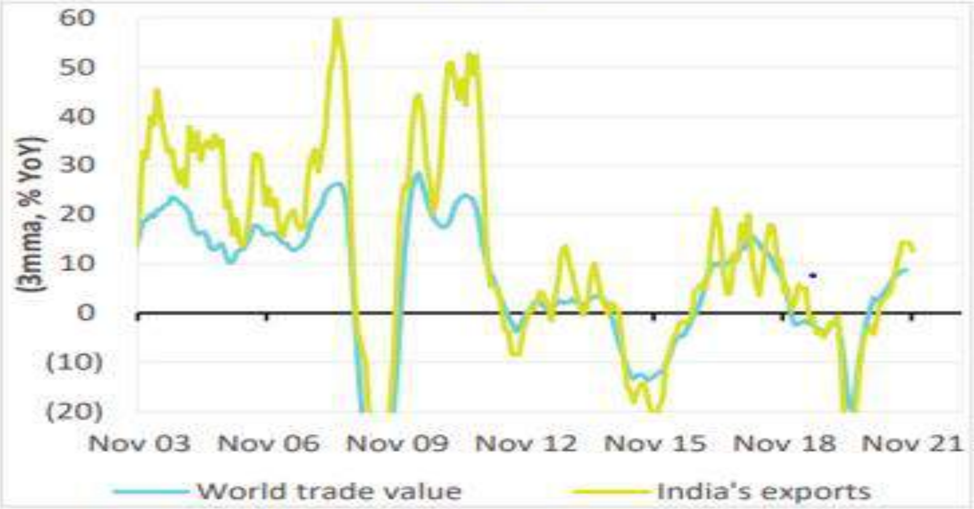
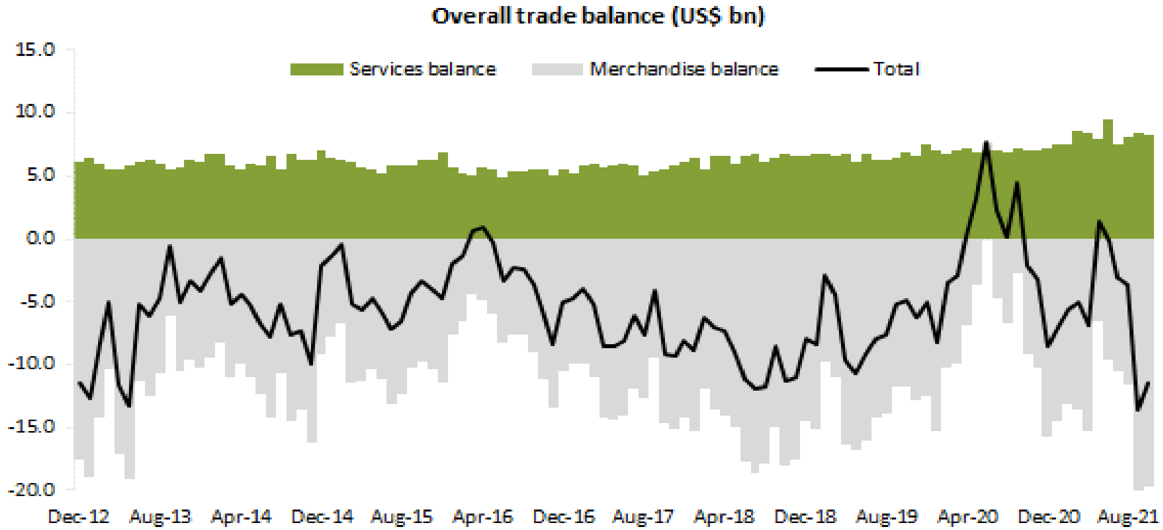


Exhibit 21: India's exports highly correlated with world trade...

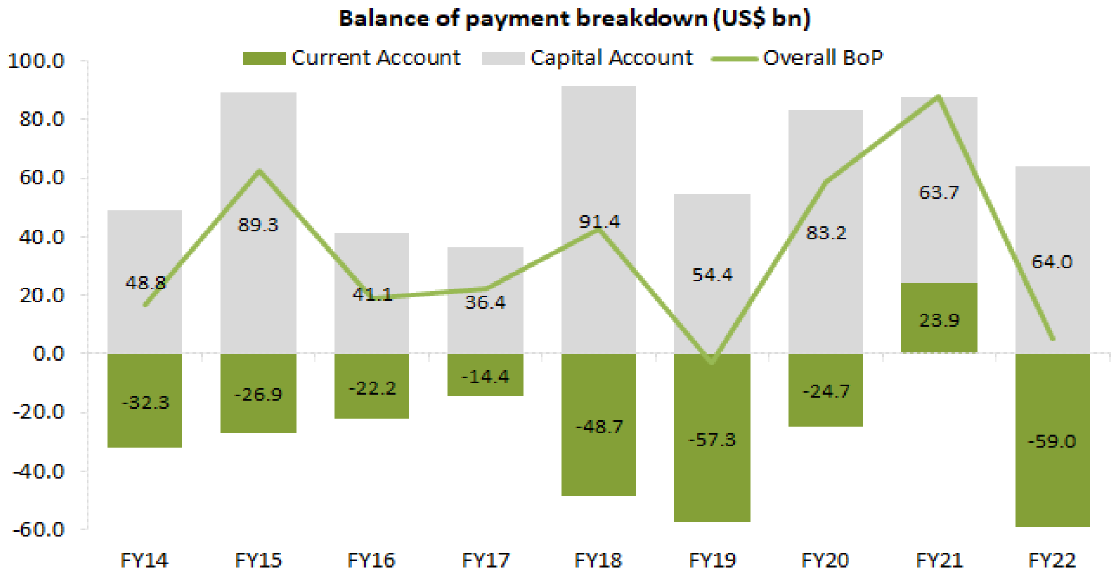




Source: Edelweiss, Citi, Credit Suisse, Refinitiv

Current account to normalise

US$ bn	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Trade account	-147.6	-144.9	-130.1	-112.4	-160.0	-180.3	-157.5	-102.2	-198.0	-228.0
Services	73	77	70	68	78	82	85	89	99	108
Transfers	65	66	63	56	62	70	75	73	75	75
Income	-23.0	-24.1	-24.4	-26.3	-28.7	-28.9	-27.3	-36.0	-35	-38
Current Account	-32.3	-26.9	-22.2	-14.4	-48.7	-57.3	-24.7	23.9	-59.0	-83.0
% of GDP	-1.7	-1.3	-1.1	-0.6	-1.8	-2.1	-0.9	0.9	-1.9	-2.4
FDI	21.6	31.3	36.0	35.6	30.3	30.7	43.0	44.0	44	50
FII	4.8	42.2	-4.1	7.6	22.1	-0.6	1.4	36.1	0	10
Loans	7.8	3.2	-4.6	2.4	16.7	15.9	25.7	6.9	10	12
Banking capital	25.4	11.6	10.6	-16.6	16.2	7.4	-5.3	-21.1	10	5
Others	-10.8	1.1	3.3	7.6	6.2	1.1	18.5	-2.1	0	0
Capital Account	48.8	89.3	41.1	36.4	91.4	54.4	83.2	63.7	64.0	77.0
Overall BoP	16.5	62.4	19.0	22.0	42.7	-2.9	58.5	87.6	5.0	-6.0
Basic balance	-10.7	4.4	13.9	21.2	-18.4	-26.5	18.4	67.9	-15.0	-33.0



- ✓ We expect current account to normalize to around 2.5% of GDP in FY23 largely due to rising trade deficit.
- ✓ Overall BoP should be close to neutral with capital account at also about 2.5% of GDP
- ✓ Basic balance is expected to turn negative despite our expectation of pick-up in FDI
- ✓ We expect moderate depreciation in INR towards 79 to a US dollar by end FY23.

Source: CEIC, ABSLAMC Research

INR to see moderate depreciation

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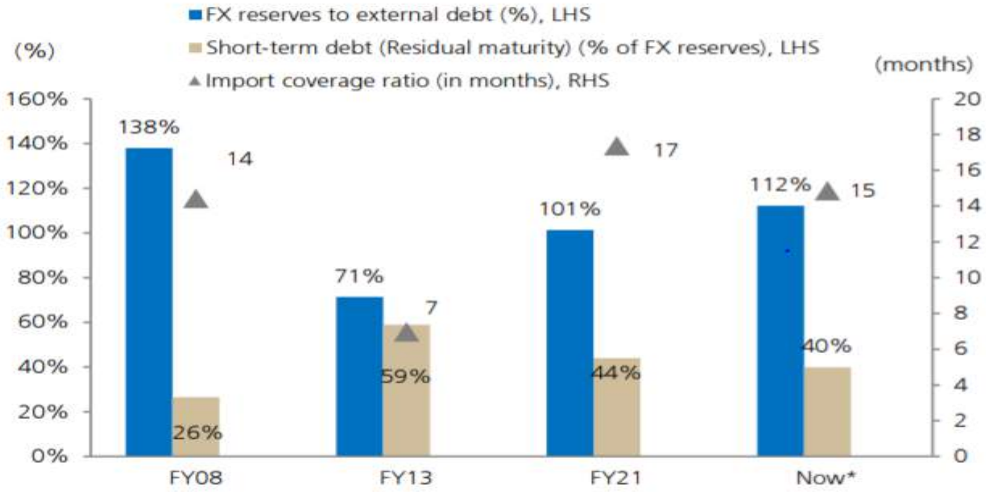
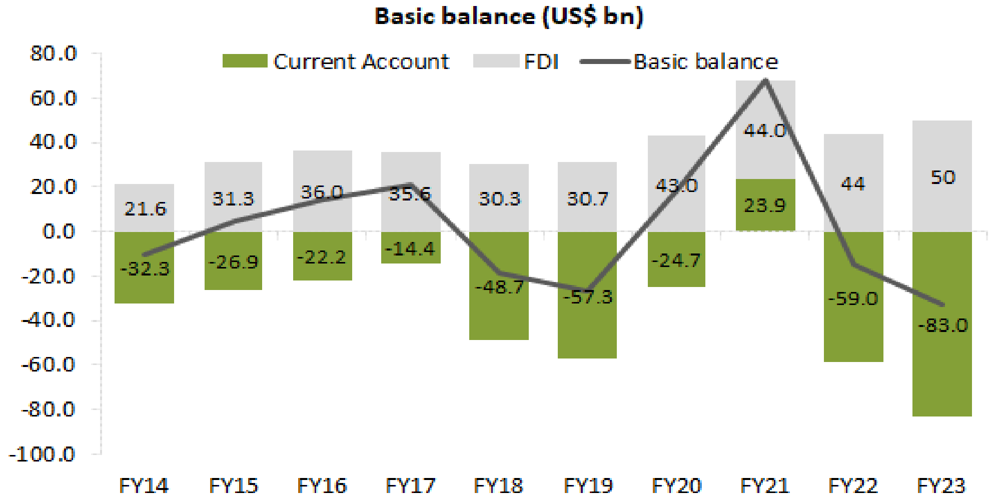
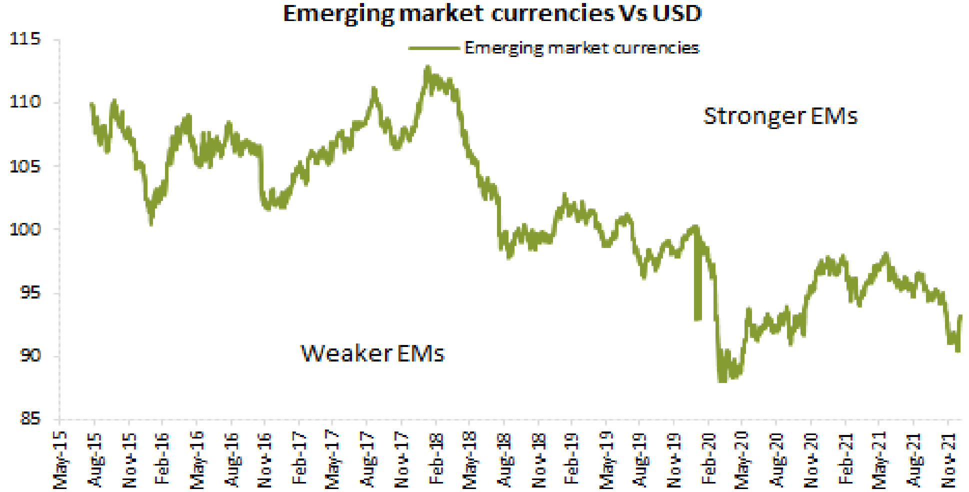
India external vulnerability indicators are benign...



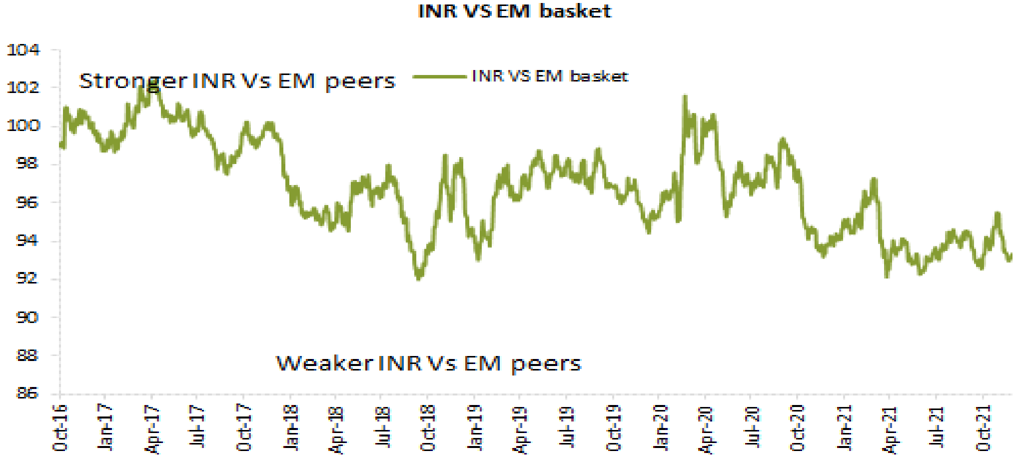
...but basic balance is turning adverse



EMs have been cheap against USD...



...and INR have been cheaper against EM basket

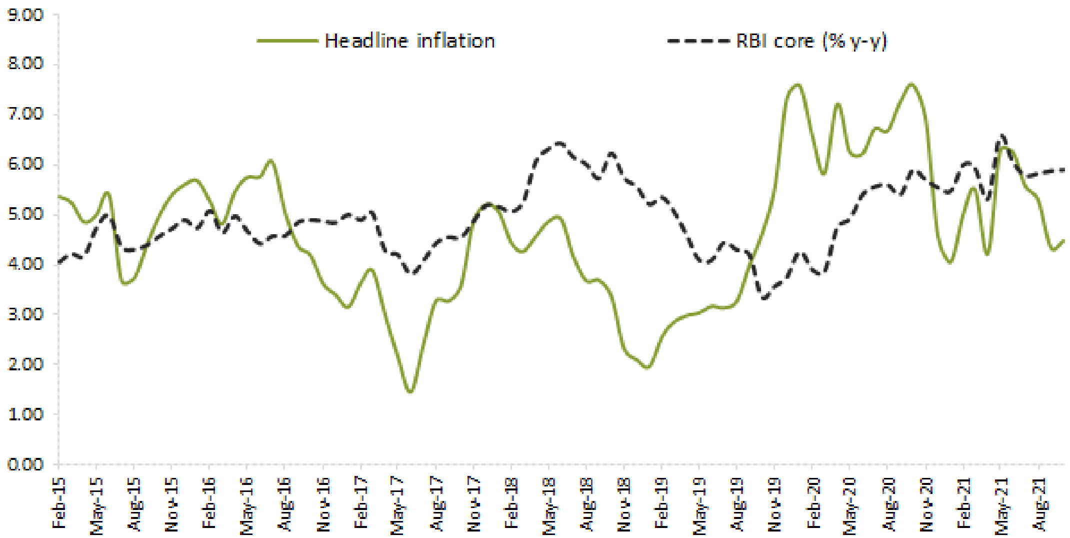


Source: CEIC, RBI, ABSLAMC Research

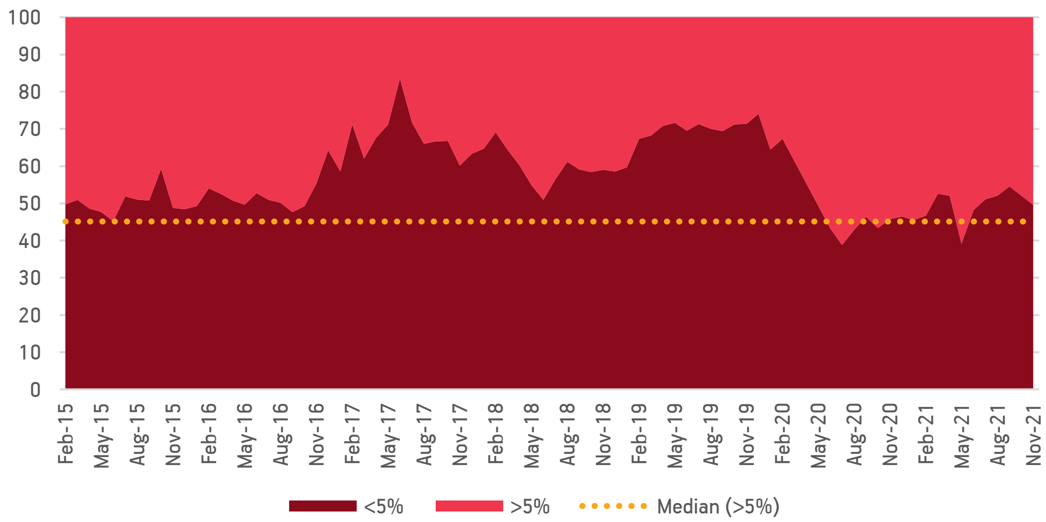
Headline inflation contained while core remains sticky

Headline CPI inflation

% oya



CPI Inflation Weightage (%, weightage)



- ✓ Our CPI inflation has hovered around the RBI inflation target range unlike that of many other countries where inflation is running multifold of their average target
- ✓ Unlike the US inflation our inflation is not as broad based and items showing >5% inflation are still around the 6-year median levels
- ✓ We expect inflation to average 5.25% for FY 23 and 5.5% for FY 22 which is slightly higher than RBI estimates

Source: JP Morgan, ABSLAMC research

Food inflation, well controlled

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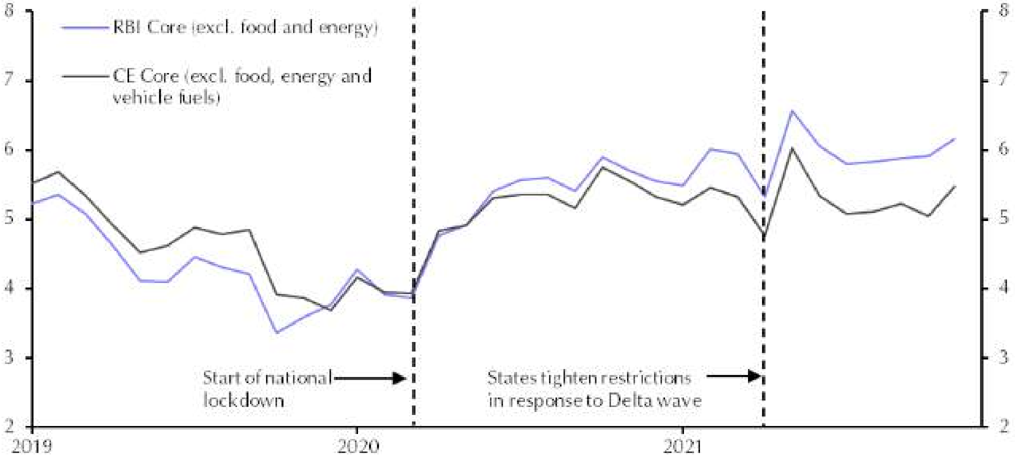


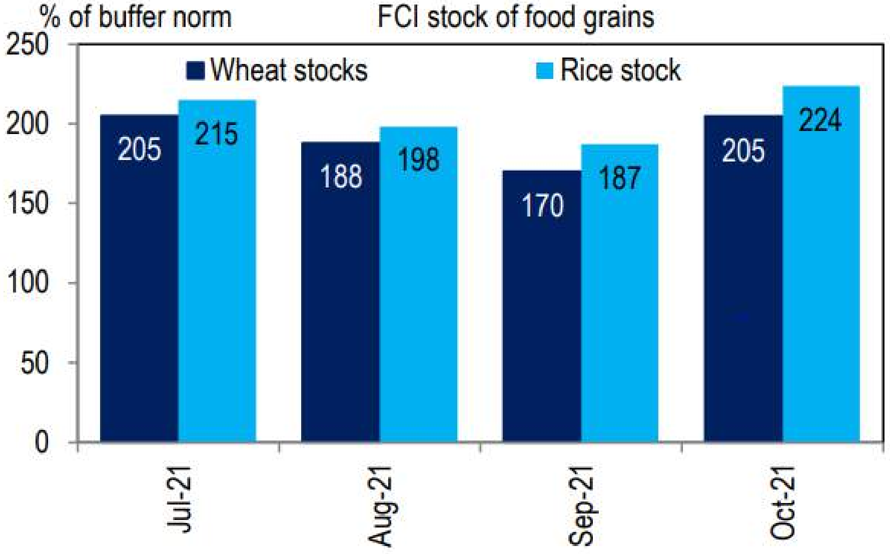
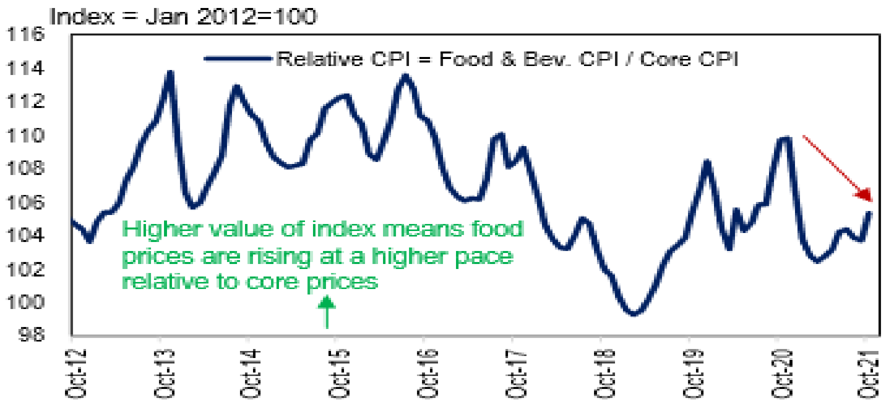
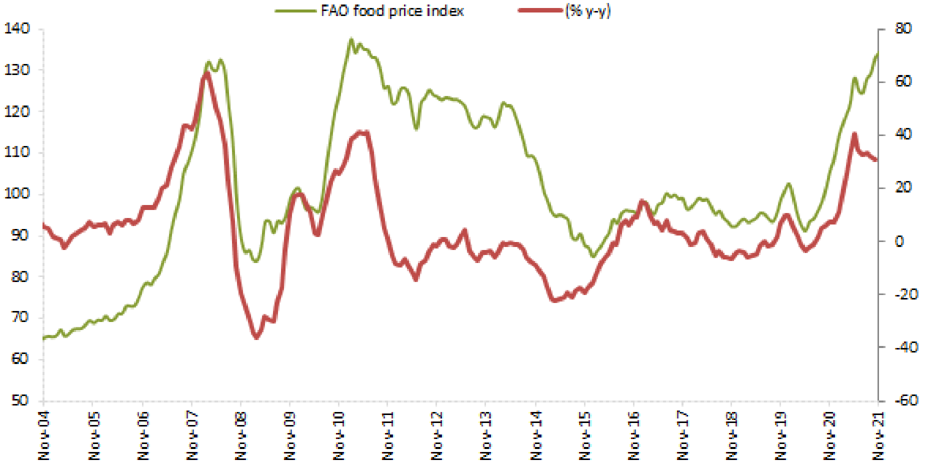


Figure 18. Farmer terms of trade has worsened compared to 2020



Source: Citi Research, CSO



Lockdowns during Covid wave caused supply side issues which has contributed to inflation inching higher

Food accounts for 46% of CPI basket, among the highest share anywhere in the world

Good monsoon, adequate buffer stocks, timely supply side intervention by government and self sufficiency in food resources shall keep us immune to high price shocks to food items globally and keep local food inflation relatively muted

Source: Citi, Capital Economics

Fixed Income Markets

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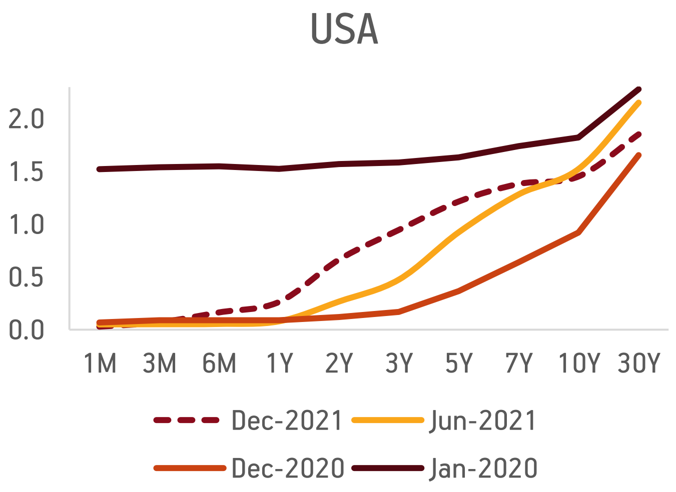
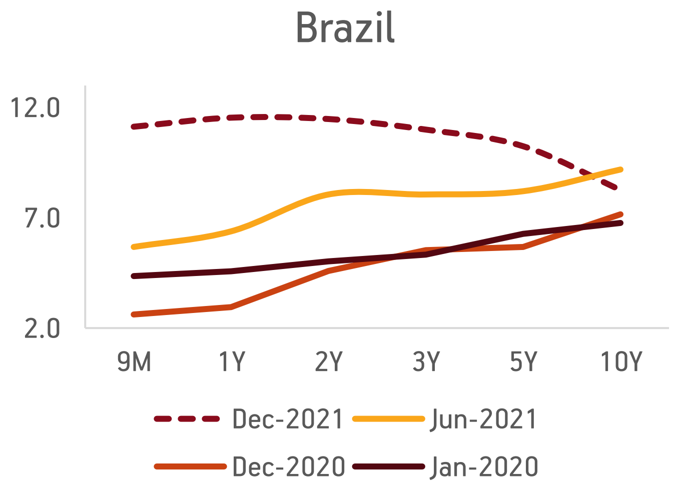
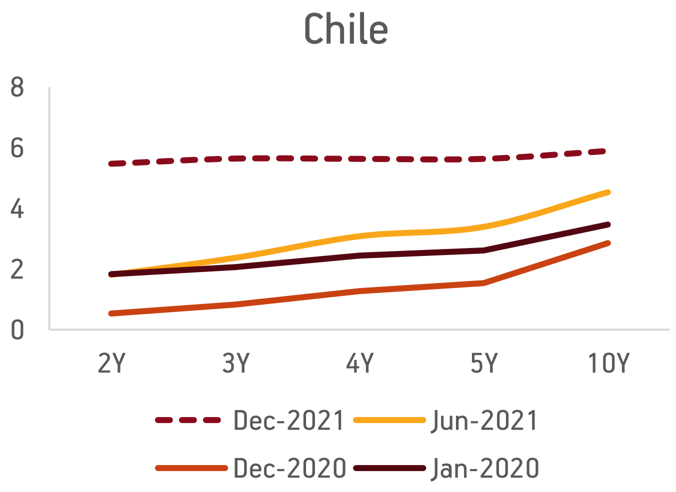
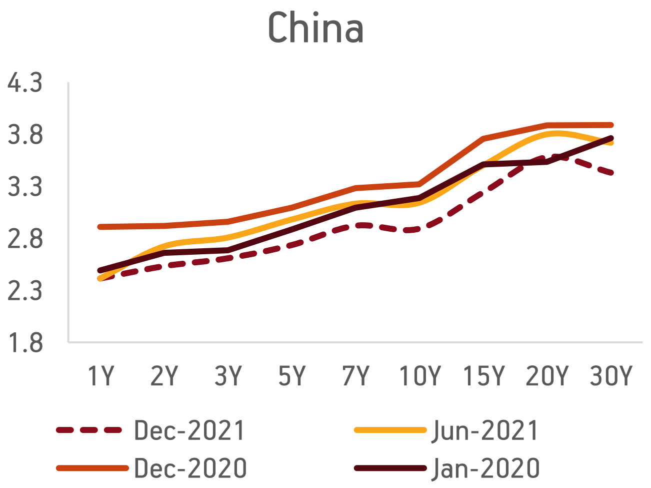
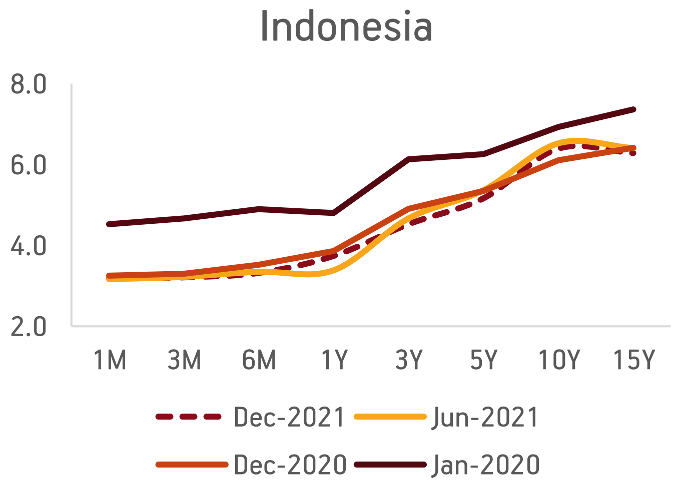
Yield Curves across EM + US

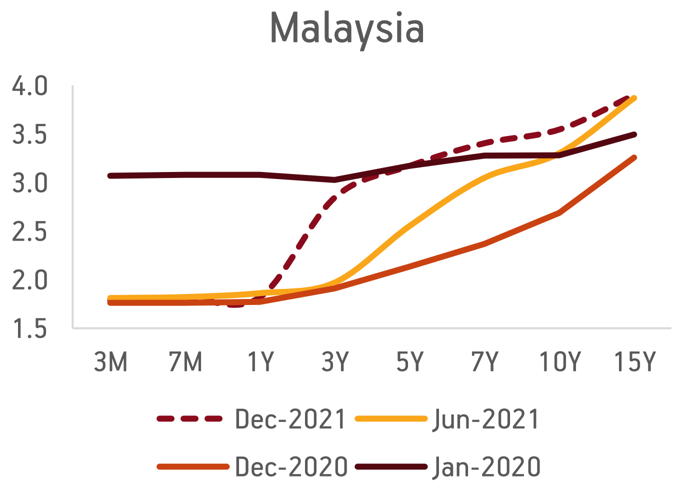






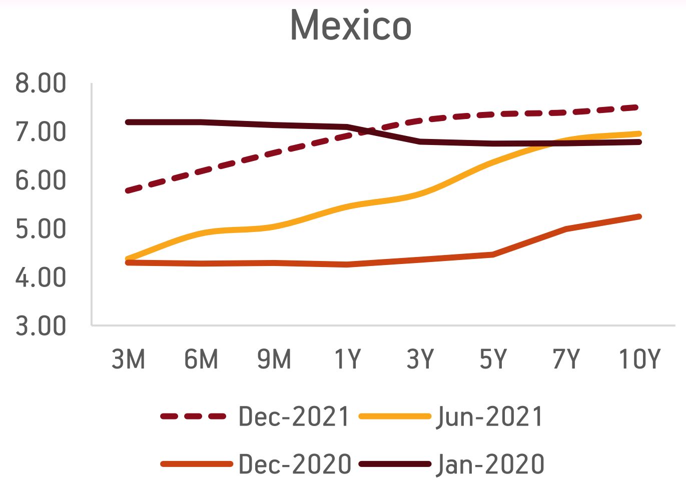


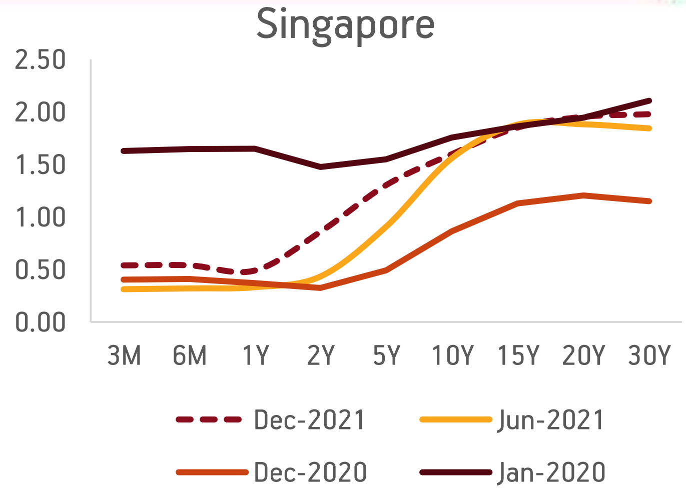


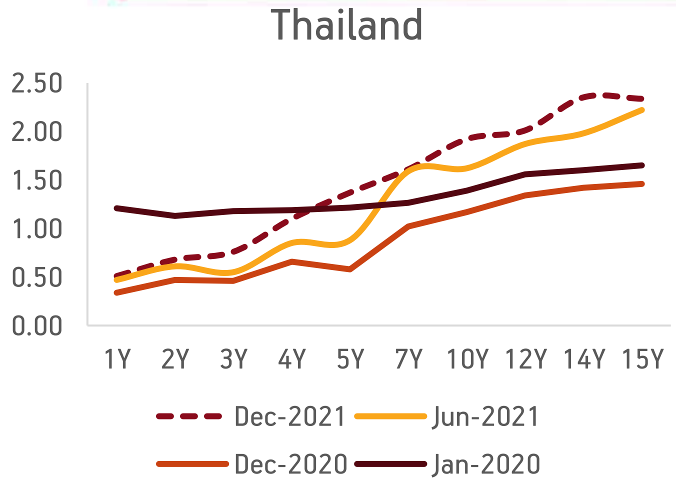


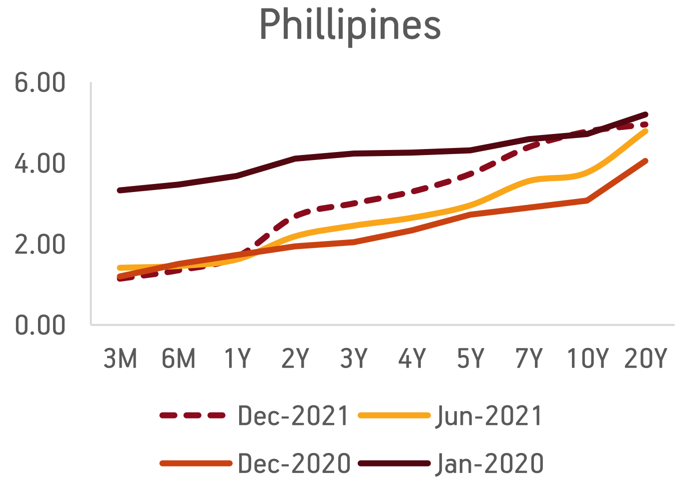
Source: Thomson Reuters, ABSLAMC Research

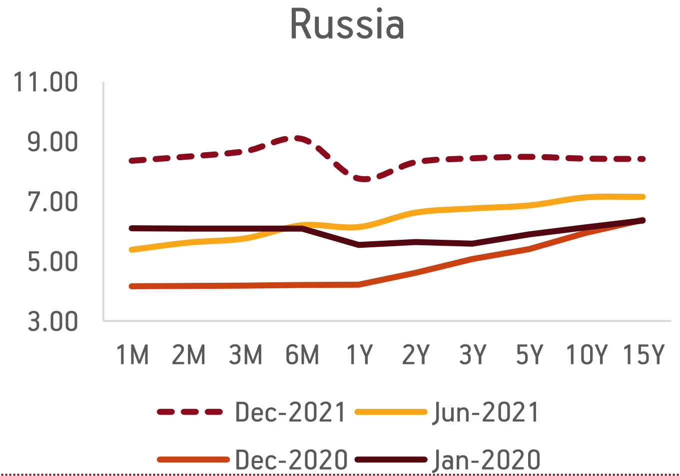
Yield Curve Shift across EM + US











Change – Dec-20 v/s Dec-21

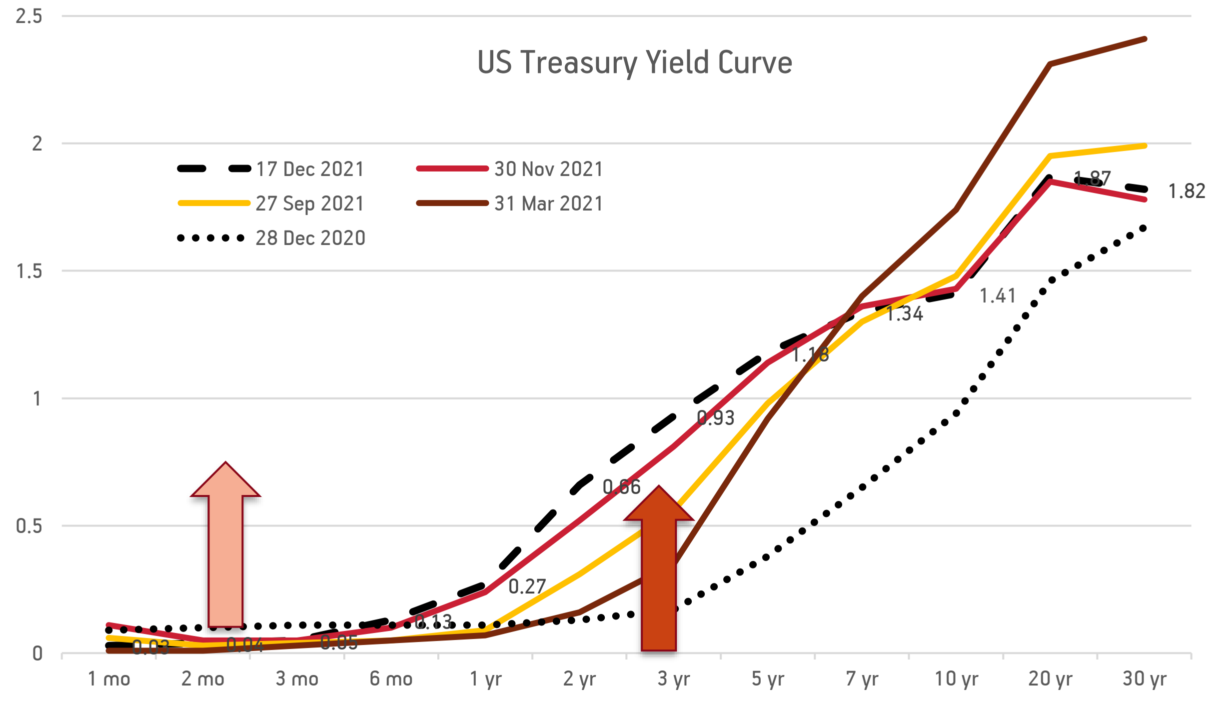
Country	1Y	5Y	10Y
Chile	4.94	4.09	4.09
Russia	3.54	3.08	2.48
Mexico	2.65	2.89	2.25
Brazil	8.59	4.56	1.11
Malaysia	0.05	-0.18	0.86
Thailand	0.17	0.79	0.75
Singapore	0.12	0.81	0.73
USA	0.18	0.85	0.53
India	0.68	0.73	0.51
Indonesia	-0.12	-0.18	0.29
Phillipines	-0.06	1.00	0.00
China	-0.50	-0.36	-0.43

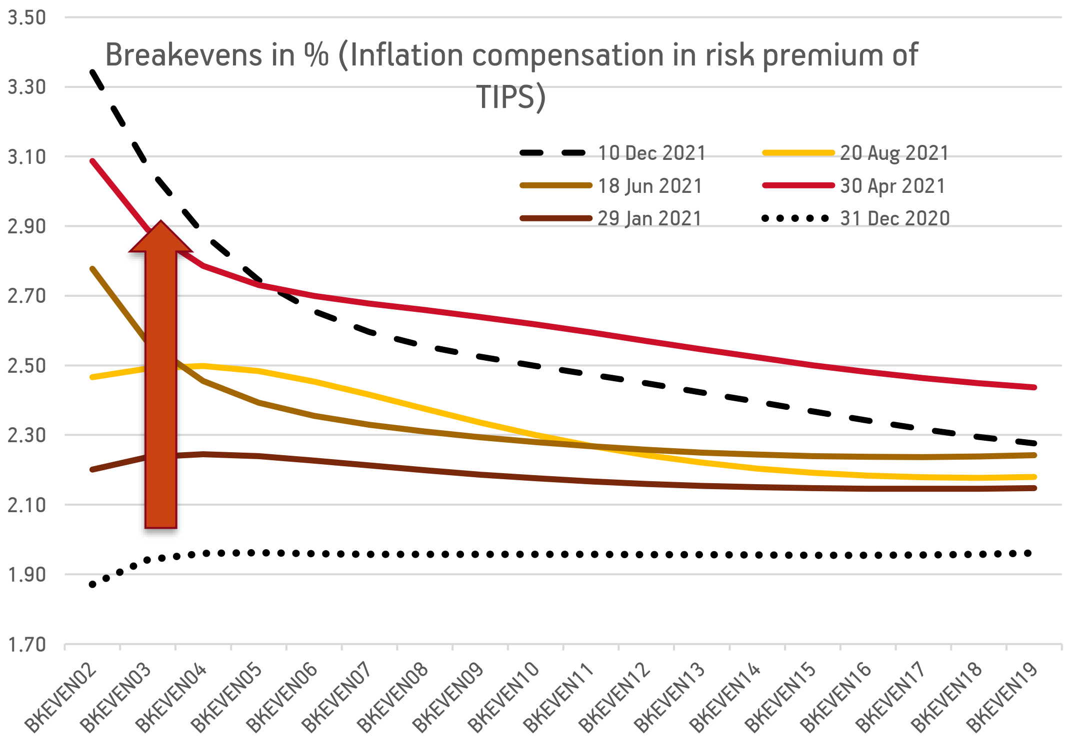
There has been a mixed global reaction on yields curves basis each countries experience on domestic inflation, commodity export orientation, central banks reaction function and domestic COVID trajectory

Source: Thomson Reuters, ABSLAMC Research

FOMC leaning towards earlier, more hikes

- Fed was true to its communication during 2021 and delivered a smooth transition from dovish to hawkish stance as it initiated tapering late 2021 which is expected to wind up by early 2022 (est Mach2022) followed by lift off (in absence of "extended wait" between tapering and lift-off) with median expectation of 3 hikes in 2022.
- Since Sept2021, post the first signal of taper at FOMC, UST yield curve has curve has been witnessing precursor of bear flattening with the medium term yields rising. If short term rates rise as per the dot-plot and US core inflation moderates, then UST yield curve may see further flattening.
- Monitorables: COVID cases/new variants and related economic slowdown

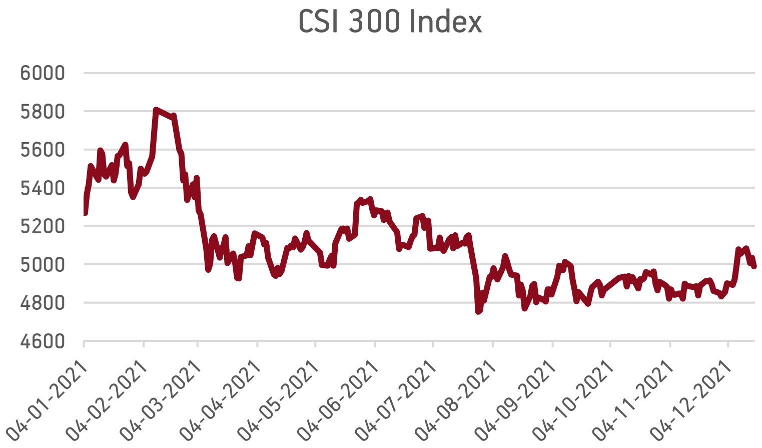


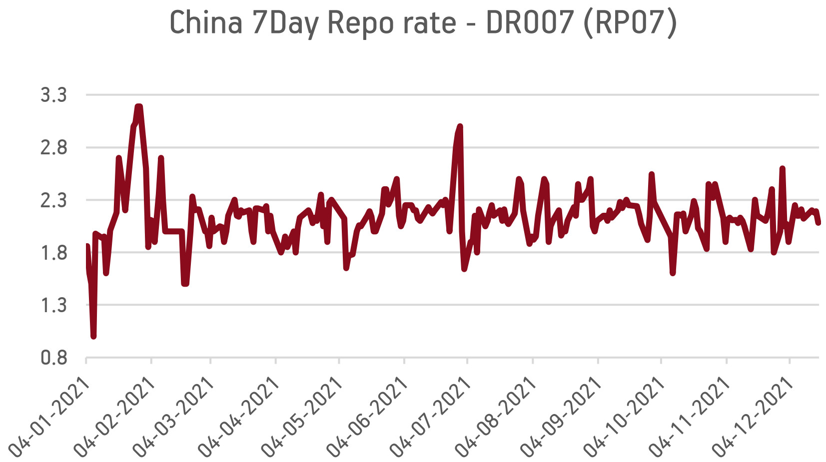


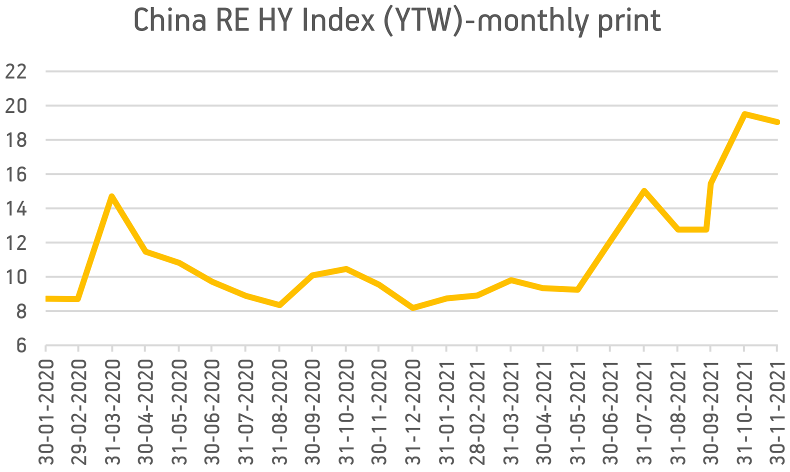
Source: Bofa, Bloomberg, US Treasury

Markets constructive about China, policy mistake remains risk

- Chinese mainland Market indicators appear well behaved though Offshore USD China credit HY yields continue to remain elevated







Source: Bloomberg, MS

Investors de-risk in EM debt and equity

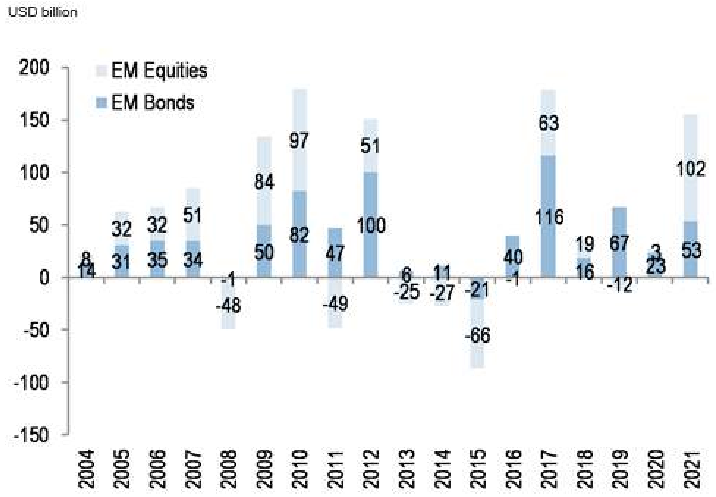
- Institutional flows continue to exit EM debt and equity with Fed notching up the pace of taper and expectation of lift-off timeline brought ahead.
- MM fund assets remain elevated but low as a % of global equity market cap (lower than pre-COVID levels)

Weekly Cross Asset Flow (week ending 15Dec21)

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	**EM Bonds and Equities**		-3.4	155.5
	EM Bonds		-0.3	53.2
	Hard Ccy		0.9	31.8
	Local Ccy^		-1.2	21.5
	o.w. EM ex-China		-0.5	-1.9
	o.w. China		-0.7	20.4
	EM Equities		-3.1	102.3
	US HG		-0.3	274.3
	US HY		0.2	-8.7
	Global Equities		23.9	449.5
	EM Bond and Equity ETFs		-0.3	72.8
	EM Bond ETFs		0.9	13.3
	EM Equity ETFs		-1.2	59.5
	Non-resident EM flows*		-1.2	-52.4

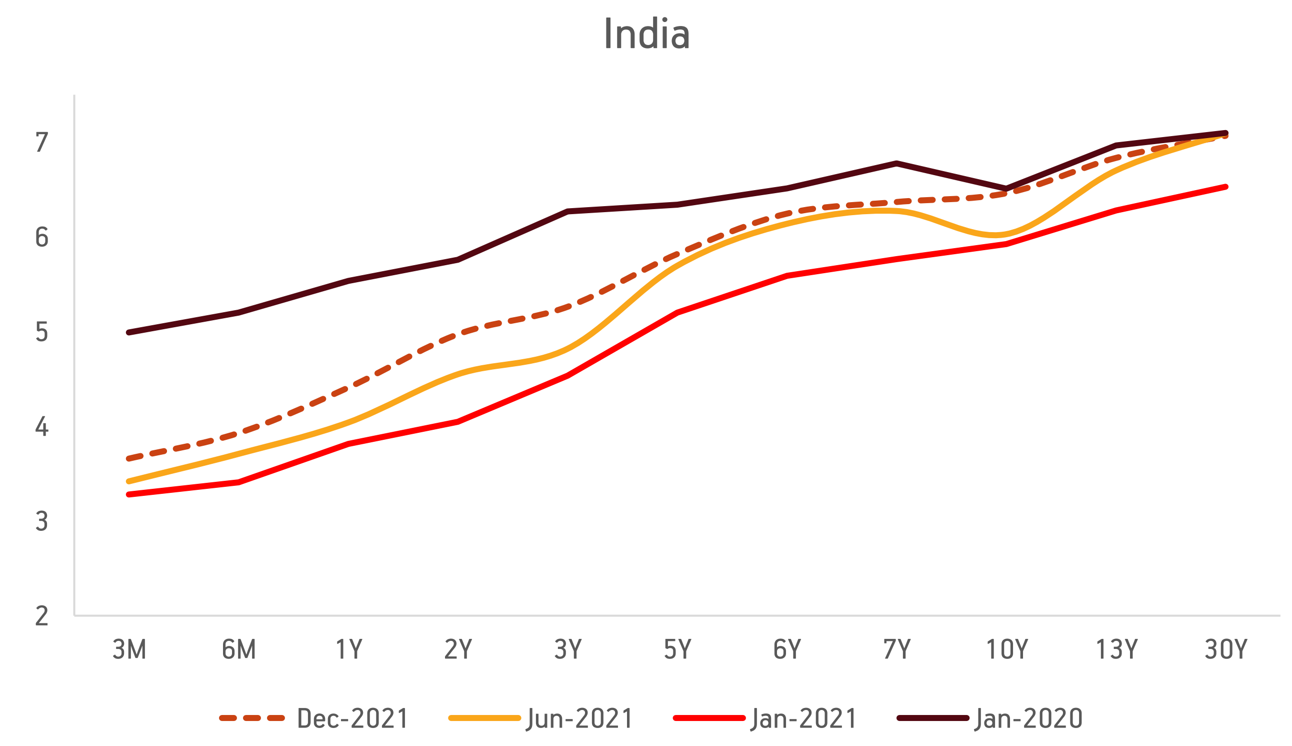
Annual EM Flows (as on 15Dec21)

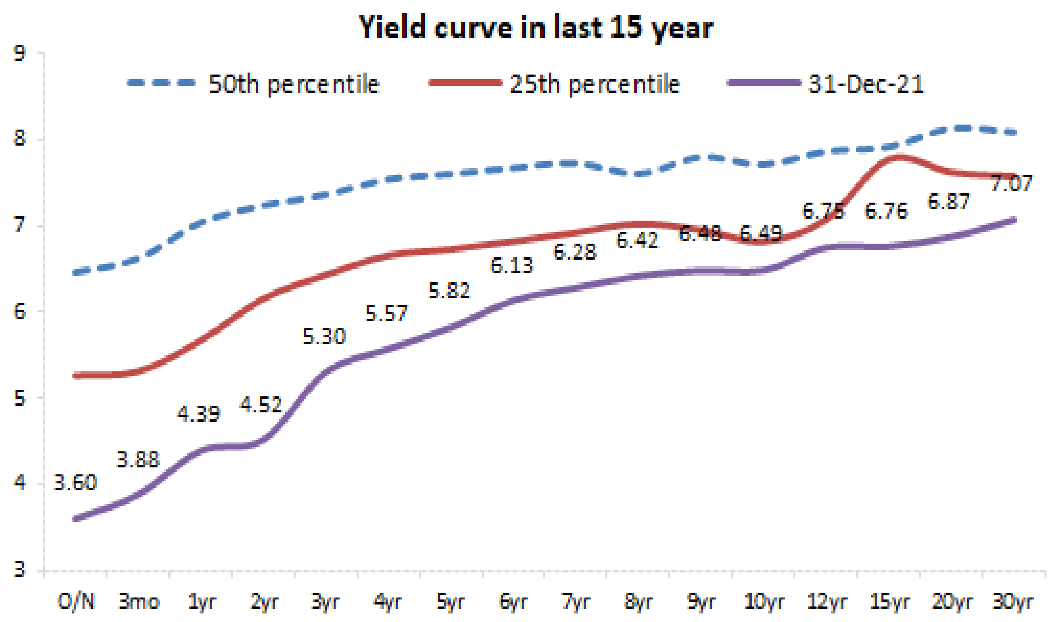


Money Market fund Assets ($ tn)(as on 15Dec21)

Source: BofA Global Investment Strategy, Bloomberg

India Sovereign Yield Curve

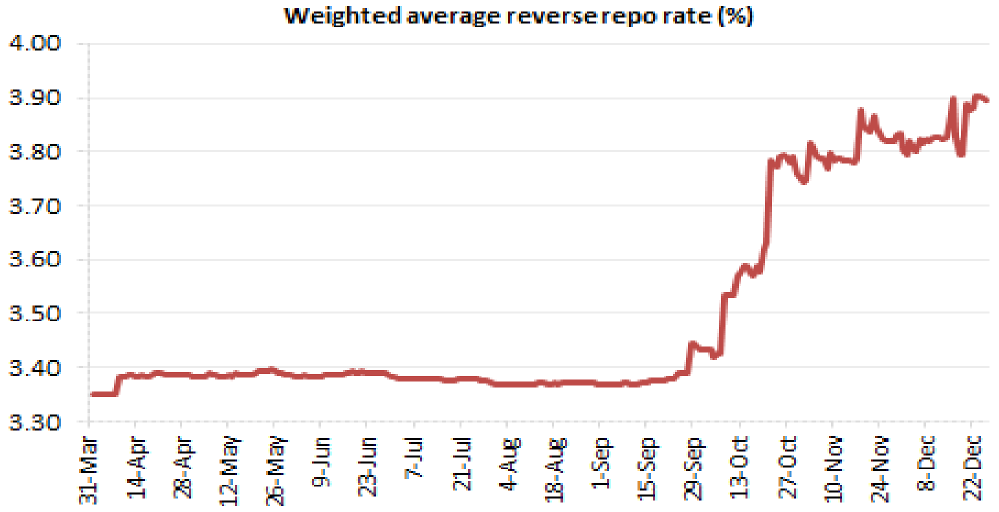


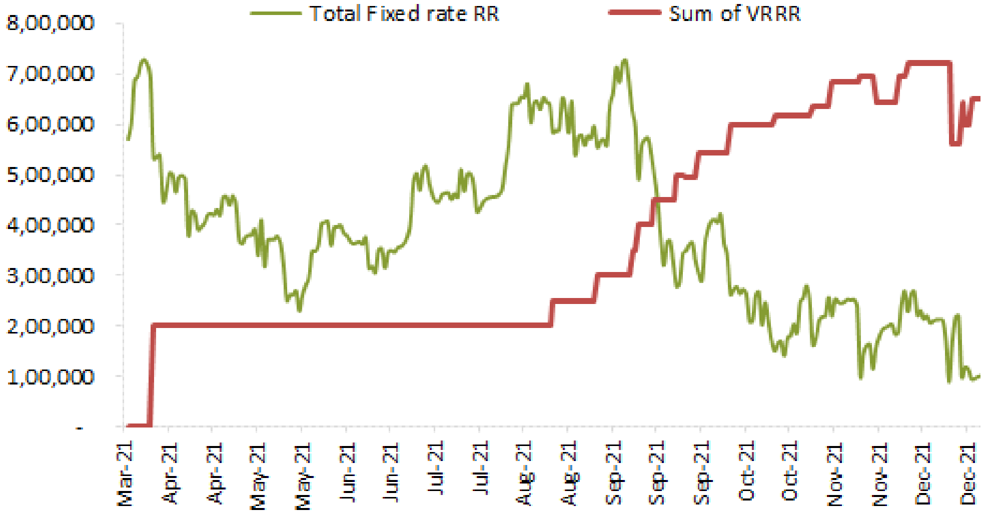


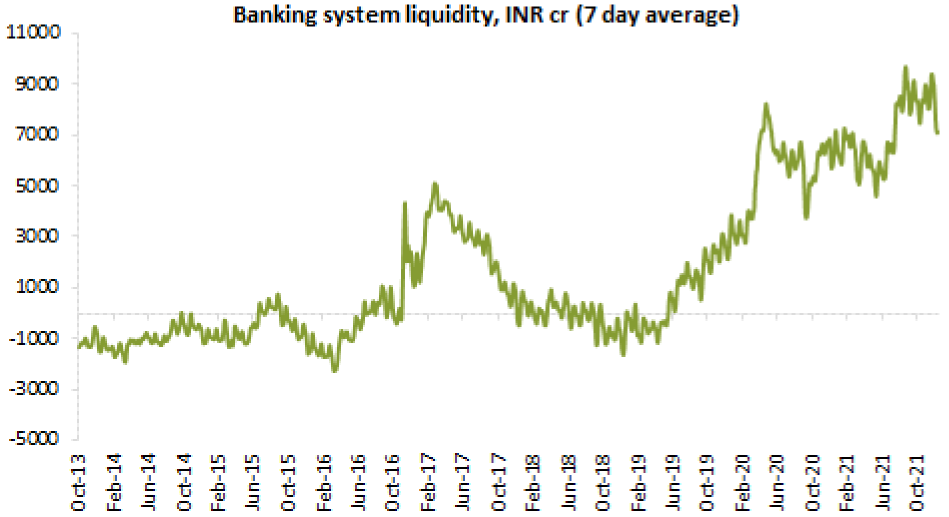
Our yield curve has moved higher over the past 1 year with a slight steepening bias as RBI began to normalize its liquidity operations and trimmed down its OMO purchase operations. Curves are pricing in atleast 2 repo rate hikes in the calendar year 2022 and steepness in the curves continue to remain attractive till the 5 year point. Overall, yields continue to be at one of the lowest points (below 25th percentile) than what we would have seen in the past 15 years.

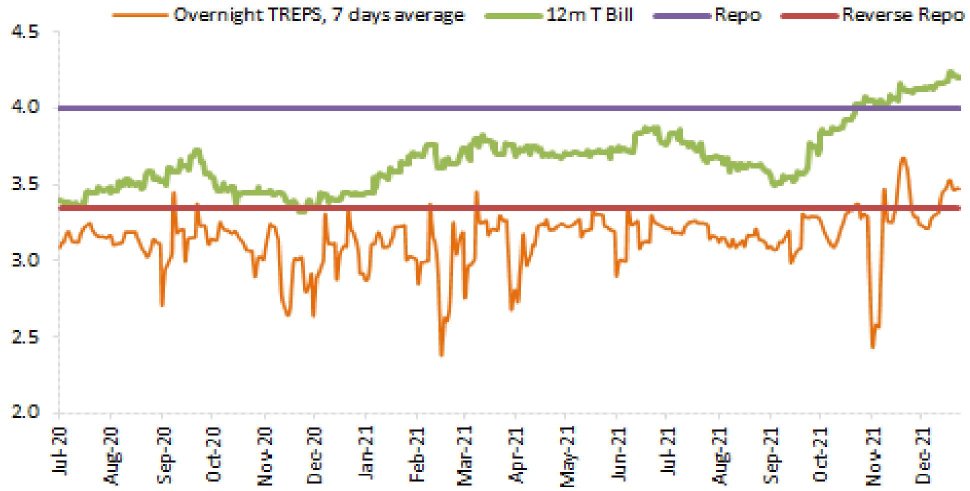
Source: Thomson Reuters, ABSLAMC Research

Rising VRRR amounts has taken weighted RBI absorption rate close to Repo



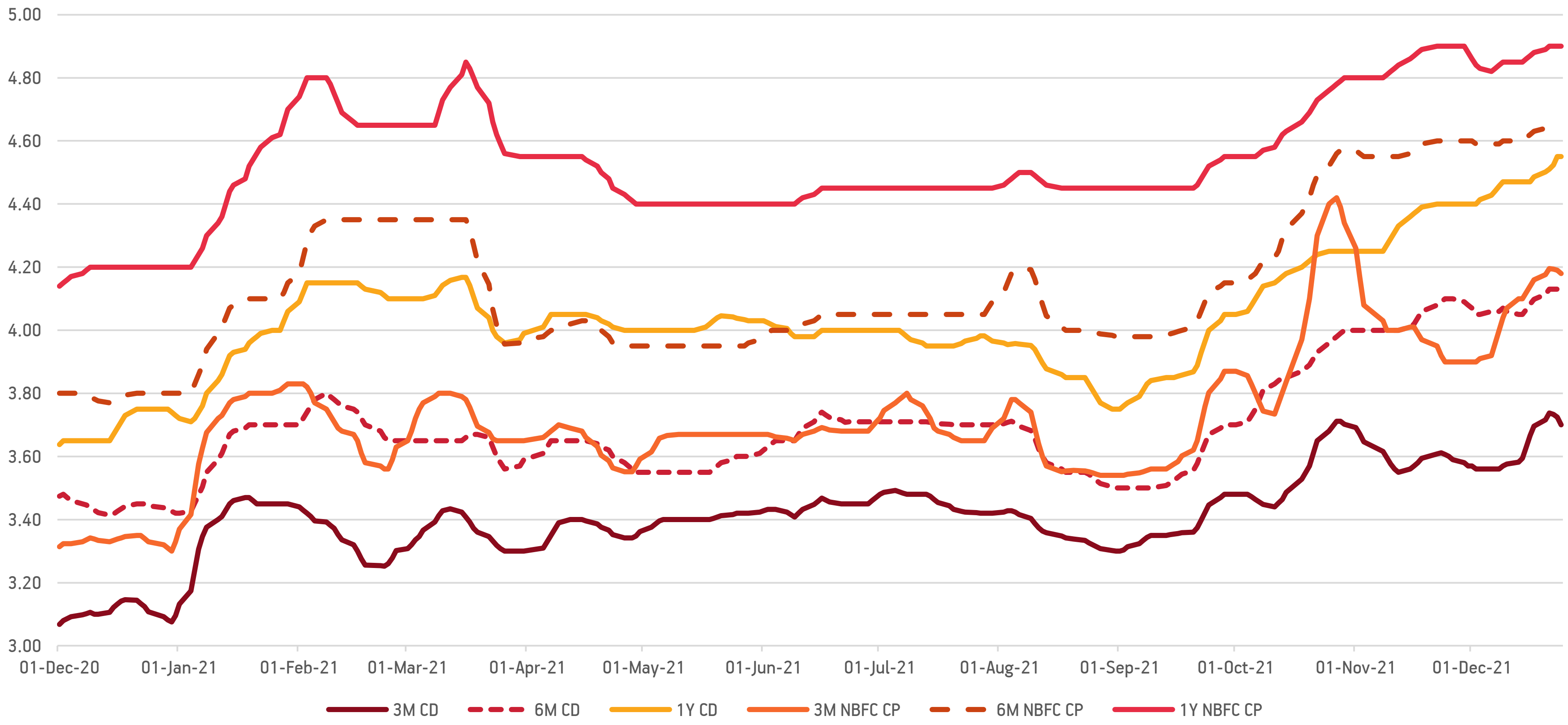






Bloomberg

Short End Rates

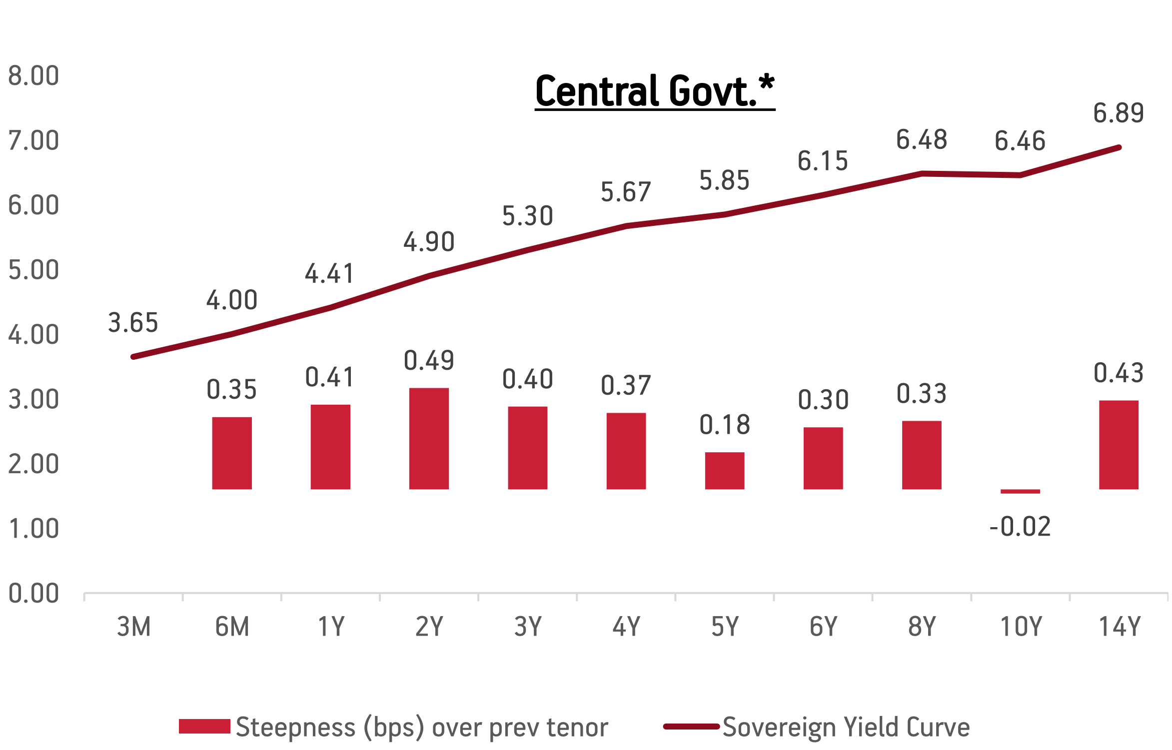


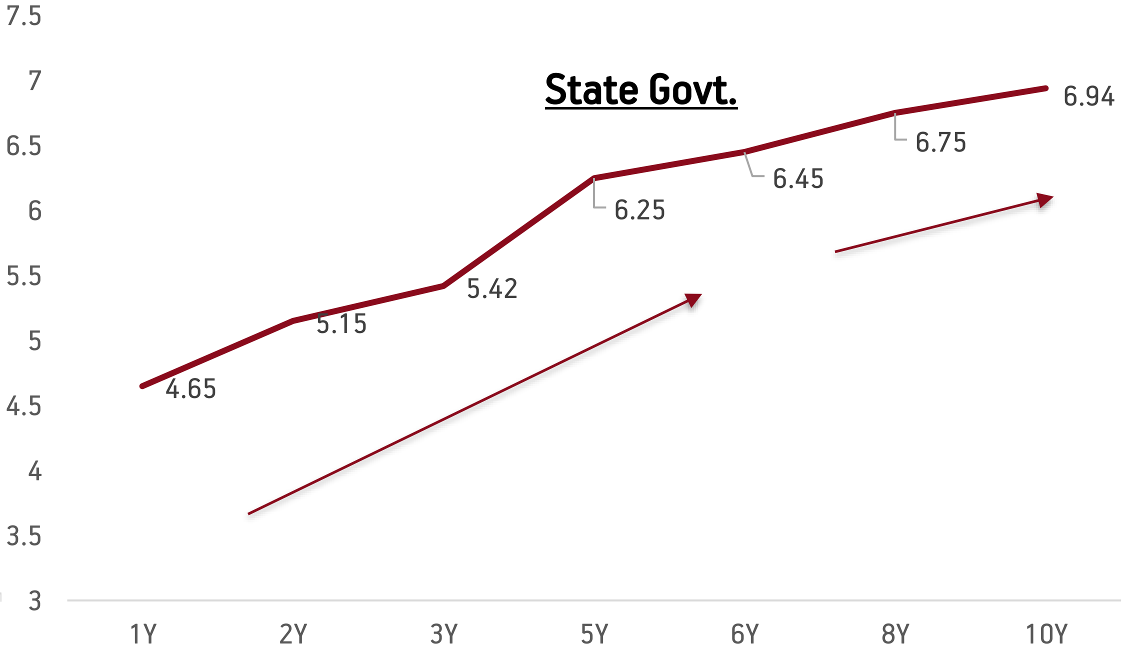
Instrument	Change in Yield (bps) YoY
3M CD	59
6M CD	69
1Y CD	80
3M NBFC CP	85
6M NBFC CP	85
1Y NBFC CP	70

Short end curves have inched up from their lows on back of liquidity normalisation by RBI; curves continue to be steep at the short end pricing in further rate actions by RBI. NBFC curves have been volatile on back of a slew of IPOs being announced this year.

Source: ABSLAMC Research

Sovereign Yield Curve – Levels and Steepness



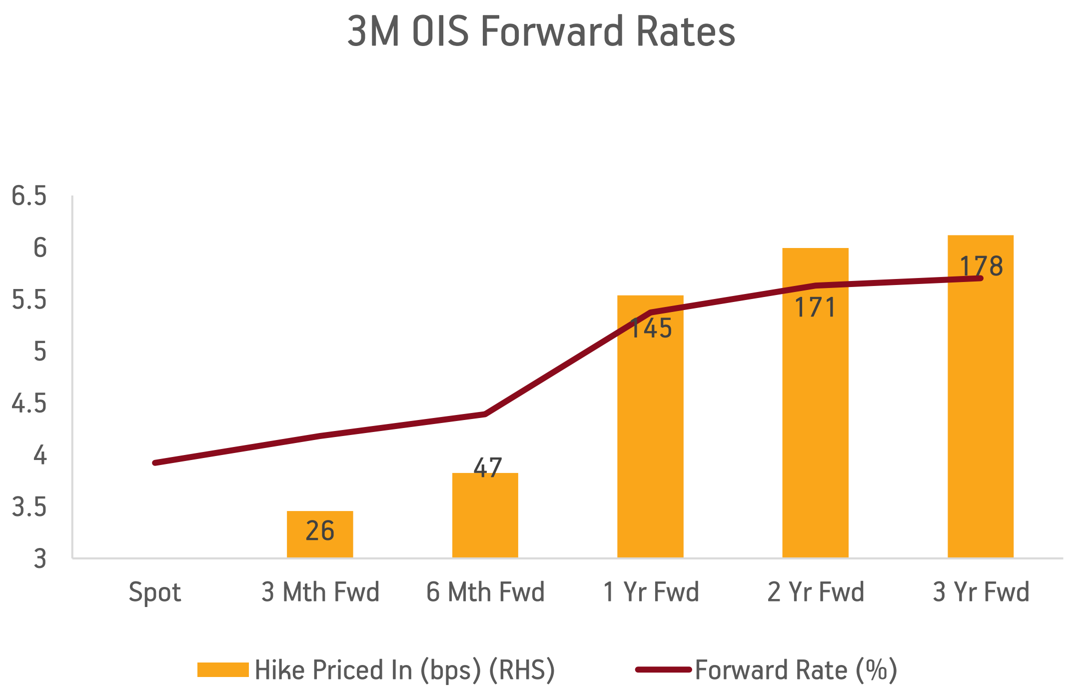


G-Sec and SDL curves looks continues to look attractive till the 5 year point as the steepness fades off from there onwards; spreads for SDL v/s G-Sec have narrowed over the past year and can expand from here marginally in light of larger expected supply in Q4

Source: ABSLAMC Research

*For 10 year point in central government curve benchmark security has been taken, other securities in similar tenor were at ~6.25-6.50%

OIS Curve Movement

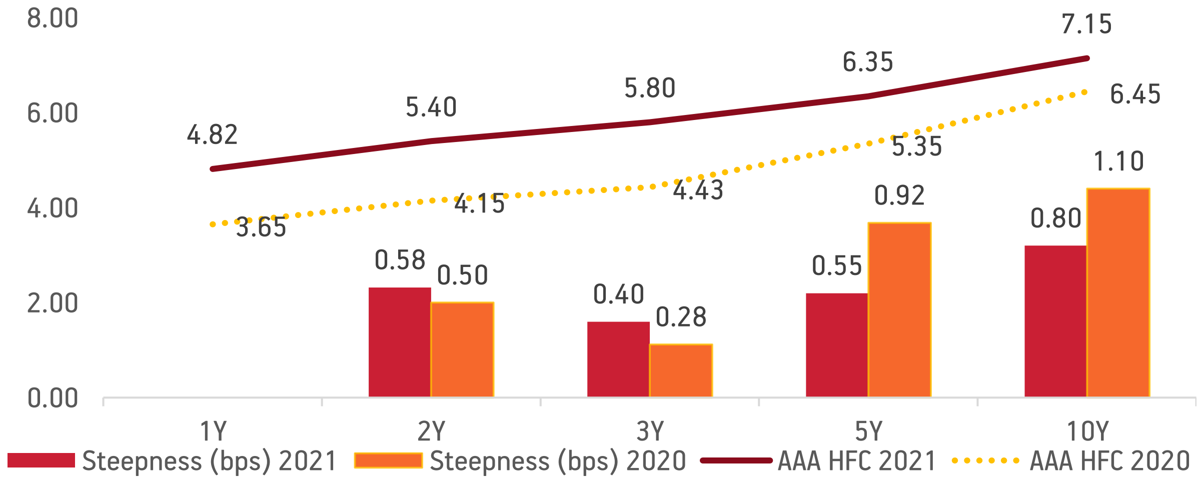


OIS curve has moved higher on back of higher crude and sell-off in global rates; forward OIS rates are now pricing about 145 bps from spot overnight rates over the next 1 year, which in our view seems to be a faster normalisation being priced in given the commentary from RBI which is pointing towards supporting our nascent recovery and incremental risk of a 3rd COVID wave because of Omicron and / or fading efficacy of vaccines

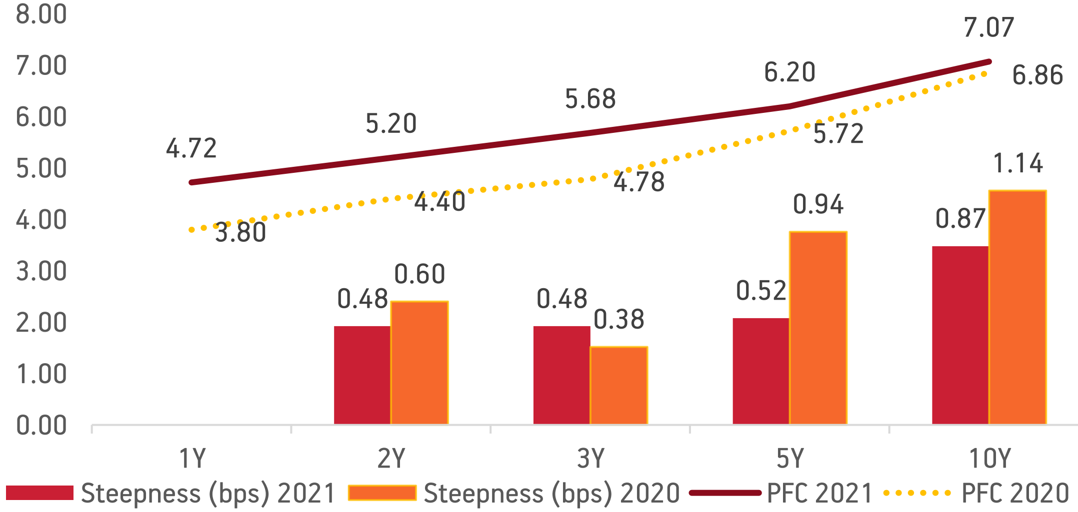
Source: Bloomberg, ABSLAMC Research

AAA Corporate / PSU Curve

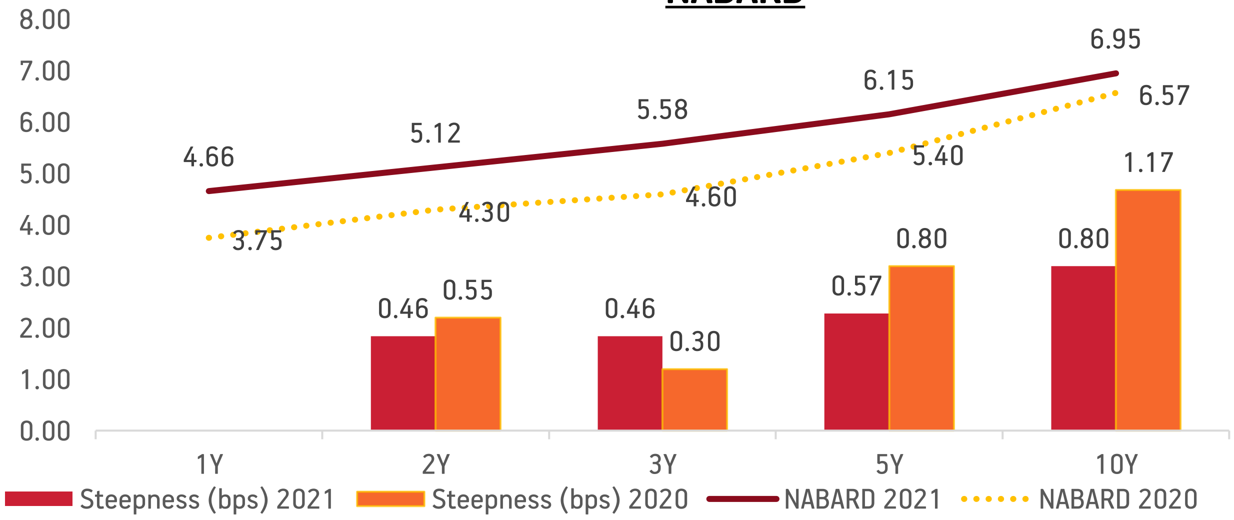
HDFC Ltd.



PFC



NABARD



Markets were pricing in 1y1y rates by about 110 bps higher last year whereas they have went up by 90 bps. Current, derived 1y1y NABARD pricing is at 5.60%, which is pricing in about 100 bps higher rates next year

Source: ABSLAMC Research

Credit Spreads

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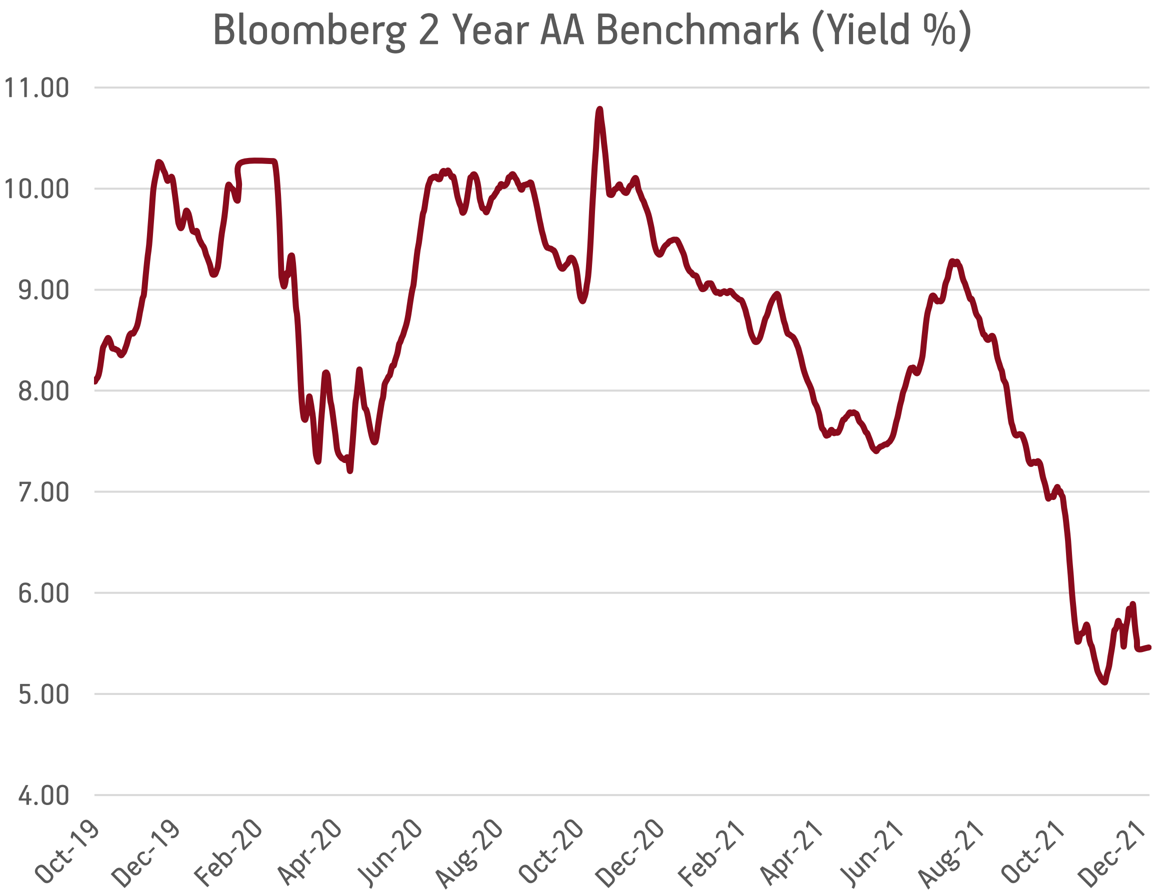

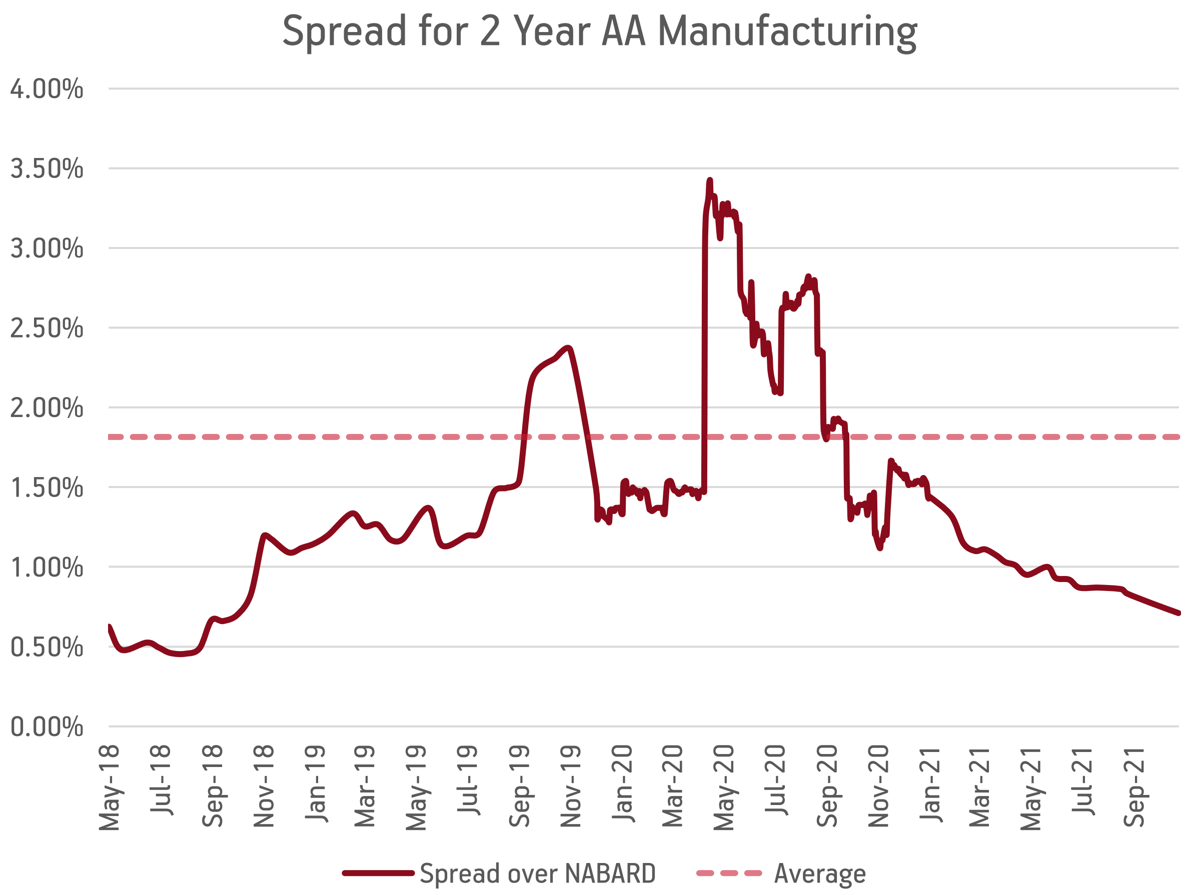

Credit Spreads have remained low on back of surplus liquidity and are lower than their average levels seen in past few years

Source: Bloomberg, ABSLAMC Research

Higher Borrowing + Lower RBI support = Higher term premium

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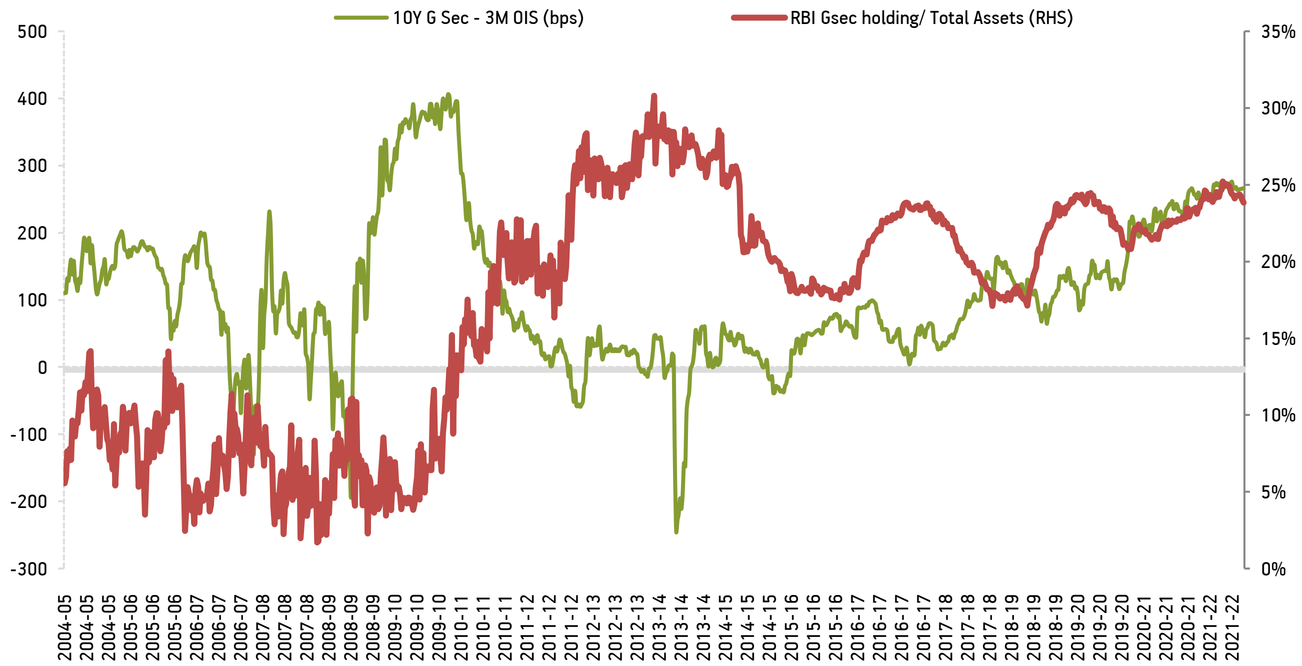
ADITYA BIRLA CAPITAL



Year	Total Net Dated Issuance	OMO	Net Issuance	Change in NDTL	Net issuance/NDTL
2022-23E	15,65,000	3,00,000	12,65,000	14,00,000	90.36%
2021-22E	15,38,708	2,70,000	12,68,708	13,50,000	93.98%
2020-21	17,75,368	3,13,000	14,62,368	14,73,614	99.24%
2019-20	11,00,394	1,13,569	9,86,825	10,28,022	95.99%
2018-19	7,72,368	2,99,232	4,73,136	11,88,274	39.82%
2017-18	7,89,679	-88,775	8,78,454	8,08,061	108.71%
2016-17	7,50,849	1,10,494	6,40,355	11,07,250	57.83%

Historically, RBI support has been an important factor in reducing the term premium. With borrowing likely to remain high in FY23, RBI's support once again becomes crucial if term premium is to be contained.

Source: RBI, ABSLAMC Research

Policy Fabric :

- Orderly evolution of yield curve was explicitly regarded as public good
    - Very strong intent – gradual increase in yields, only in line with macro fundamentals
- Reversal from the extraordinary accommodation will happen in a calibrated manner and considering the market reaction at every stage, NO shock at any point of time
- RBI has used Flexible part of FIT
  (Financial stability & Growth) > Inflation

Path to Normalisation Started:

- Balance sheet growth peaked in October 2021
- Systemic liquidity likely to stay in Rs 8 Tn over next one year; VRRR to be policy choice
- Reverse repo is likely to be the operative rate
- Normalisation of repo-reverse repo corridor in H1 2022 and repo hikes in H2
- OMO purchase to balance demand supply mismatch or Bond Indices have to come in to fill the large gap

Sectoral Views

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Credit Outlook

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(A part of Aditya Birla Capital Ltd.)

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Corporate Health

- Corporate India continued its resilient march by deleveraging balance sheets and reducing interest rate costs - all in the backdrop of tailwinds to the economy resulting in increased EBITDA margins and accommodative policies by RBI.
- RBI publication data on ~2716 listed non-financial non-government companies shows an improvement versus pre-covid levels on various operating and financial parameters.
- CRISIL ratings saw its Credit ratio (the ratio of upgrades to downgrades) jump to 2.96 times in H1 FY 2022 from 0.45 in H1 FY 2021 reflecting the sharp improvement in the credit quality of India Inc. The improvement was seen across sectors with manufacturing and infrastructure sectors outpacing the services sector.

Financial Sector

- The financial sector is picking up again with collection efficiencies improving post June 2021, once the constraints of the second wave started easing.
- Many companies are now indicating that the collection efficiencies have reached pre-Second Wave levels however, the Collection Efficiencies have stagnated at ~ 100% indicating that roll backs due to receipt of overdues is still some while away.
- Microfinance and MSME financing have likely undergone some permanent scarring and recovery is likely to be delayed with collection efficiencies still below 100%.

Infrastructure Sector

- With Power demand rebounding, Thermal Power Generators' PLFs are expected to increase while we expect merchant power prices will moderate in the face of softening coal prices and expected increase in availability of coal.
- India has set for itself a new climate target under the Conference of Parties (COP) including a target to increase renewable capacity to 500 GW by 2030 and increase the share of renewables [including hydro] in the overall generation to 50% from the current ~20%. We believe that lower PLF variability and less volatility in payments gives solar power the edge over wind generation.
- Discom receivables have started accumulating again after declining post the relief provided in the Atmanirbhar package.
- The Road sector has started seeing improvement in toll collections with the re-open resulting in increased movement of people, goods and services as well as very good Fast-tag penetration.
- The government announced a telecom package which should ease the burden on telecom companies and also reduce further cash flows with the AGR definition getting amended.
- The infrastructure sector is likely to see a renewed thrust with the government rolling out its monetization plan. We believe that the monetization of assets like Roads through the Invit / TOT route; Transmission assets via the TOT route and Airport assets via PPP route which have already found some success can be easily replicated. However, some tweaks may be required to existing Concession Agreements to ensure Contractual rights and resolution in case of conflict are well defined.
- We continue to like regular cash flow throwing assets like power transmission and operating power assets particularly in the renewable solar space

Credit Outlook (Contd.)

Metals

- While China led the first phase of the recovery in global steel markets till the early part of CY 2021, going forward, the continuation of the upcycle would hinge on healthy demand momentum continuing outside of China.
- The spread of primary steel producers is expected to moderate due to expected moderation in steel prices though expected lower raw material prices would limit significant corrections in spreads.
- We expect aluminium prices would remain high in CY 22 due to improved demand with Green cycle & ESG augmenting demand and tepid supply response due to stricter emission norm & capacity cap in China.
- Zinc prices are expected to moderate from current level considering the expected surplus expectations and prevailing cost structure.
- Operating profits of non-ferrous players is expected to witness healthy increase due to sharp increases in metal prices and reduction in operating cost.

Real Estate Sector

- The real estate residential market has seen a revival after a long down cycle. The market share of the large and organized players has increased, and we believe that this shift from small and unorganized to organized is likely to persist going forward.
- The Commercial real estate space has also started showing signs of revival despite Work from Home and various hybrid models; The large Grade A properties will continue to command their premiums particularly with increased hiring seen by their target clients.

Credit Outlook (Contd.)

Automobile

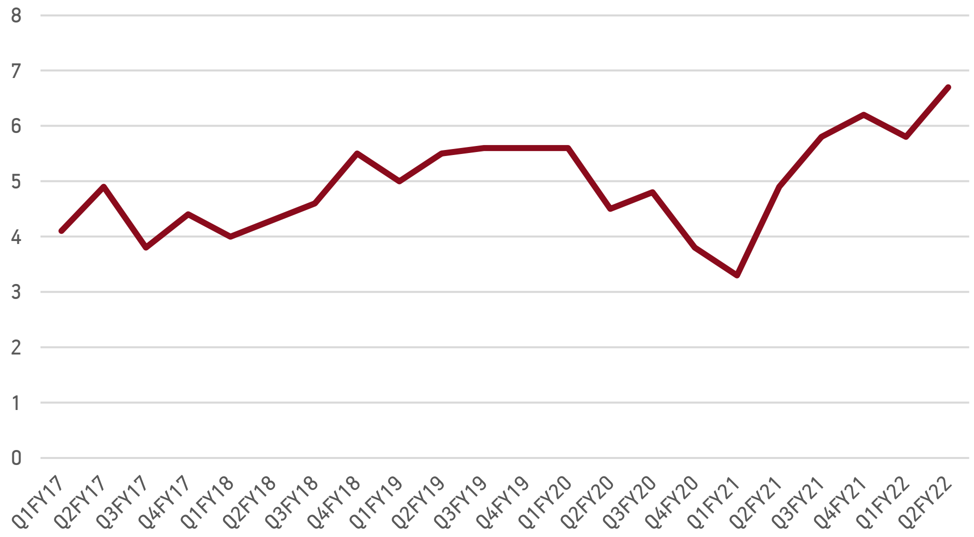
- Passenger vehicles have seen robust recovery on the back of pent up demand, preference for personal mobility but constrained by supply side issues caused by shortage of semi conductor chips.
- Commercial Vehicles and Two wheelers are witnessing tepid to negative growth.

Summary

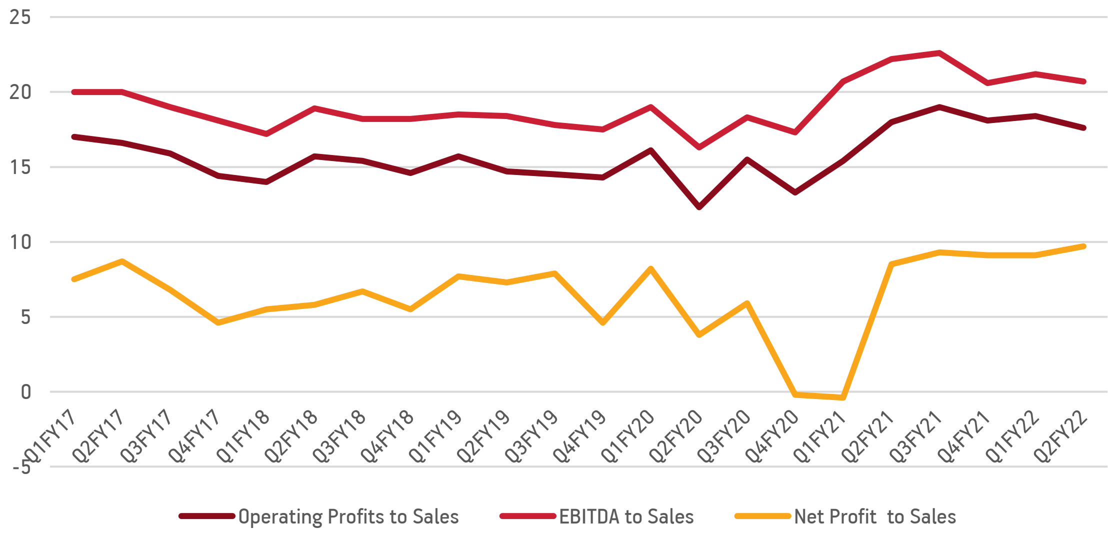
The manufacturing sector has seen a shift of market share from small and unorganized to the large, organized players. We believe that the services sector will see some momentum build up with the re-opening trade play out, however a full recovery to pre-covid levels will still take some more time given Omicron and various virus mutant concerns. We continue to prefer cash flow throwing companies and sectors, with good track record and promoters and a conservative capital structure and accordingly will selectively invest in those sectors and companies that meet those criteria.

Corporate India is faring relatively better

Cash Coverage Ratio – EBITDA / Interest (times)



Profitability Ratios



- Data on the performance of the private corporate sector during the second quarter of 2021-22 drawn from abridged quarterly financial results of 2,716 listed non-government non-financial (NGNF) companies from RBI Publications shows that on various operating and debt servicing matrices corporate India health has improved considerably versus pre-covid levels.

Source: RBI Publication ABSLAMC Research

Non-Bank Finance Companies

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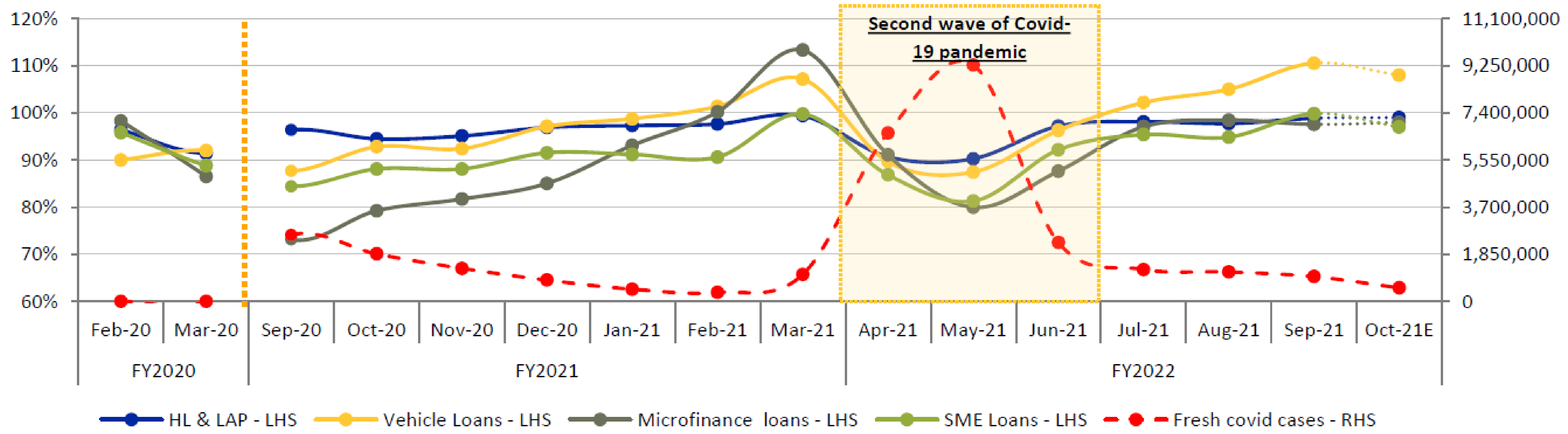
Pick up in collection efficiencies of Securitized Pools



- While recoveries had been steadily picking up till March 21, the second wave impacted collection efficiencies across all NBFC asset classes in Q1FY22 and pick up happened in Q2FY22 in line with fall in covid cases
- There has been a bounce back in collection efficiencies from June 21 onwards. However, trends indicate a plateauing of numbers at ~100% levels, meaning that overdue collections are going to require more effort/time to collect.

Source: ICRA, ABSLAMC

Asset Quality trends peaked in June, 2021 - however still on higher side

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Exhibit 1: Asset quality trends – GNPA/Gross Stage 3

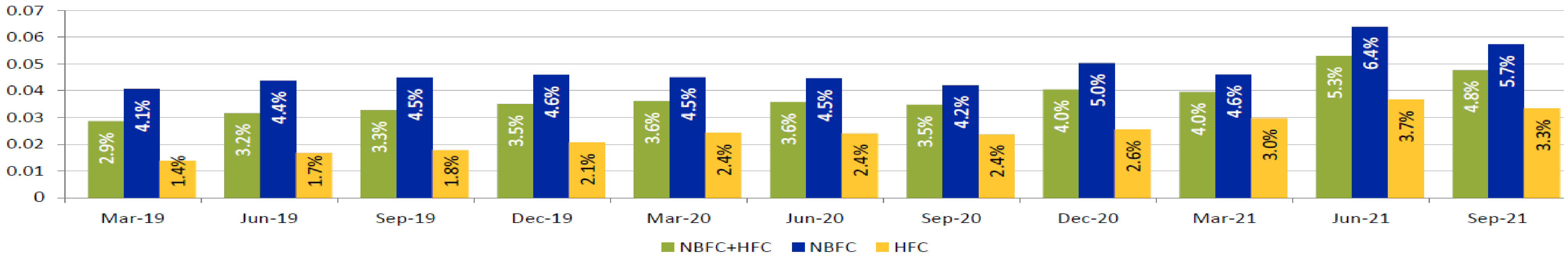


Exhibit 2: Restructured book trend

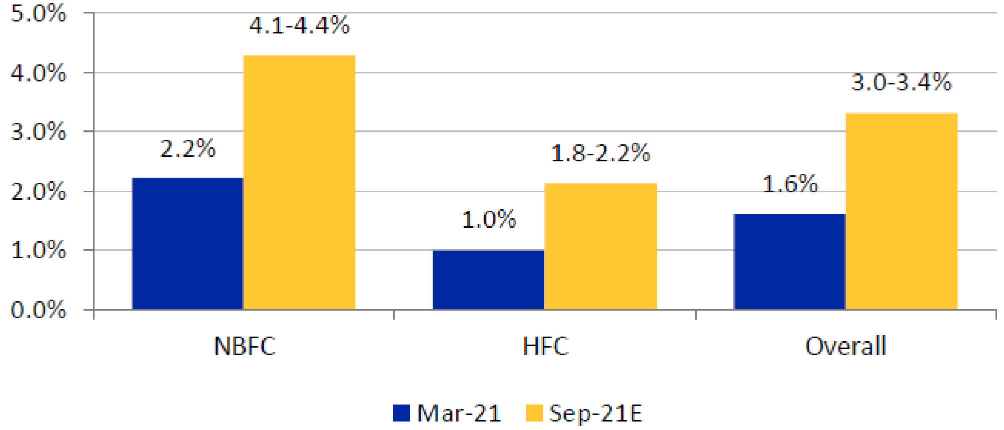
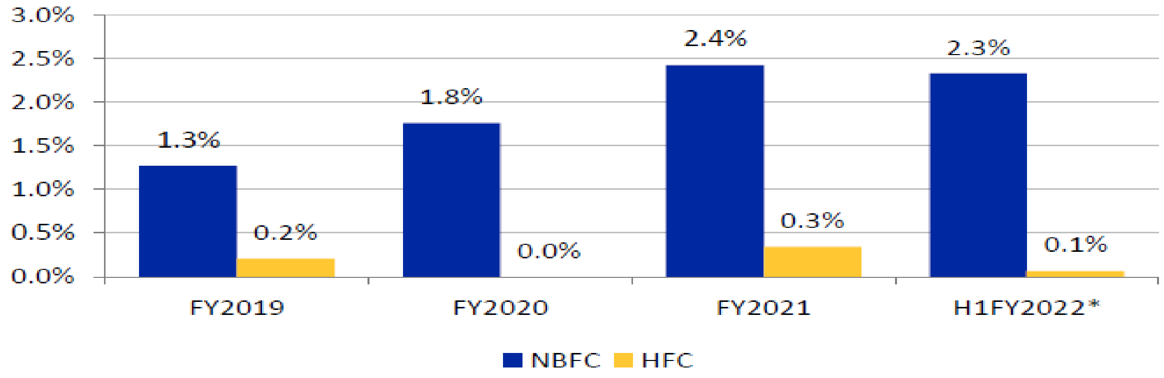


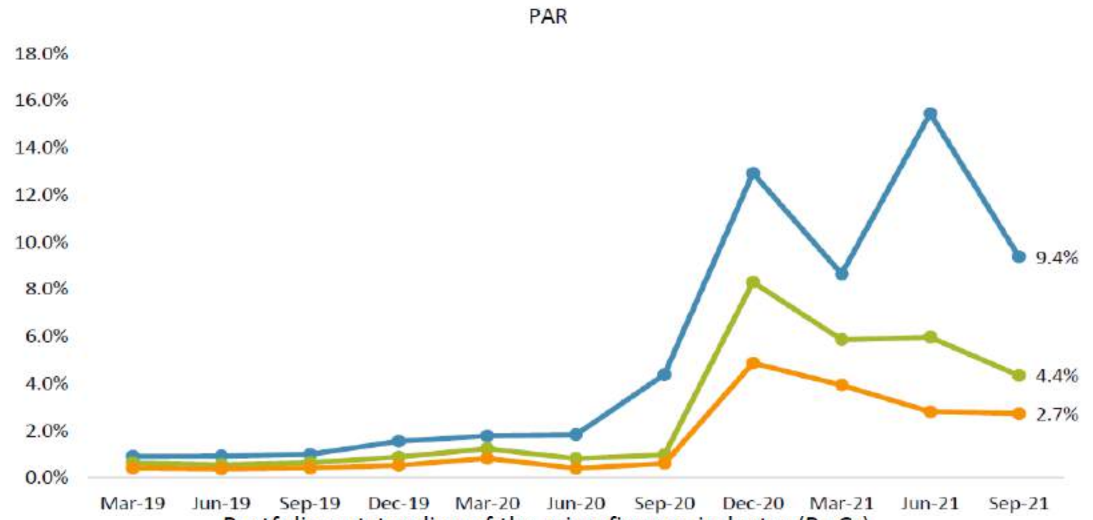
Exhibit 3 :Write-offs as % AUM

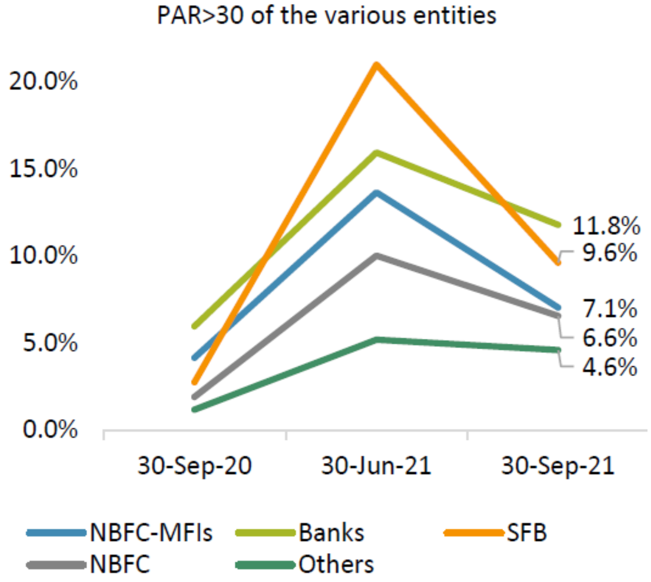


Overall asset quality stress including restructured assets and write-offs post covid wave 2 is much higher as against wave 1

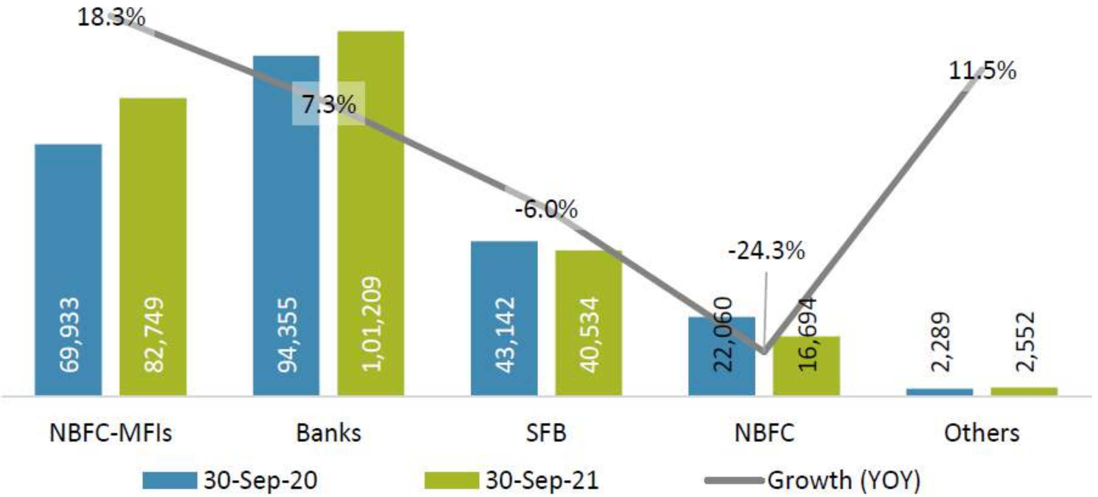
Source: ICRA, ABSLAMC Research, charts are based on sample of few large NBFC/HFCs

MFIs – most vulnerable segment , however off the peak in Q2FY22





Portfolio outstanding of the microfinance industry (Rs Cr)



- MFIs have also seen improvement in collections in Q2FY22, however being the most vulnerable segment sector may take longer then others to come to normalcy and new waves can further delay the return to normalcy
- There is divergence in PAR30 numbers of various types of entities in MFI business which could be explained by difference in growth trend of these entities
- Comfortable leverage of 3.4x can see them tide through this phase

Source: MFIN

Expected Impact on Asset Classes

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MSMEs

1. MSME segment has been the most vulnerable over past few years and during both the lockdowns led by covid wave 1 and covid wave 2 - also it would be one of the most impacted segments
2. However, the MSME Government guarantee scheme has helped in easing cashflow positions for them and hence a large part of stress will not materialize immediately.
3. The sector may remain vulnerable with expected covid wave related disruptions going forward and increase in market share of formal players at the cost of unorganized segment

Commercial Vehicle

1. Post wave 1, CV financiers have bounced back fairly well especially those whose vehicles were involved in essential services (basis the m-o-m improvement in collection efficiencies across all major CV players). We had seen that even during lockdown , goods transport resumed faster, whereas food chain related transport was the quickest.
2. However, in wave 2, collection efficiencies were impacted which seemed more due to the impact of both collection machinery as well as actual credit deterioration due to strained business finances.
3. While the collection efficiencies have bounced back in Q2FY22, it may take longer this time to get back to normal levels, further new NPA recognition norms are likely to impact this segment the most
4. We expect government guarantee schemes, restructuring window as well as likely fiscal push in infrastructure will reduce the ultimate credit losses in this sector.

Expected Impact on Asset Classes

Housing Finance Companies

1. Disbursements for HFCs continued to be strong aided by underlying demand and soft rates
2. Most HFCs have reported stable profitability. However, asset quality numbers have now settled at higher levels and look worse on a lagged basis. This is despite improvement in Q2FY22 and good disbursements
3. However, most players expect reversal in asset quality metrics in the second half of the year.
4. Continued growth with good underlying asset performance is key to ensuring that credit cost remain under control
5. With restructuring window available to builders, it is expected that financiers/builders use it to get some relief in the current scenario

MFIs

1. MFIs continue to be the most vulnerable segment amongst all asset classes impacted in COVID
2. Though March 21 quarter had shown good improvement, June 21 quarter showed significant weakening in collection efficiencies. In each Covid wave the sector got impacted badly
3. While collection efficiencies have improved in Q2FY22, however with the continuing recognition of stress most MFI players reported worse results in even Q2FY22.
4. With few large players facing management change overhang along with the asset quality issues, the sector may stabilize only over next few quarters
5. However lower leverage levers will help the sector in tiding over the current issues

Power

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Power Demand recovery is higher than pre-covid level as impact of Covid 2.0 eases

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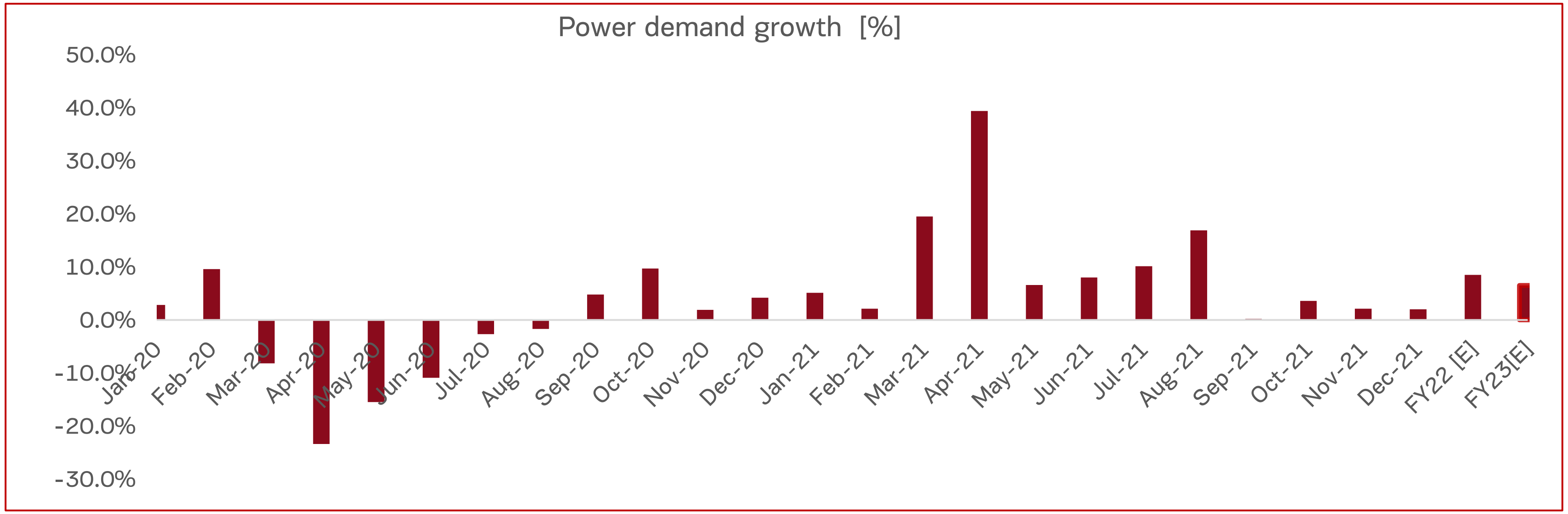

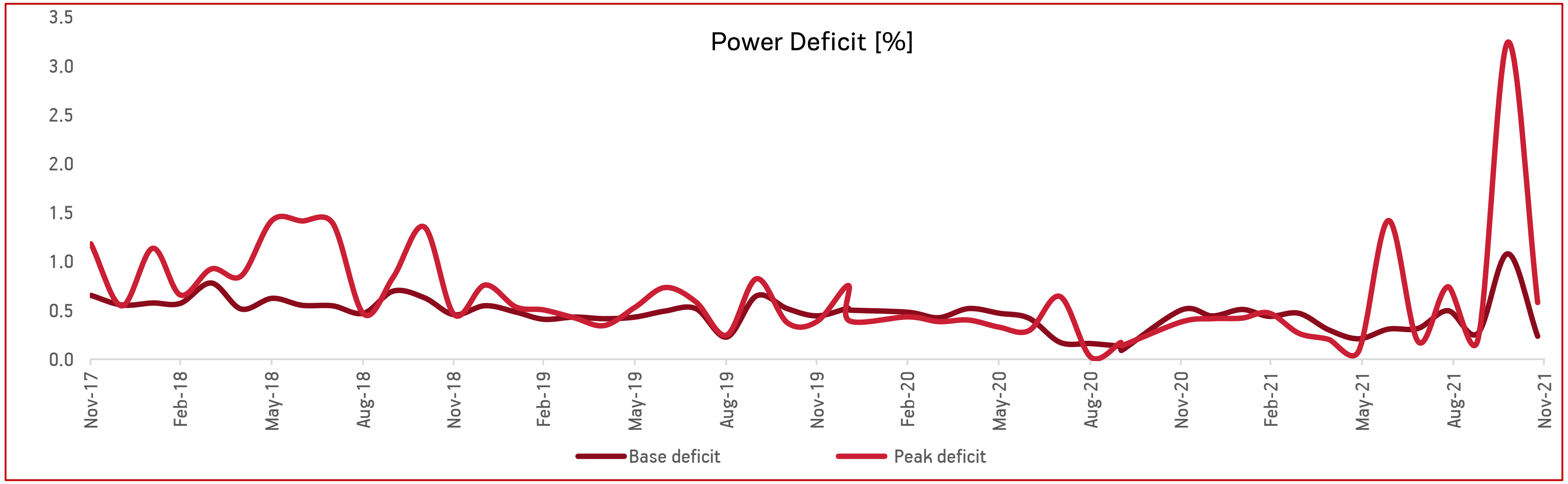

- Power Demand registered strong growth of 10% [YTD till Dec 01] on YoY basis and was higher by ~6% compared to the pre-covid period of CY 2019.
- The growth was driven by improved economic activity [with lockdown easing], hot weather conditions in Northern & Eastern regions, reasonable industrial demand growth in Gujarat, Maharashtra & Tamil Nadu [which contributes ~40% of total demand growth] and pick up in agricultural demand.
- Both peak and base deficits remained low till Sep'21 but increased during October'21 due to sharp spike in demand and lower power supply due to coal shortage and drop in hydro generation.
- We remain constructive on overall demand recovery in FY23 with stable growth of ~6% YoY.

Thermal Power Generation – Plant Load Factors (PLFs) expected to improve further

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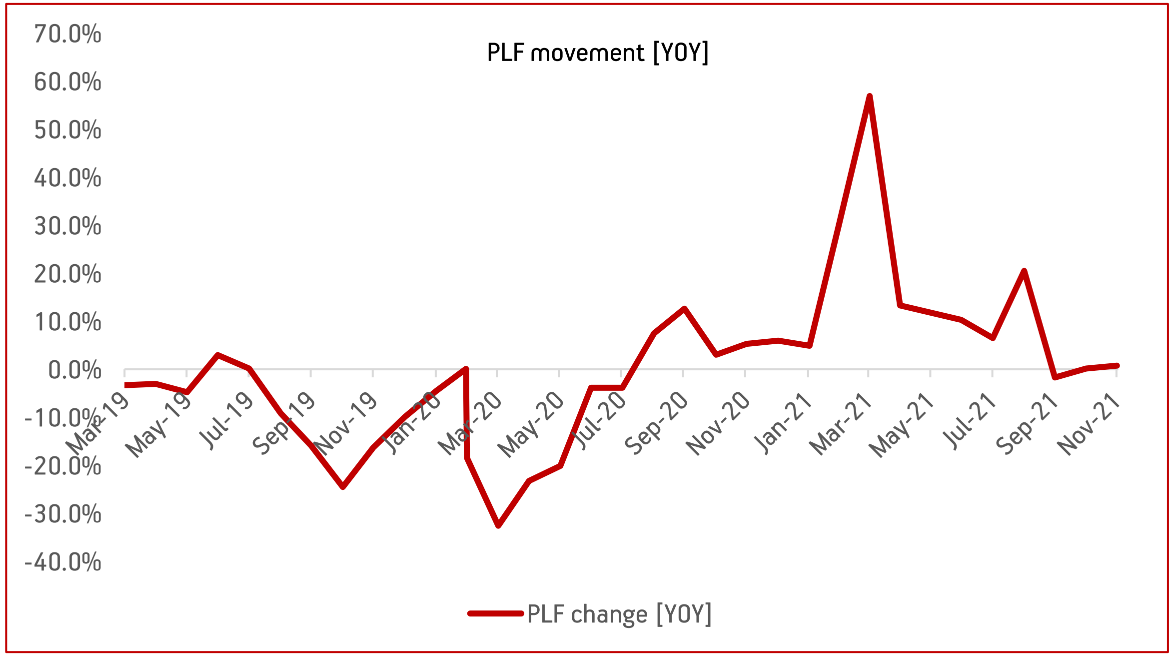
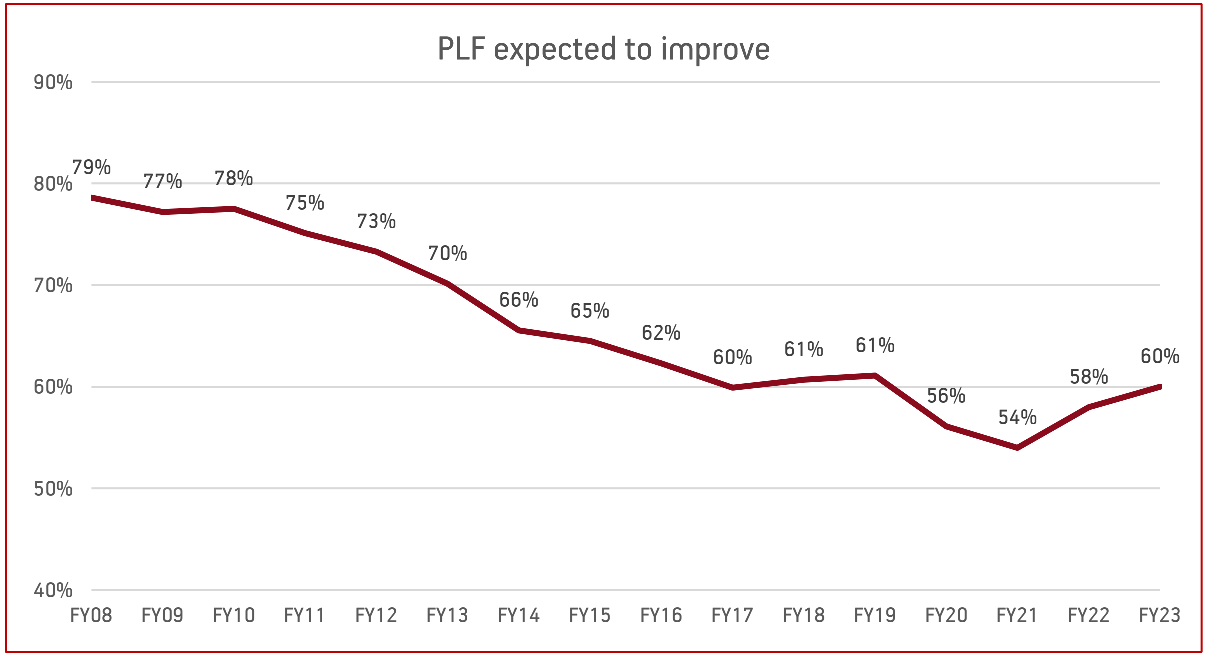


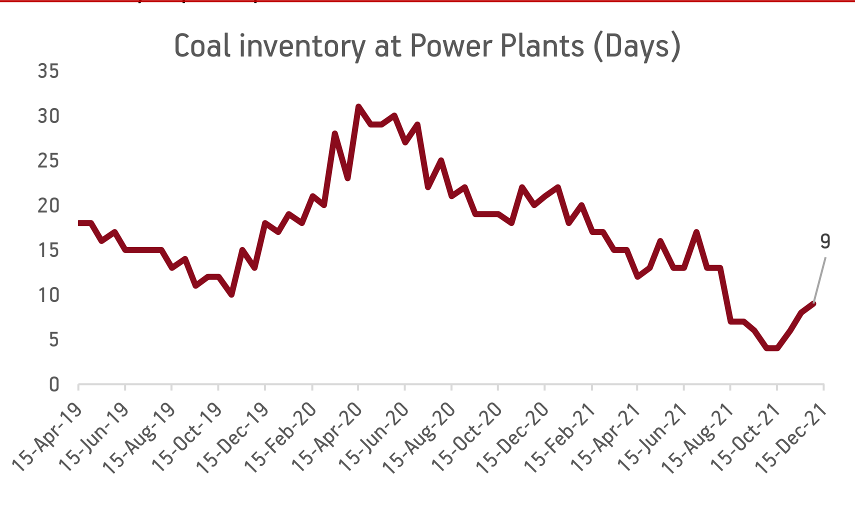


- Thermal Coal PLFs reduced during Nov 21 to 53% as compared to 59% in August 2021 despite the higher demand for electricity. This was on account of coal supply constraints amid spikes in demand and higher international coal prices. We expect FY22 to end with a PLF of ~57-58% [as compared to ~54% in FY 21] and further to ~60% in FY 2023 led by the electricity demand growth.
- A sustainable improvement in thermal PLF level along with signing of PPAs by discoms remains important for improving the Outlook for the thermal generation segment.

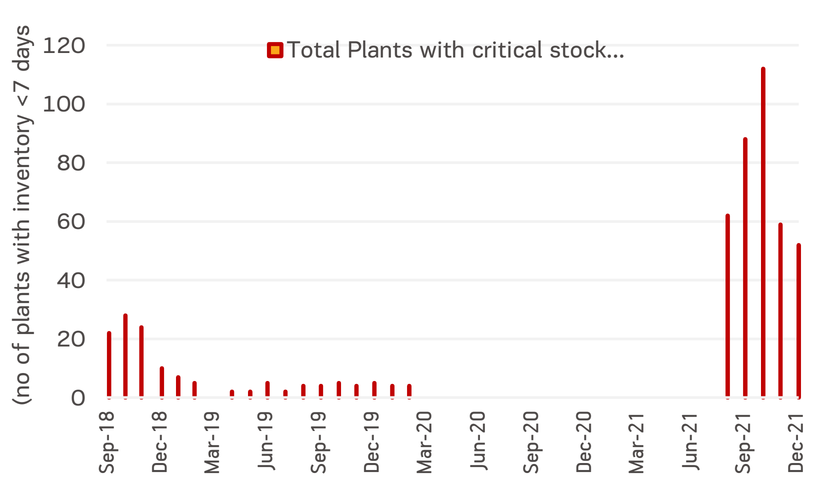
Source: CEA, ICRA,ABSLAMC Research

Thermal Power –Coal availability remains subdued, but the situation is expected to normalize shortly

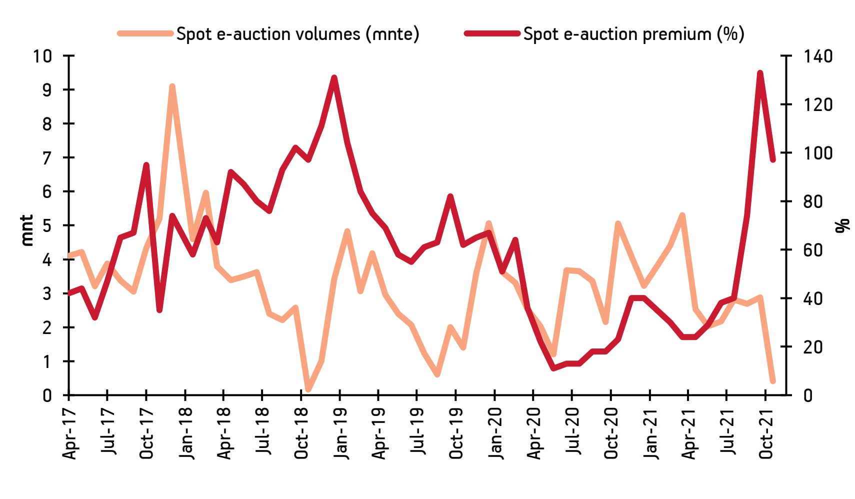
Coal inventory at power plants has started to normalize



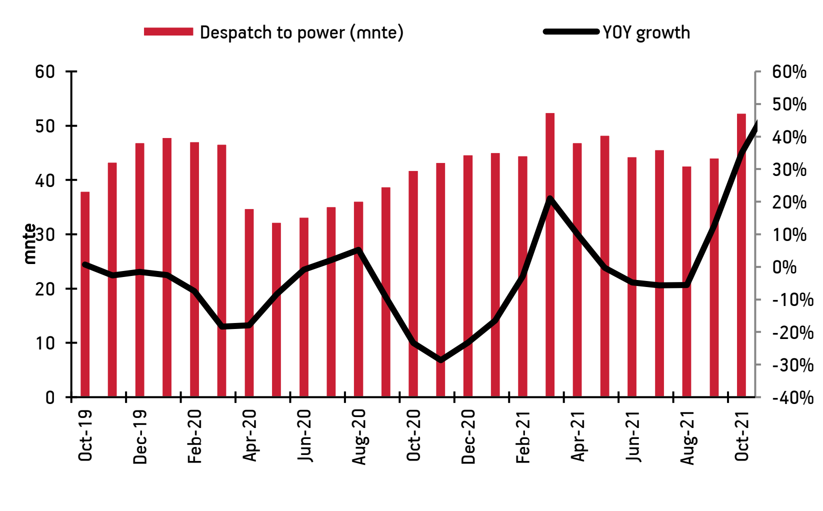
No of Plants with critical stock levels <7 days



Spot premium increased to 130% in Sep 21; while volume remains low



Coal dispatches to power plants has started improving



- ❑ High international coal prices, robust power demand, supply restrictions by Coal India to ~14GW of capacity due to non-clearances of past dues resulted in low coal inventory across power stations in Sep'21.
- ❑ Inventory at power stations deteriorated significantly in Oct'21 with as many as 112 stations [126GW] facing critical level of inventories.
- ❑ Dispatches from CIL to the power sector has started improving, which has resulted in the decline in E-auction premiums and volumes. We expect e-auction premiums to normalize to 30-40% in FY 23 and improvement in coal inventories to 9 days.

Source: Isec research/CEA/ABSLAMC Research

Renewable– Increasing share of renewable in generation and capacity mix

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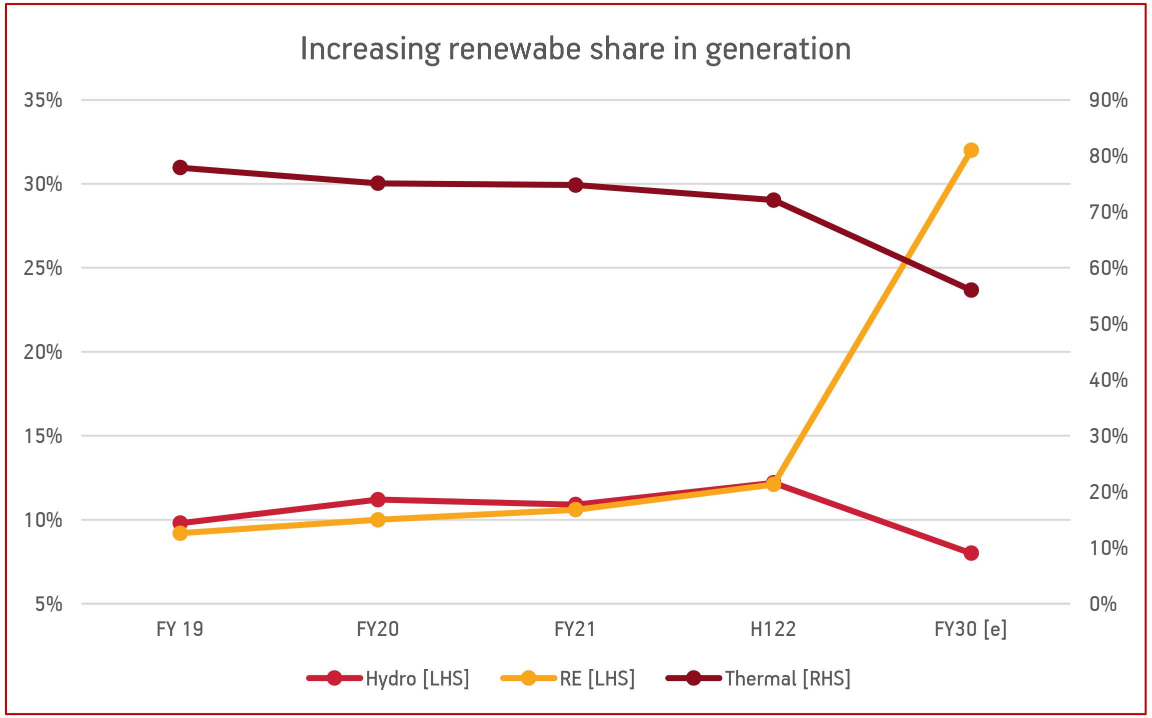
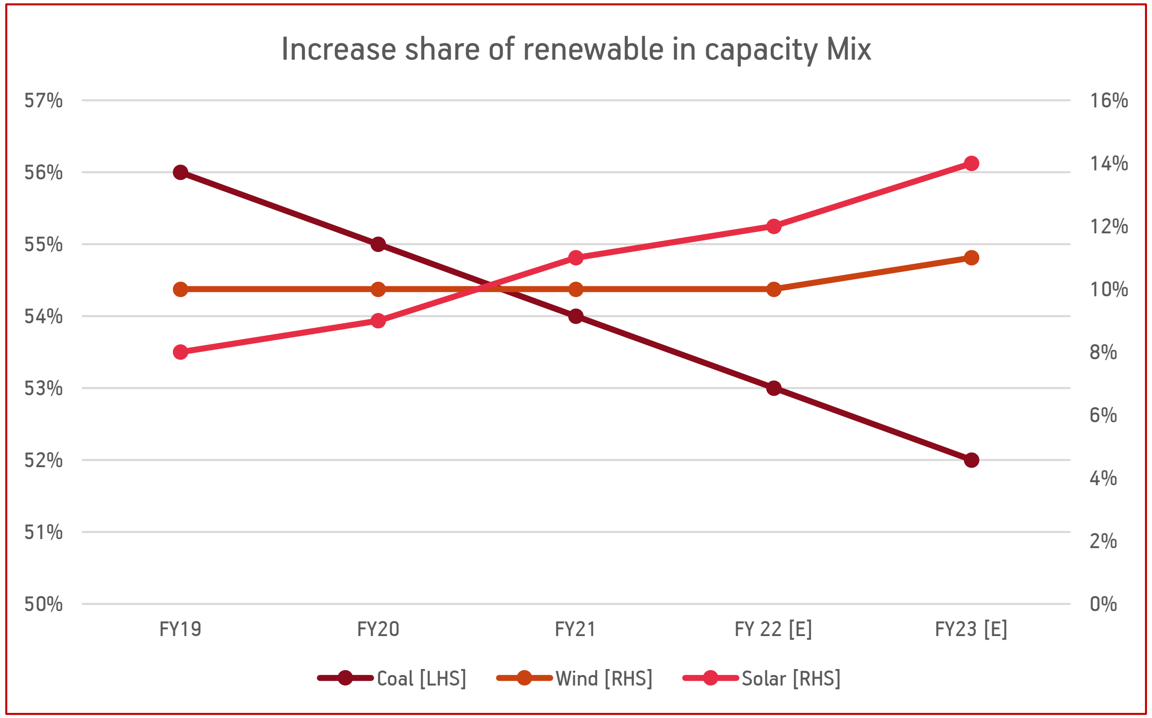
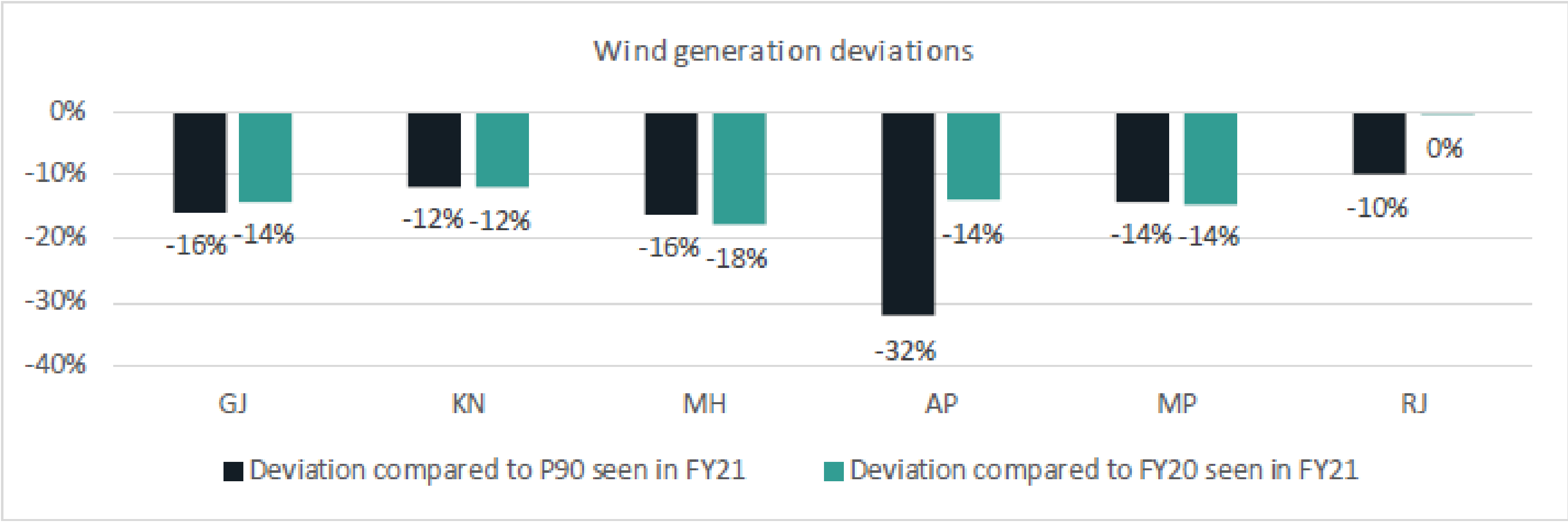


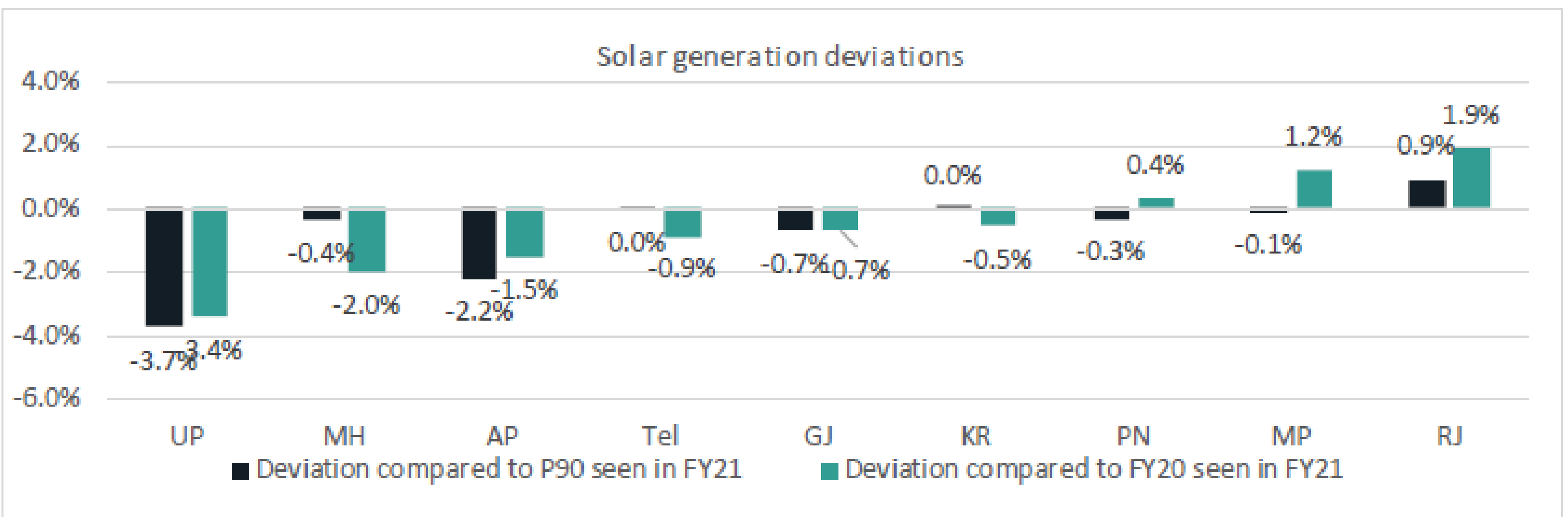


- As per new Conference of Parties[COP], India has set up new climate target including target for renewable capacity to 500 GW by 2030 and increase in the share of renewable [including hydro] in overall generation to 50% from ~20% presently. The same along with competitive tariff advantage & low construction period would aid in renewable generation as well as capacity addition.
- As per CEA, India <u>will not</u> invest in new coal beyond the currently construction projects of ~38 GW, which would result in increase in renewable segment in overall capacity mix V/s fossil fuels.

Source: CEA, ABSLAMC reserach

Renewable Power Generation– Solar Vs Wind





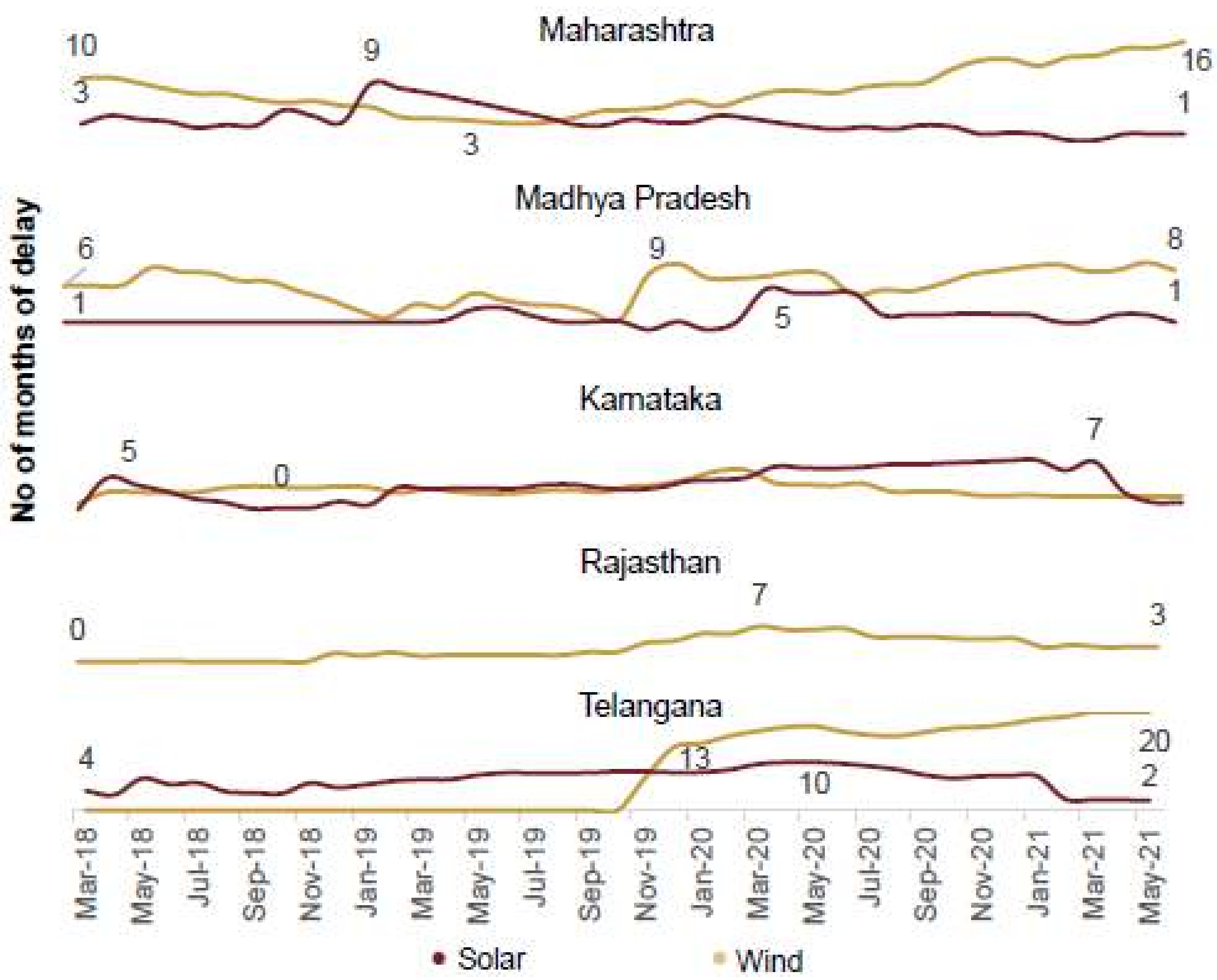
P90 means probability of 90% that the plant would generate the indicated Capacit Utilisation Factor in the first full year of operation

Source: CARE ratings [105 solar & 45 wind portfolio]

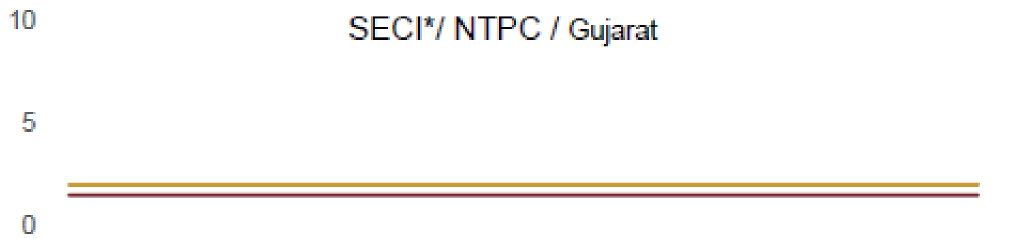
- Uncertainty with the availability of wind resource led to negative deviation in the actual wind generation in FY21 vis-à-vis P-90 estimates as well as the FY20 PLF levels.
- Solar generation performance continues to be largely stable with both positive and negative deviations in a narrow range of 1%-4% in majority of the states.
- Stability in generation of solar power plants augurs well from a credit rating perspective and would be a preferred asset class.

Renewable Power - Solar V/s Wind –Greater volatility in payments to Wind Generators

Payment profile of state discoms remains unpredictable



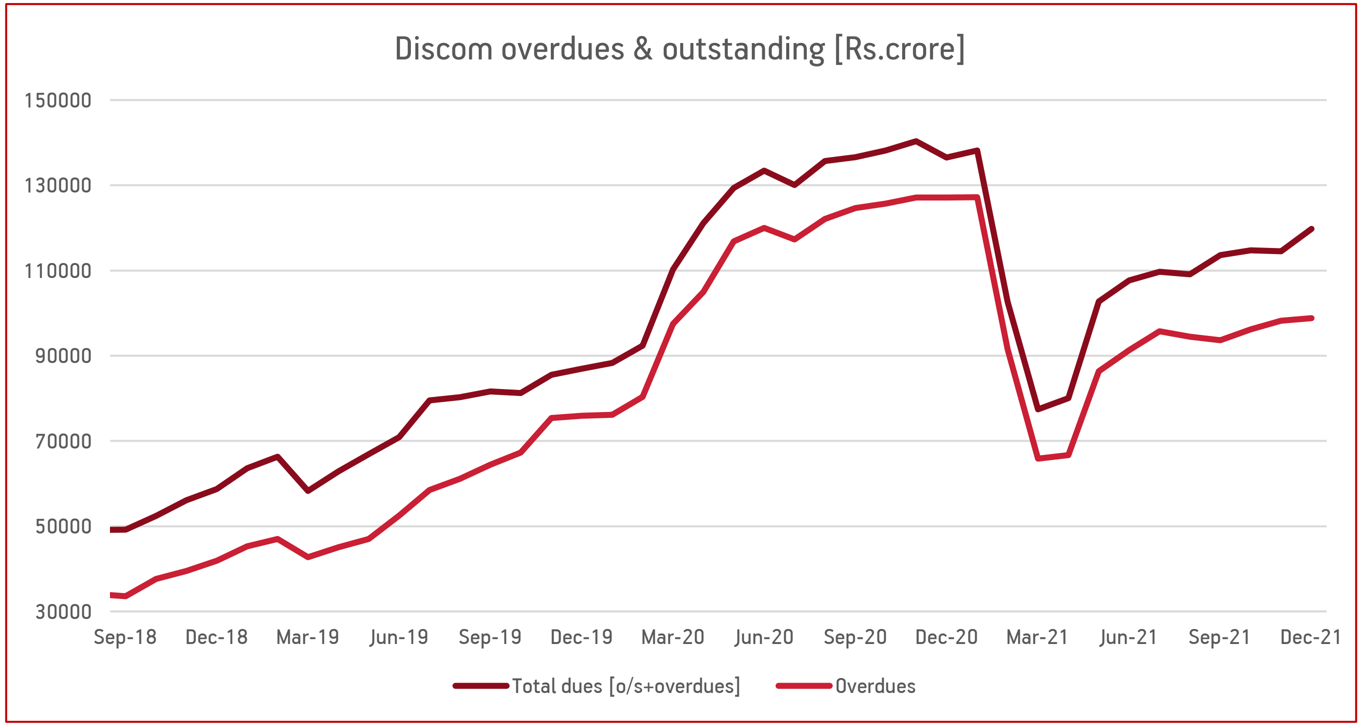
Payment profile of Gujarat and central states has been stable



- The Financial profile and flexibility of SECI remains strong but needs to be monitored with expected growth in scale.
- The Payment Security Fund of SECI covers about a quarter of payments, which also provides some cushion although the same needs to be ramped up with rising capacity to cover the entire portfolio.
- Uncertainty over state discom agreeements [after the PPA re-negotiation issues in Andhra Pradesh/now in Punjab] is expected to result in more bidding under SECI/NTPC projects.
- We would continue to prefer central utility portfolios/diversified portfolios vs concentrated state discom projects.

Source: CRISIL, ABSLAMC Research

Discoms –Overdues creeping up again after reducing due to the Atmanirbhar scheme



❑ Discoms dues are increasing again nearing ~Rs 120000 cr [after sharp reduction in March/April 21], which would again result in liquidity issues/higher working capital requirements at power generators.

❑ The situation is expected to remain stretched in-spite of the short-term relief provided under the liquidity scheme till the reform measures including privatisation, delicensing, smart metering are implemented in the desired manner.

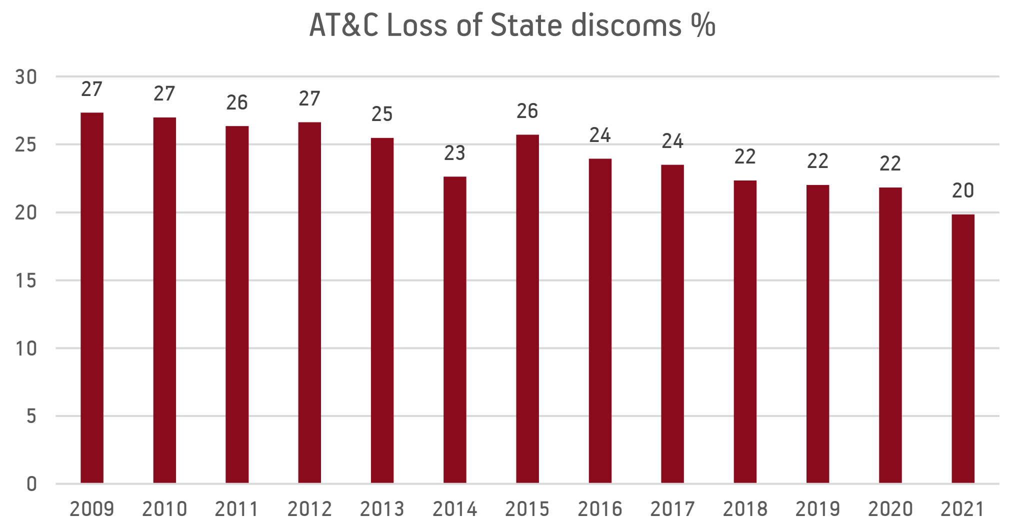
❑ The outlook for Public distribution segments remains Negative amid the weak operating efficiencies, lack of timely and adequate tariff revisions and high debt levels and payables to power gencos.

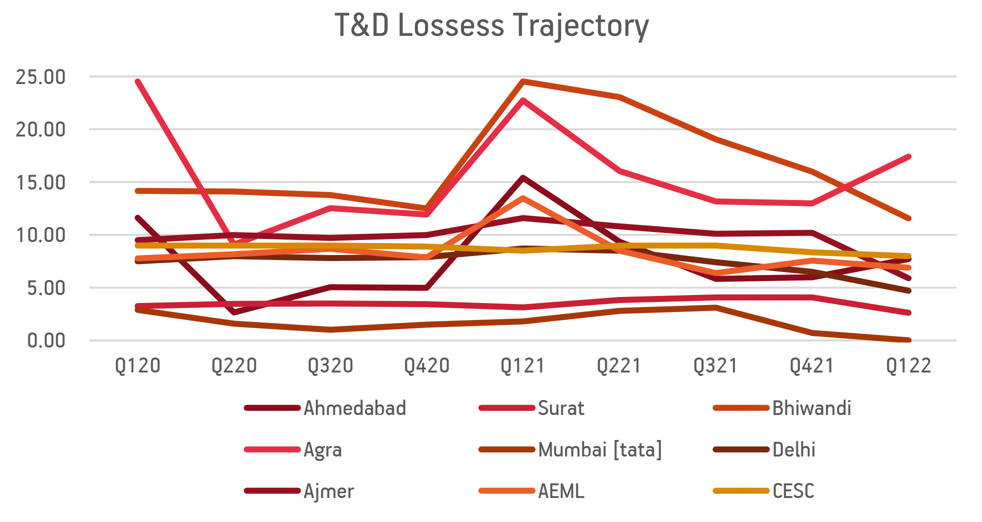
Atamnirbhar Liquidity Package details -Rs. Crore		
State	Loan Sanctioned	Loan disbursed
Andhra Pradesh	8370	7422
J&K	11024	6012
Karnataka	7247	0
Manipur	112	112
Meghalaya	1346	672
Punjab	4000	1000
Rajasthan	6530	2788
Telangana	12652	12580
Uttar Pradesh	33900	32840
Puducherry	150	
Maharashtra	14310	2500
Uttarakhand	800	600
Bihar	3502	3492
Tamil Nadu	30230	14700
West Bengal	1021	454
Himachal Pradesh	138	138
Total	**135332**	85310

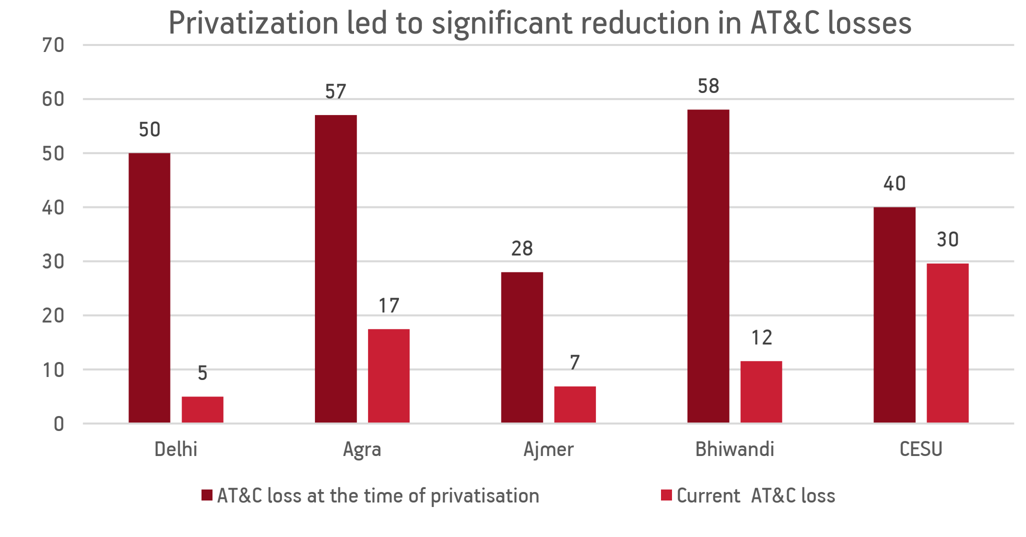
❑ *PFC & REC discom scheme of 1.2 lakh crore for 10 years against discoms receivables from state government in the form of electricity dues and subsidy (2-year moratorium).*

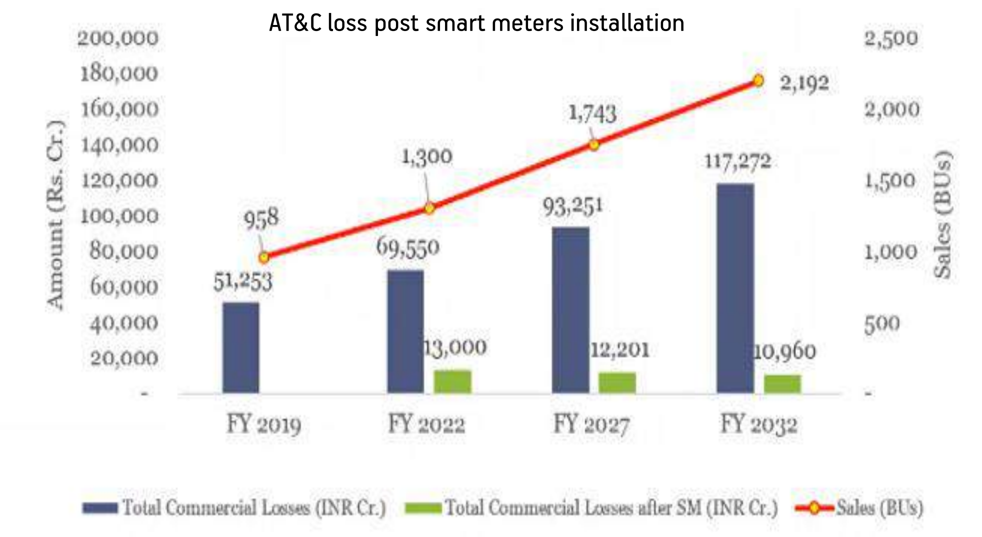
Source: PRAAPTI Portal, ABSLAMC Research

Discoms -Privatisation and Delicensing to improve distribution companies' financial health





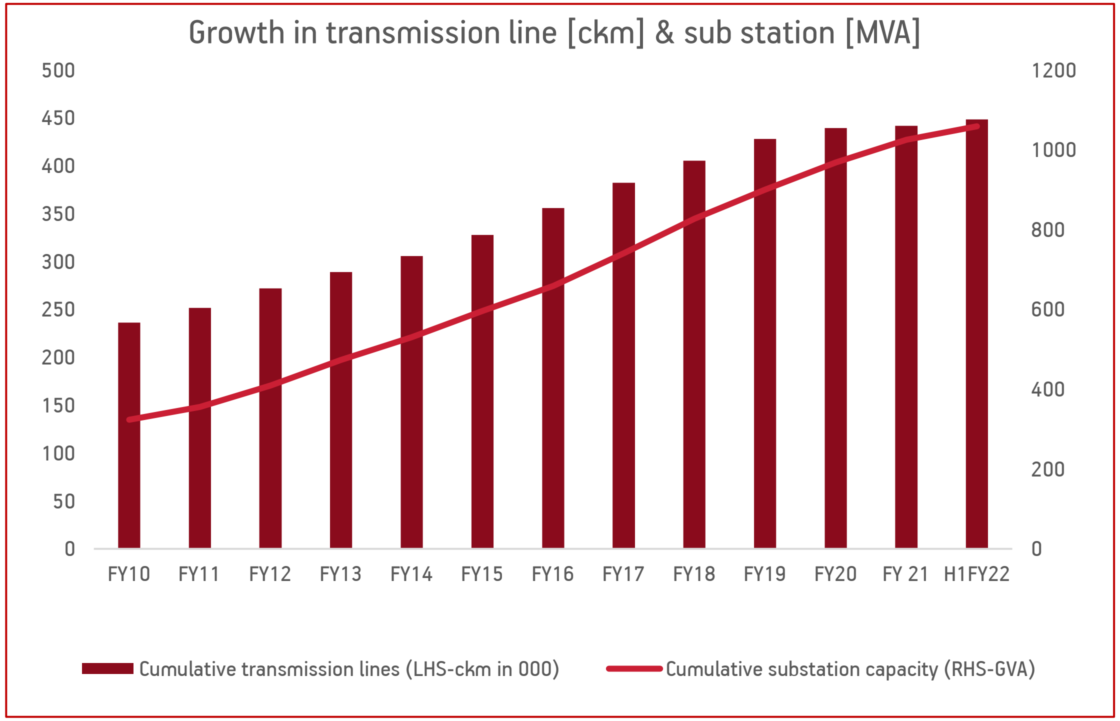


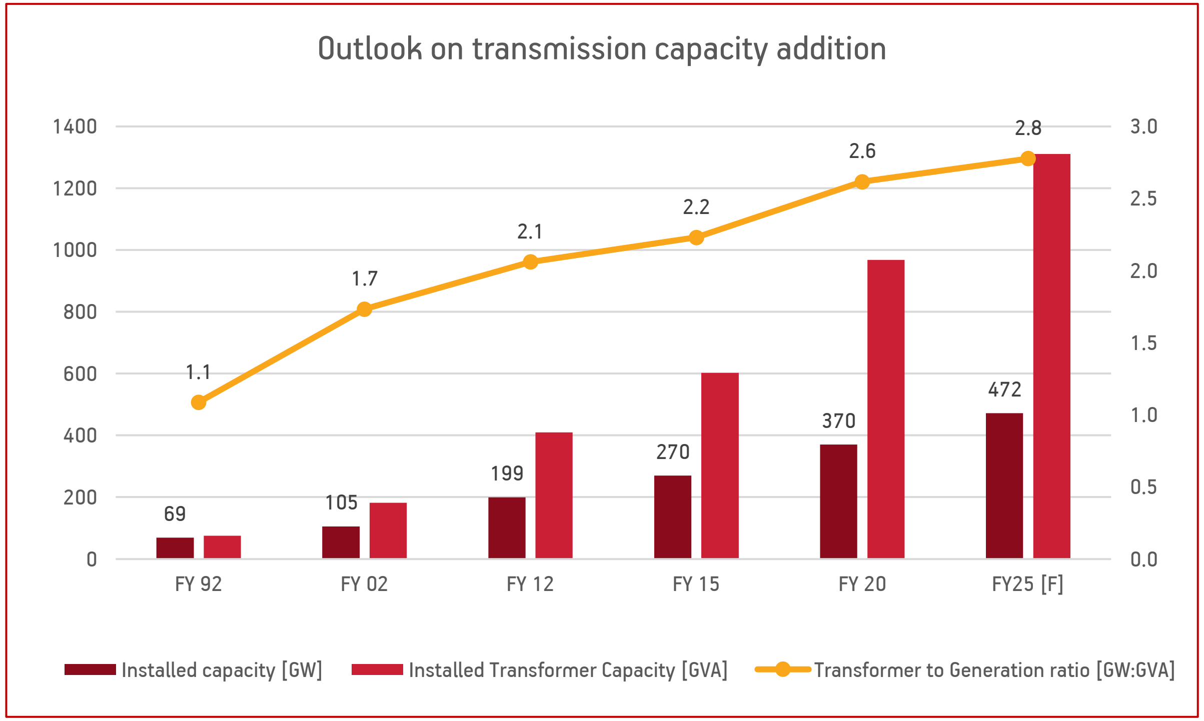


- Privatisation as well as Delicensing of Discoms are expected to reduce losses and improve performance of business.
- Post implementation of planned 250 mn smart meters, discoms' revenue would increase by ~Rs.300/meter and AT&C losses are expected to reduce by 10% from the current level.
- Private Distribution Business model is robust and regulated and many success stories are now being seen.

Source: Uday website, ABSLAMC Research

Transmission –Investment opportunities

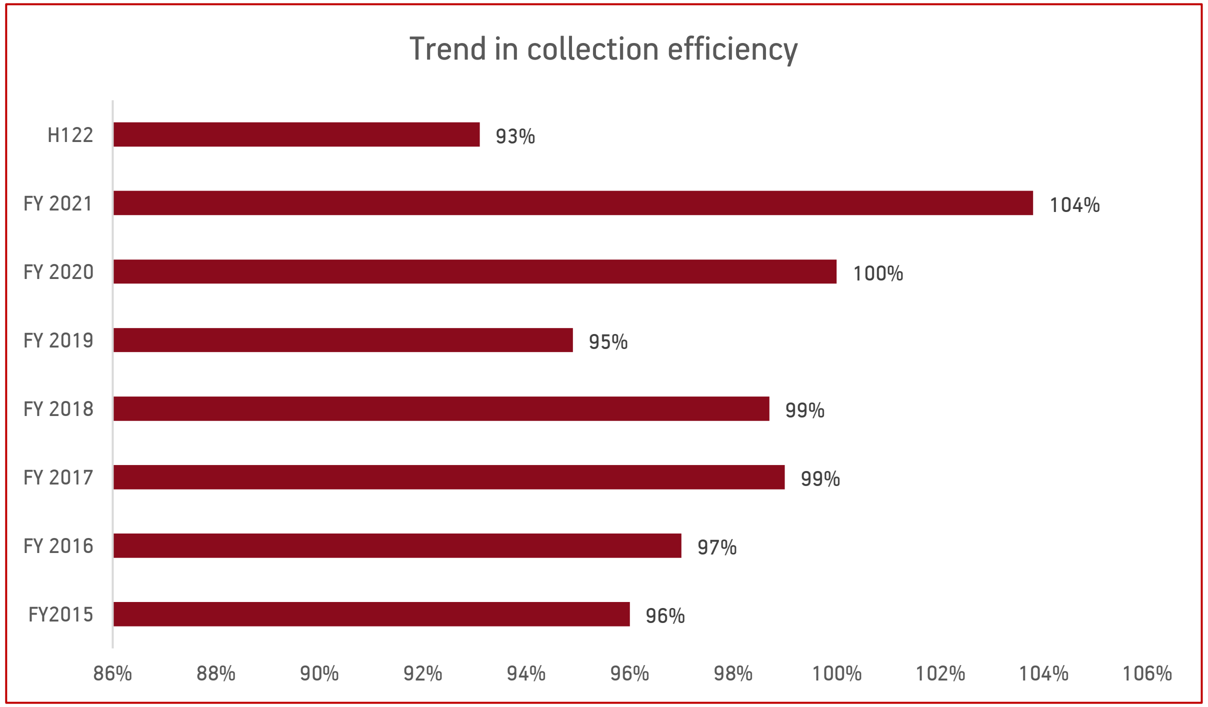


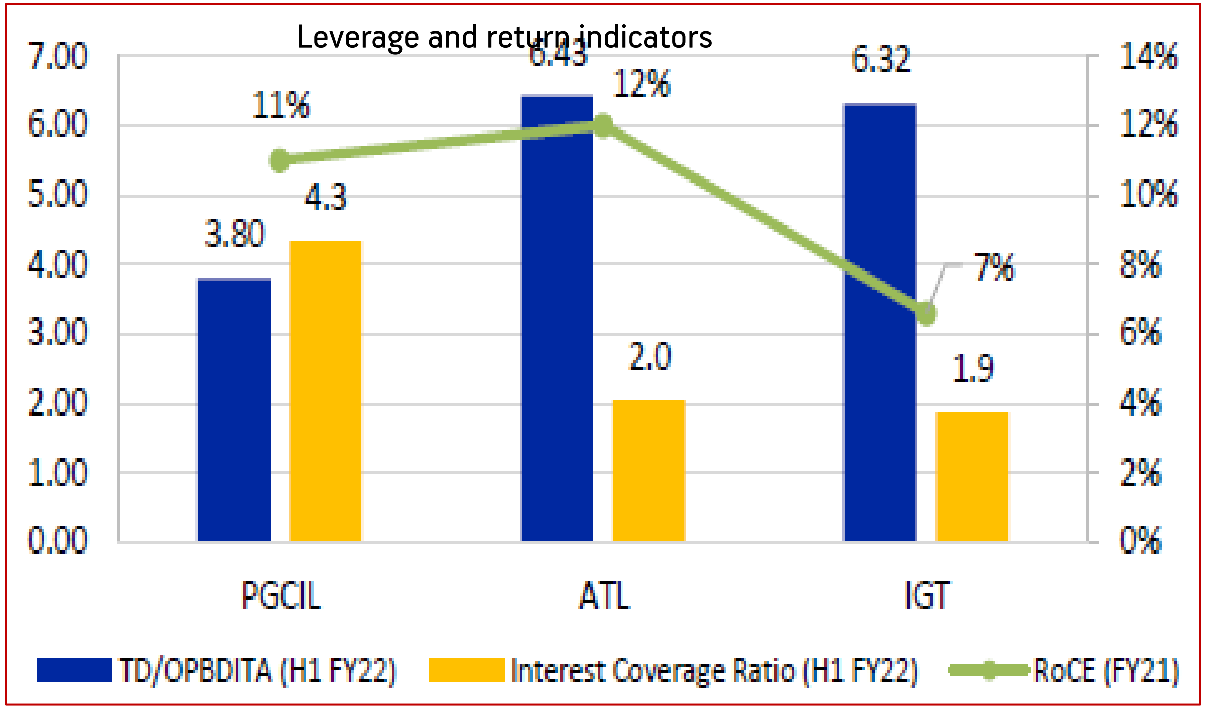


- Growth in transmission capacity is low at 22% v/s 64% in generation during last 5 years] resulting in low MVA/MW of ~2.76 vs global avg of 7x indicating large investment requirement.
- Development of transmission infrastructure, renewable & green energy corridor to support the increased generation capacity would require investments of Rs. ~3.35 Trillion over next five years as per CRISIL Research.
- National monetisation pipeline provide large monetisation opportunity of transmission assets of 28,608 circuit km worth of~ Rs.50000 crore [8% of Rs.6 lakh crore], which is expected to be through INVIT route on similar lines of PGCIL Invit.

Source: PGCIL, CEA, ABSLAMC Research

Transmission –Robust business models support credit profile





- ❑ Collection efficiency remains healthy supported by the presence of the pooling mechanism, with the Central Transmission Utility (CTU) undertaking billing &collection.
- ❑ While there was a dip in collections in the first quarter of FY2022 (65%) because of the lockdown restrictions amid the second wave of Covid-19 on the state discoms, the collections have improved in the second quarter of FY2022 to 121% for PGCIL with overall H1 collection efficiency was 93.1%. Collection efficiency is expected to improve further and remain >95% level in FY22/23.
- ❑ The Outlook for transmission players remains given lower revenue risk due to availability linked revenue stream, stable operating performance with line availability remaining higher than normative level, deemed availability for force majeure etc.

Source: PGCIL, CEA, ABSLAMC Research

Power - View

Views on Asset class

- ✓ Thermal Generation
  - ❑ With the expected increase in peak power demand, thermal PLFs are expected to increase.
  - ❑ Discom liquidity is expected to remain tight despite the Atamnirbhar package disbursement.
  - ❑ Would remain negative on this asset class and avoid entities having high merchant exposure.
- ✓ Renewables
  - ❑ CY 22 power growth would be largely driven by renewable and green/ESG play. Inter-state transmission charges waiver till FY 2025 would provide the necessary boost for renewable investment.
  - ❑ Unpredictability and volatility in payment pattern to renewable projects is a key risk for operational projects. In view of that, we would prefer projects where the counter parties are NTPC/SECI/diversified portfolio as compared to individual state discoms.
  - ❑ PLF variability remains more prominent for wind projects as against solar projects. As an assets class, would prefer solar over wind. Preference would depend on quality of PPA, strong parentage, payment track record and assets vintage.
- ✓ Distribution
  - ❑ Delicensing would reduce entry barriers. This coupled with privatisation of select discoms would improve performance of the sector
  - ❑ Robust& regulatory business model provide revenue as well as return assurance;
  - ❑ Would remains opportunistic for private distribution companies.
- ✓ Transmission
  - ❑ Encouraging large-sized opportunities related to upcoming RE capacities/ISTS tenders would derive investment in sector.
  - ❑ Transmission sector remains the preferred asset class due to its robust busines model, PUC revenue sharing mechanism, stable cash flows, availability linked revenue stream, stable operating performance with line availability remaining higher than normative level.

Roads

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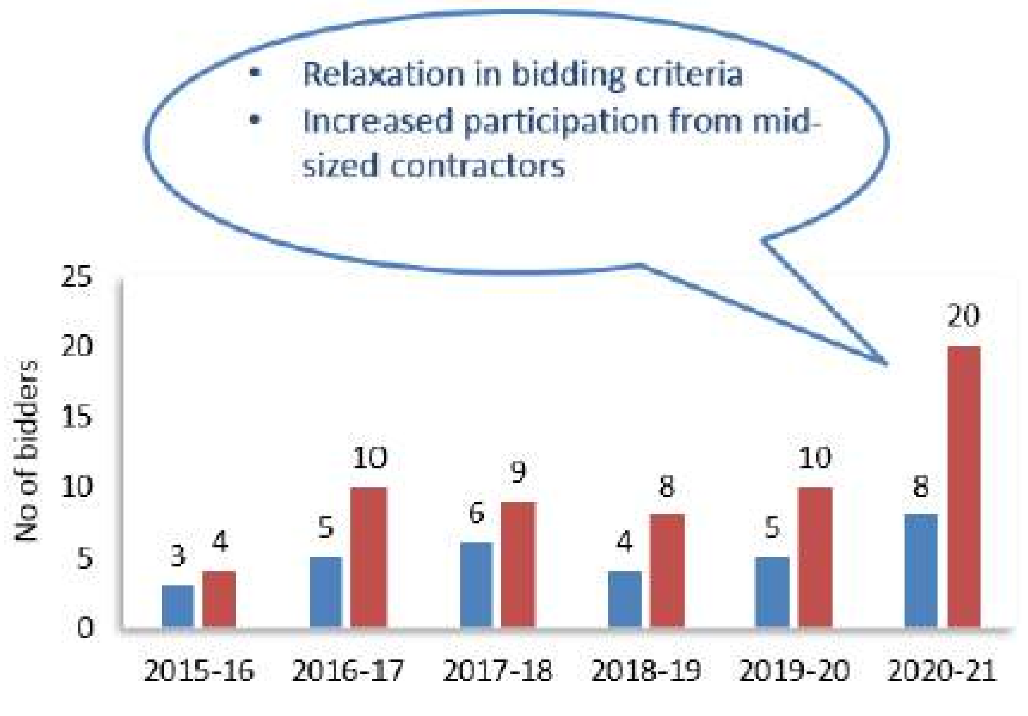
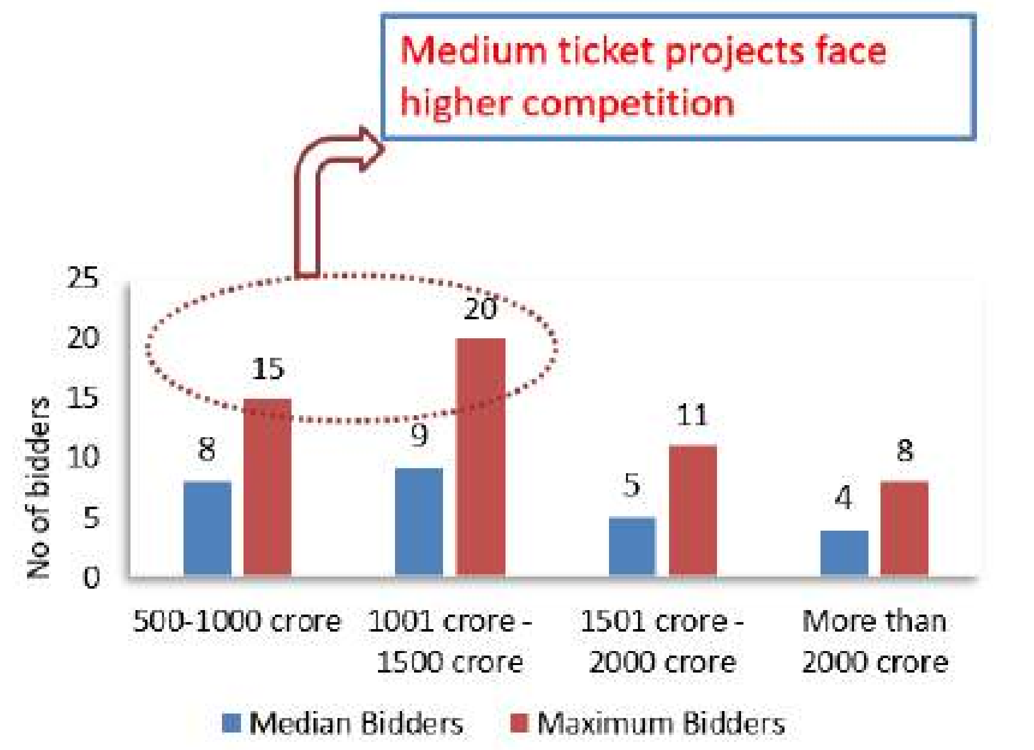
Growing Competition in Road Sector



Source: CARE Ratings



- Intense competition in Road Sector was observed in FY'21 was due to
  - Limited Opportunity from State and Private Sector forcing EPC players to bid for EPC Road projects from NHAI & MORTH.
  - Also, last year, NHAI relaxed the Technical and Financial qualification norms for EPC and HAM projects.
- As per CARE Rating Study, relaxation in the bidding criteria and changes in the model concession agreement of HAM projects have intensified competition in the bidding from Q3FY21. The number of maximum bidders rose to 20 in FY21 as against maximum 10 bidders till FY20. Competitive intensity continued to remain high during H1FY22 also.

Source: ICRA, CARE and Edelweiss Research

Road Sector – Toll Revenue and Collections showing improvement

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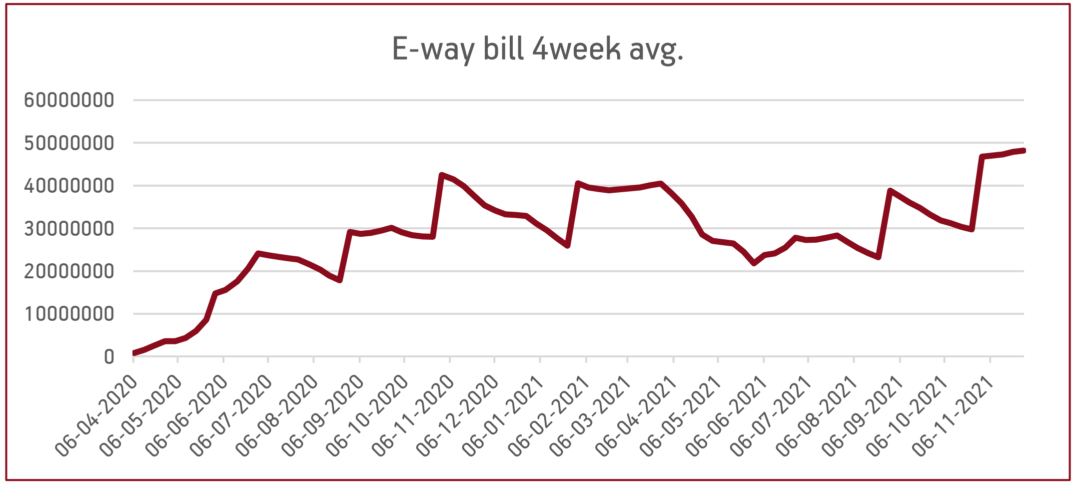
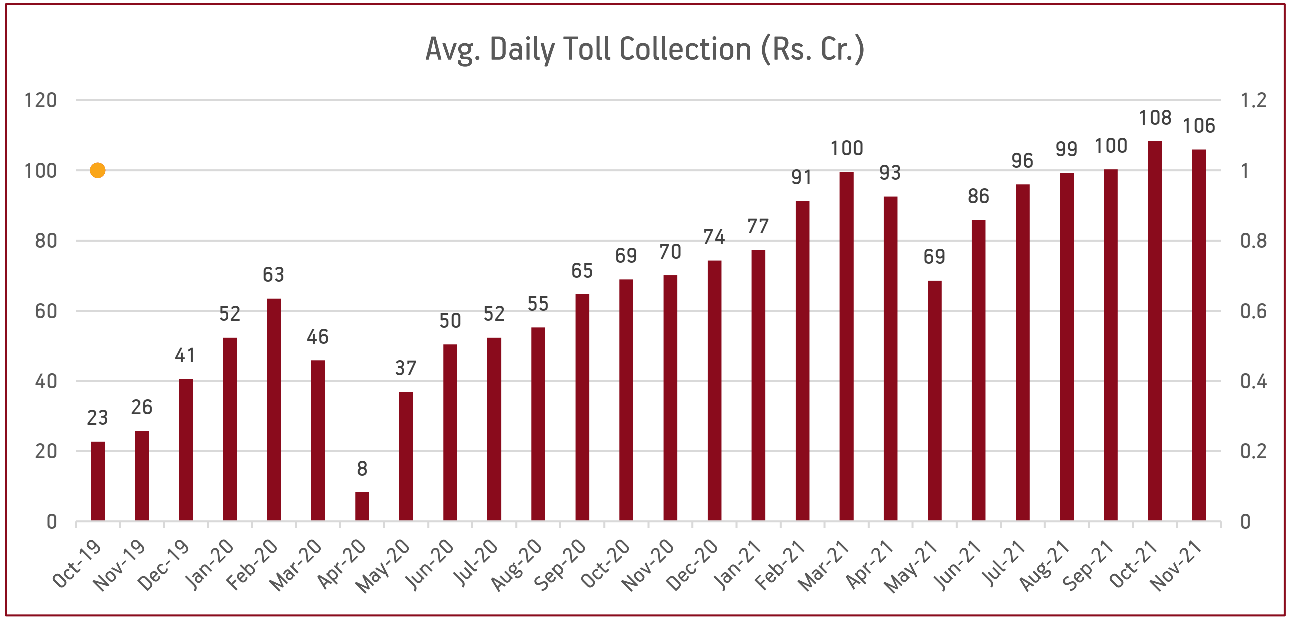
	FY'17	FY'18	FY'19	FY'20	FY'21
Toll Revenue (Cr.)	17,942	21,948	24,396	26,851	28,548
Avg Daily Toll Collection (Rs. Cr.)	49.2	60.1	66.8	73.6	78.2
Fasttag Toll Collection (Rs. Cr.)	660	3352	5760	11294	22762
%	3.7%	15.3%	23.6%	42.1%	79.7%

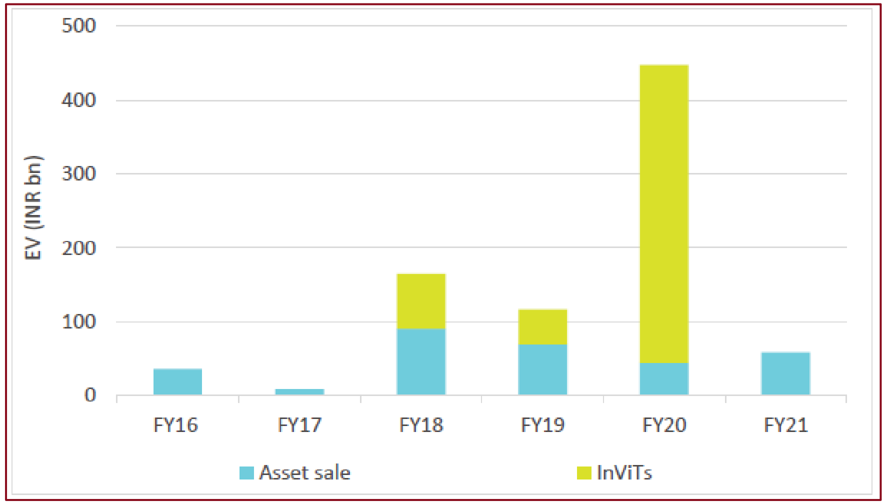


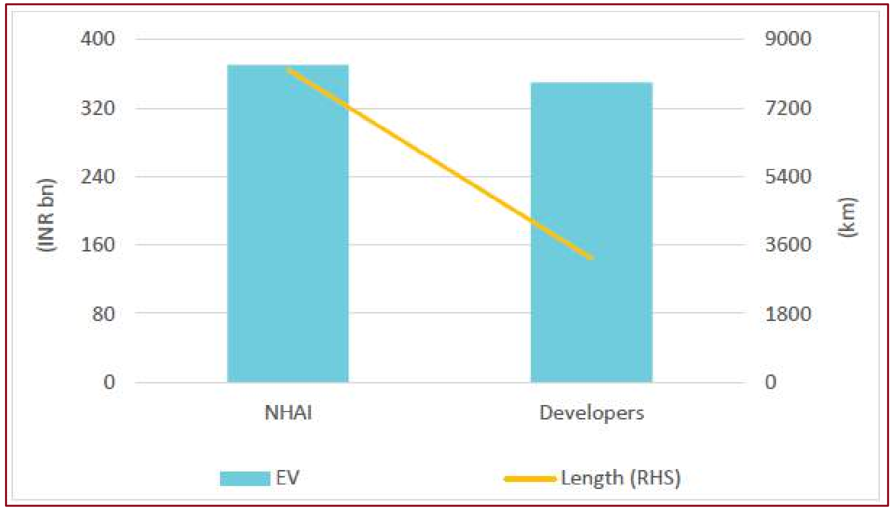


- ❑ Overall Highway Toll Collection in FY21 increased by 6.3% YOY to Rs. 28,548 Cr. (CAGR 12.3% from FY'17)
- ❑ Fasttag penetration achieved over 95% with more than three crore users in the country. Many of the toll plazas have reached ~ 99% penetration.
- ❑ Avg. monthly E-Way bill generation showing improving trend.
- ❑ Avg. Daily Fasttag Toll collection in Oct 2021 was the highest at Rs. 108 Cr. With the opening of new expressways over next few years, collection is expected to improve going forward.

Source: NPCI, GST& Newspaper Articles

Asset Monetization through Sale and InvIT have improved private players balance sheets





- M&A deals in road sector over the past three years (CY2019- Nov2021) have been mainly driven by developers' intent to monetize operational assets to unlock capital, reduce debt and improve liquidity position.
- During this period, a total of 30 assets were sold with a total project cost of Rs. 35,988 Cr. compared to 52 assets sold during CY2015-CY2018 with a total project cost of Rs. 37,019 Cr.
  - *Out of the 30 projects monetised between CY2019-YTD CY2021, 16 were toll, 8 were HAM and 4 were annuity road projects.*
  - *5 out of the 30 projects were state road projects,*
  - *21 out of the 30 projects have been operational for more than four years and the median balance concession period stood at 14 years.*
- As per ICRA Research, ~ 57% of the projects sold were to relieve the liquidity stress of promoters and 13% were sold as part of the debt reduction plans of the promoter.
- Currently, ~ 7projects have signed definitive share purchase agreements while 14 other assets worth Rs. 20,700 crore are on the block for monetization.
- As per CRISIL, there is a potential to monetise assets worth more than ~ Rs.70,000 Cr. (EV) over the next few years on aggregate via NHAI and road developers.

Source: ICRA, CRISIL and Edelweiss Research

Road - View

- EPC and HAM models will remain the preferred mode to award projects in future.
- Companies with unleveraged Balance sheets, asset light balance sheets through reducing or exiting Ownership Assets (BOT) are expected to benefit.
- Although Order book is not an issue for companies in this sector, however, the ability to maintain the profitability margin needs to be observed as main raw material prices (cement and steel) have been rising.
- NHAI targets awarding Rs 2.25 lakh Cr. (~ 5000 k.m) worth of Road projects in FY'22 as compared to Rs. 1.71 Lakh Cr. (4788 k.) worth of projects in FY'21.
- CRISIL Research expects private construction investments in national highways to increase 2x to Rs 1.5 trillion over fiscals 2022 to 2026 compared with the previous five years
- NHAI's Leveraging is expected to rise. How they are able to manage this through TOT / InvIT needs to be observed. NHAI has set a target to raise Rs. 15000 Cr. through TOT and InvIT route in FY'22.

Telecom

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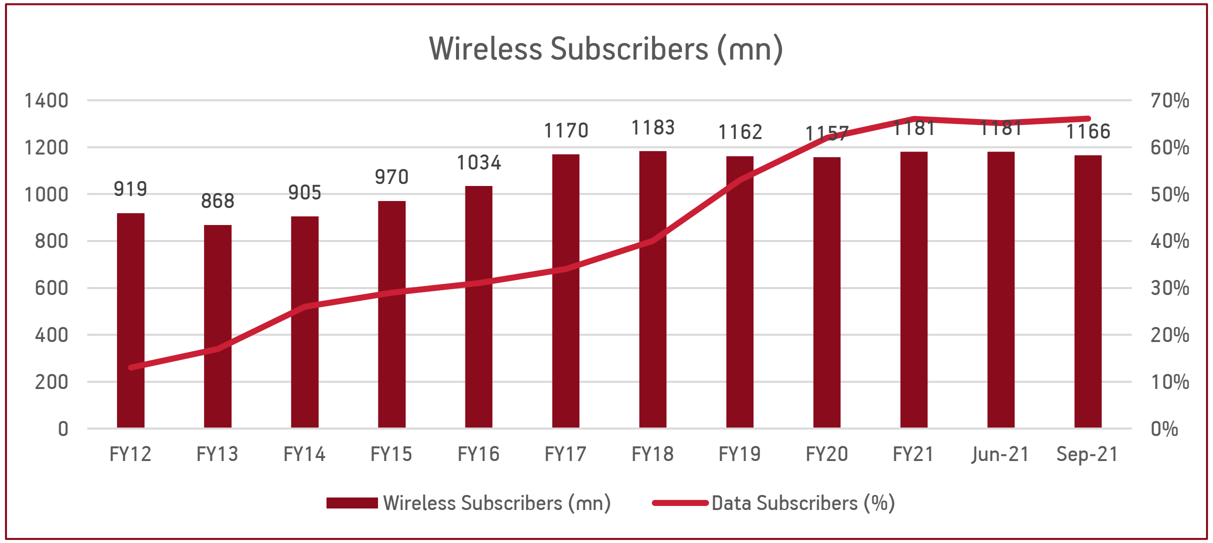
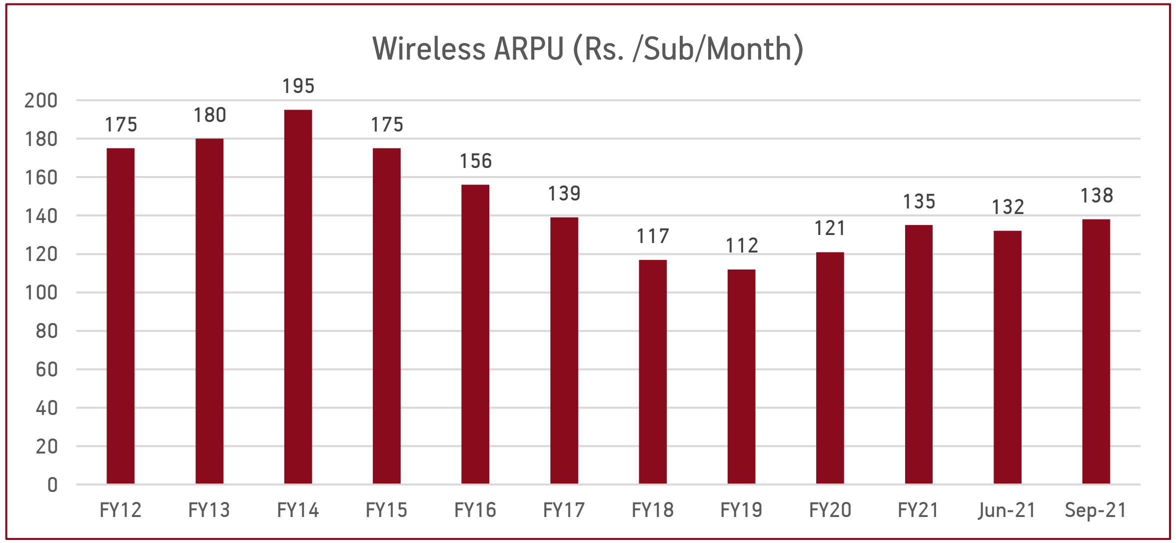
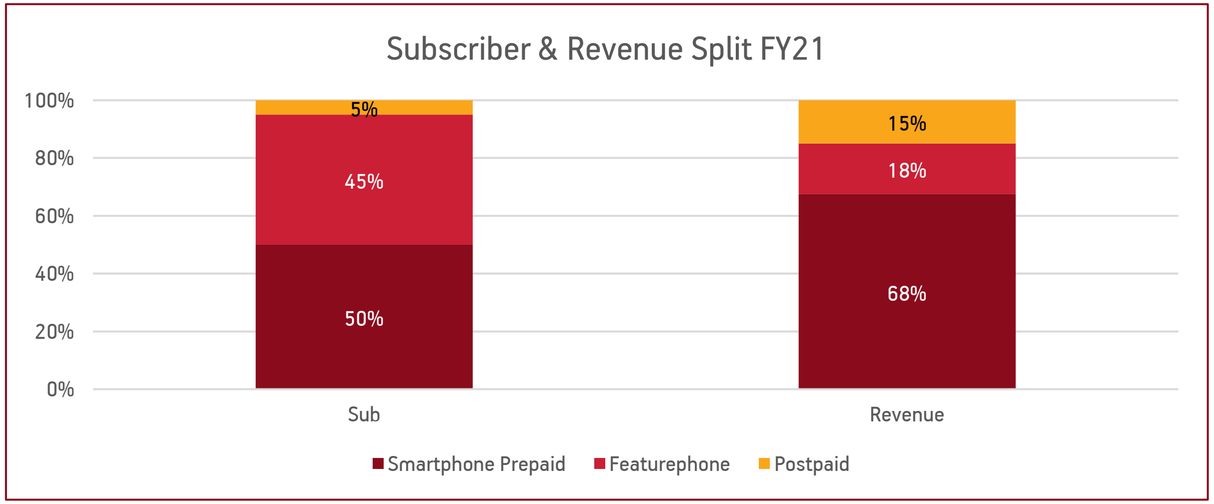
Telecom Trends – Wireless Sub Base, ARPU & Data Consumption



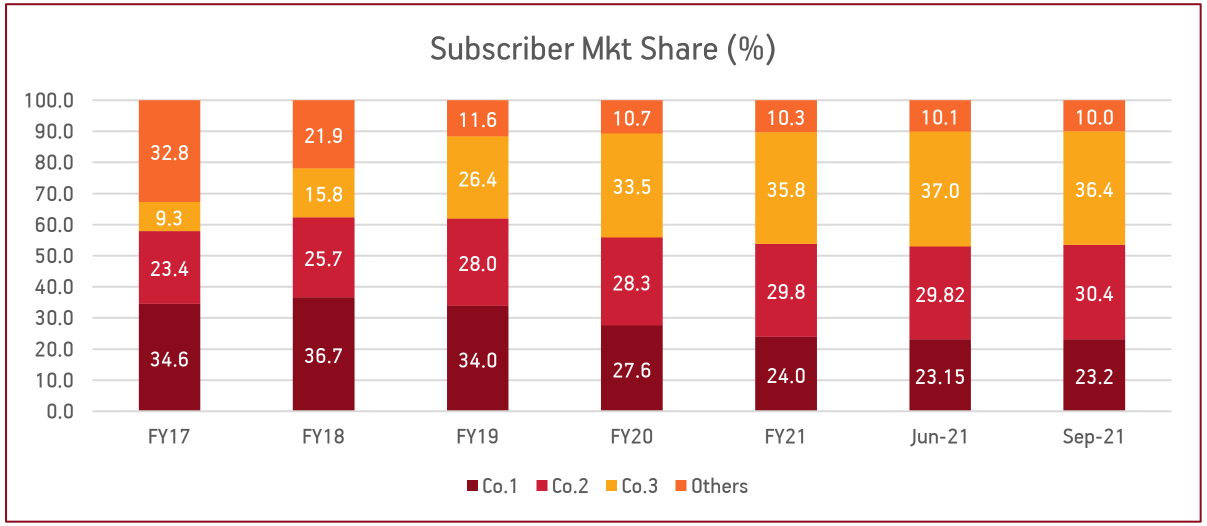


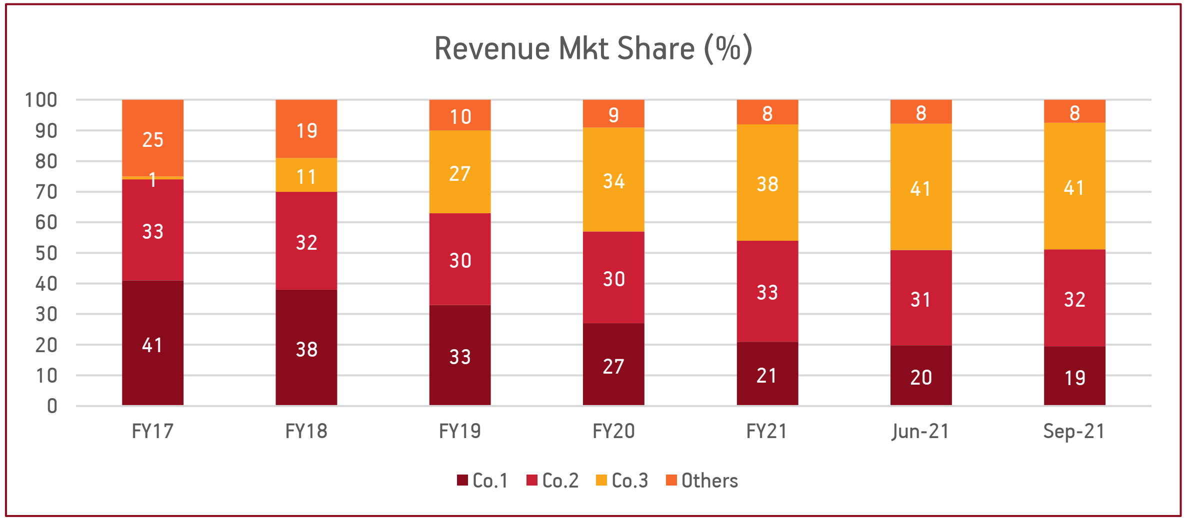


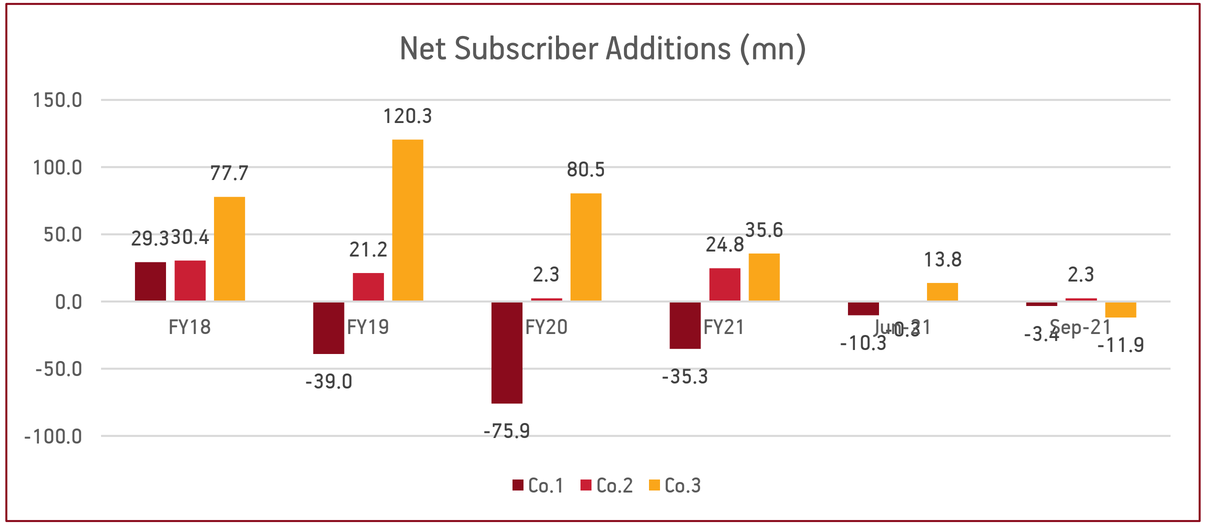
- Total Wireless Subscriber base remained stagnant in the past 5 years, meanwhile Data Subscribers increased exponentially with the penetration of 4G.
- ARPU declined marginally in H2'FY21 due to discontinuance of IUC charges from Jan 1, 2021 but showed improving trend in FY'22 post tariff hike by Bharti Airtel & Voda Idea in H1' FY'22.
- About half of feature phones connection account for just 18% revenue, showing huge upside potential for revenue via Data usage through Smartphone.

Source: TRAI, CRISIL Report

Telcos – competitive positioning







- With the entry of a New Player in the India Telecom market in FY'17, no. of Telecom Players reduced from ~ 16 to nearly 3 players in Pvt. Sector.
- The Strategy of aggressive pricing and better network experience led to shrinkage of market share (Subscriber & Revenue share) of the remaining large 2 Players over the past 3 years.

Source: TRAI, Industry Research

Main Announcements by DoT in Sept 2021

Announcement	Impact
Moratorium/deferment of up to 4 years in annual payments of dues arising out of the AGR judgement.	Liquidity support to Telecom Operators in Short to Medium Term.
Moratorium/deferment on due payments of spectrum purchased in past auctions (excluding the auction of 2021) for up to four years	
Conversion of dues into Equity at the end of Moratorium period at the option of Govt.	Govt. may opt for the option however, equity dilution at the end of tenor can be viewed negatively by Investors
Rationalization of Adjusted Gross Revenue	This will expand the margin of Telecos. As per IIFL report, it would ~ 60 bps
Huge reduction in BG requirements (80%) against Licence Fee (LF) and other similar Levies. No requirements for multiple BGs in different Licenced Service Areas (LSAs) regions in the country. Instead, one BG will be enough.	Non-Fund based limit of Telecos will be freed up and can be utilized for other business purposes.
For auctions held henceforth, no BGs will be required to secure instalment payments. Industry has matured and the past practice of BG is no longer required	

Source: Govt. Circular

Tariff Hike

	Bharti Airtel			Vodafone Idea			Reliance Jio		
	Earlier	Aug-21	Nov-21	Earlier	Aug-21	Nov-21	Earlier	Aug-21	Nov-21
Entry Level Tariff Voice Plan	49	79	99	49	79	99	75	75	91
Hike		*61%*	*25%*		*61%*	*25%*		*0%*	*21%*
Post Paid Plan (1.5 GB / Day)		249	299		249	299		199	239
Hike			*20%*			*20%*			*20%*
Data Top Ups		48	58		48	58		51	61
Hike			*21%*			*21%*			*20%*

- Recent Tariff Hike by all Telecom Players will not only restrict the subscriber Churn but it will help to improve the Revenue, profitability and overall Outlook for the Sector.

Source: Company websites

Telecom – View

- Wireless subscriber level is expected to remain range bound and addition to total subscriber base post COVID -19 is expected to slow down.
- Industry Revenue is expected to grow by 15% on account of improvement in ARPU backed by Tariff hikes and higher data consumption. This would improve the profitability of Telcos.
- Govt is expected to auction 5G in FY'22 which will increase the leveraging of Telcos going forward.

Metals: Ferrous and Non-Ferrous

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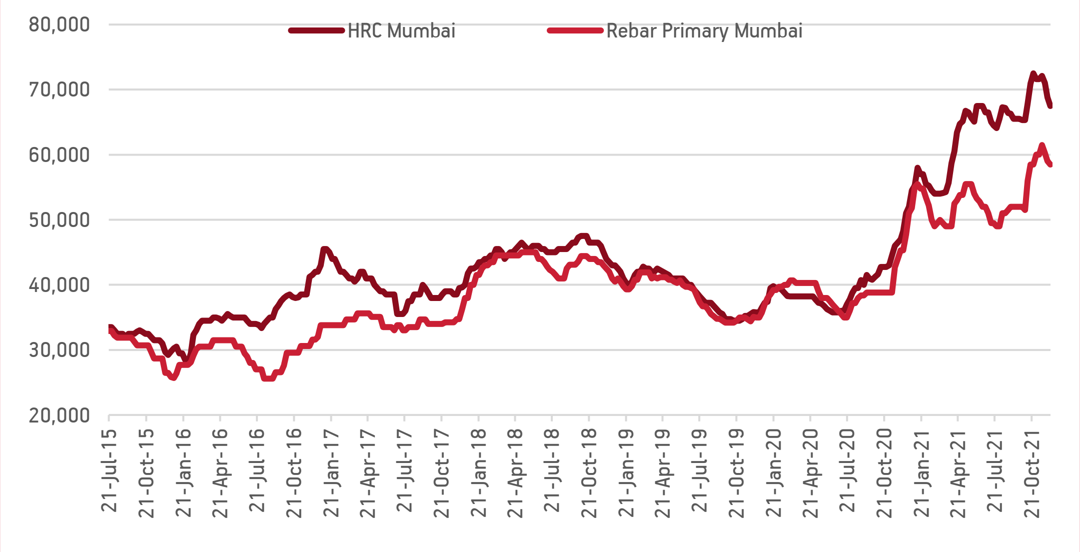
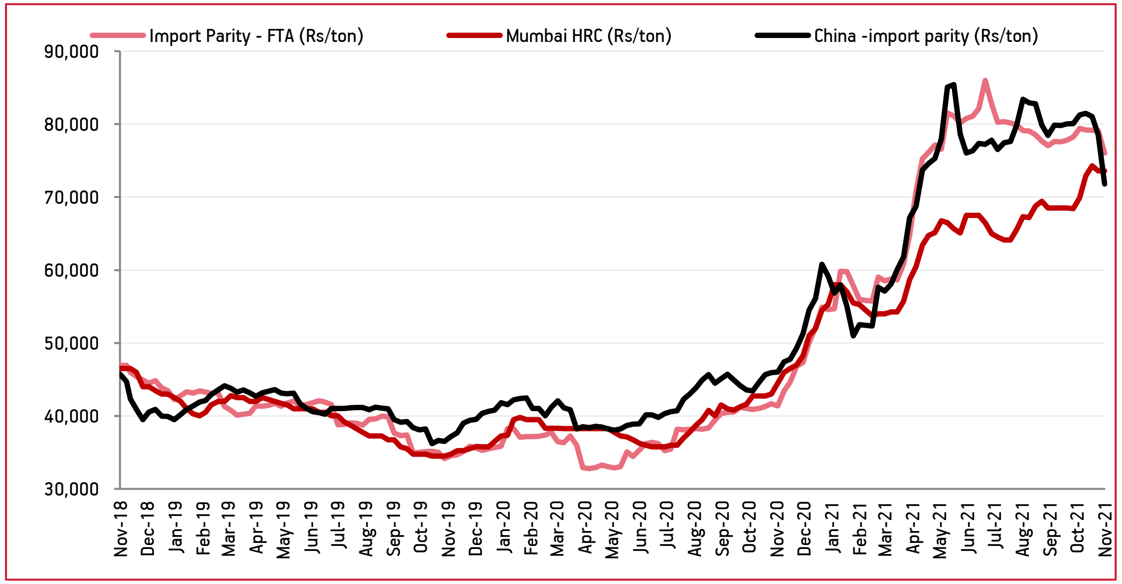
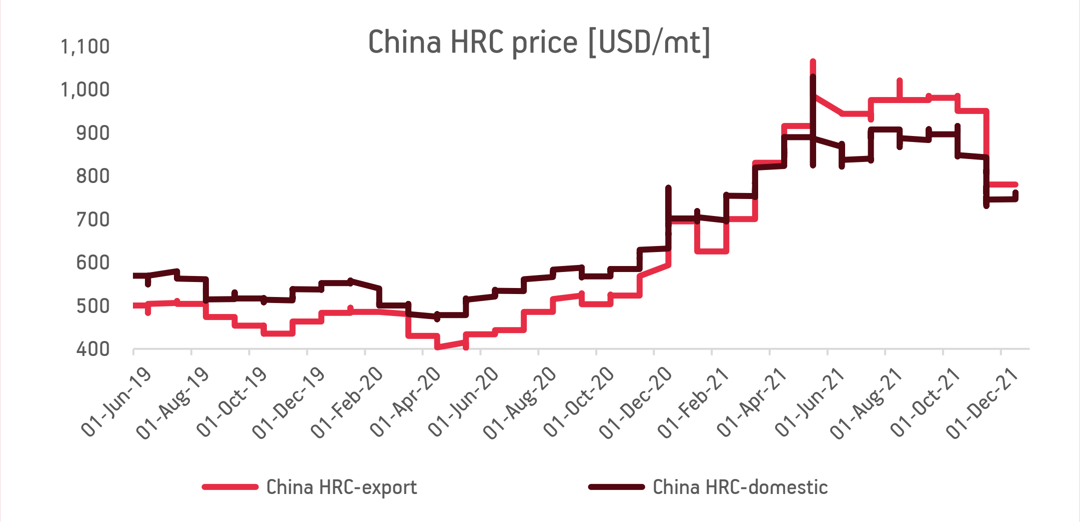
Ferrous – Domestic prices to decline from peak ; trading at premium to import parity







- Both domestic HRC prices as well as rebars moderated in line with global price/domestic demand. The spread between rebar and HRC are wider at ~Rs.10000/tonne [v/s historical average of ~Rs.4000-5000/tonne], which is expected to moderate, and rebar prices are expected to increase in near term.
- China domestic ferrous prices corrected on government warning against speculation and lower demand. We expect that supply cuts shall keep the Chinese market tight and prices shall moderate marginally from current levels.
- Domestic prices are trading at ~5-6% premium to import parity from China/FTA countries. We expect HRC prices to correct by ~8-10% in CY22 from current level.

Source: KIE, ABSLAMC Research

2022: Deleveraging to continue in-spite of large capex

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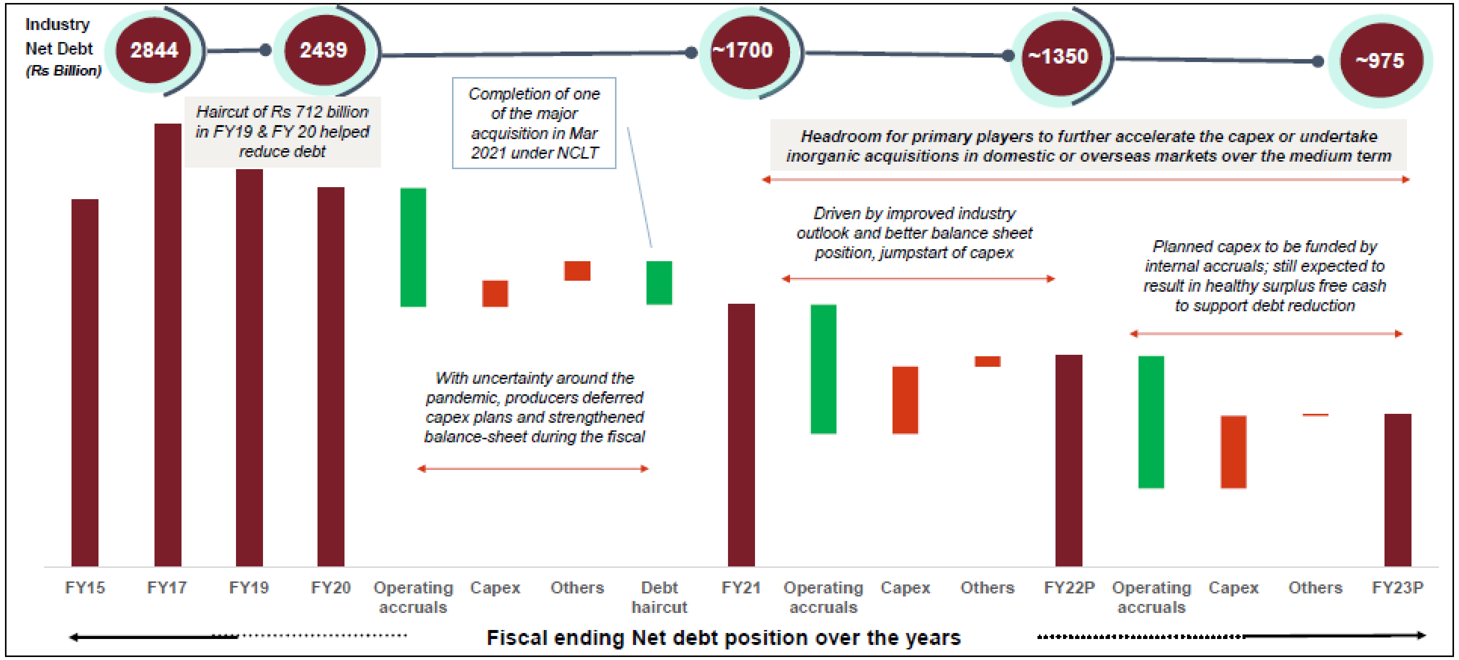

Major capex announcement	FY22 [E]	FY 23 [E]	FY 24 [E]	FY 25 [E]	FY 22-25 [Total]	Rs. crore
Tata Steel	-	-	-	5	5	15500
JSW Steel	5	1	-	5	11	25115
JSPL	1	-	3.3	3	7.3	18000
NMDC	--	3	--	--	3	22800
EAF/Mini mills	--	2	2	2	6	
Total	**6**	**6**	**5.3**	**15**	**32.3**	**81215**

Source: KIE, CRISIL, CARE rating, ABSLAMC Research

- ❑ Govt has announced PLI scheme for 5 categories of specialty steel [coated, high strength, alloy steel, specialty rail and electrical steel] with a budgetary outlay of Rs 6322 cr. The scheme is expected to bring in investment of ~Rs 40,000 crores and capacity addition of 25 MT for specialty steel.

Why current capex cycle has relatively lower risk ?

- ❑Majority of capex is brownfield [v/s greenfield capex in 2015-18] having faster payback period with lower capital cost of ~$400/tonne against $ 700/tonne.
- ❑New additions (FY22-25E) is ~21% of existing capacity, significantly lower vs 35% in FY15-18.
- ❑Strong deleveraging by primary players expected to continue [top 4 players deleveraged by ~Rs 40000 crore in FY 21].
- ❑Capex would partly be funded by internal accrual unlike last cycle which was majorly debt funded
- ❑Strong balance sheets with healthy cash balances and concentrated market shares amongst top players.

Non Ferrous –Al: Deficit market to support price for long term

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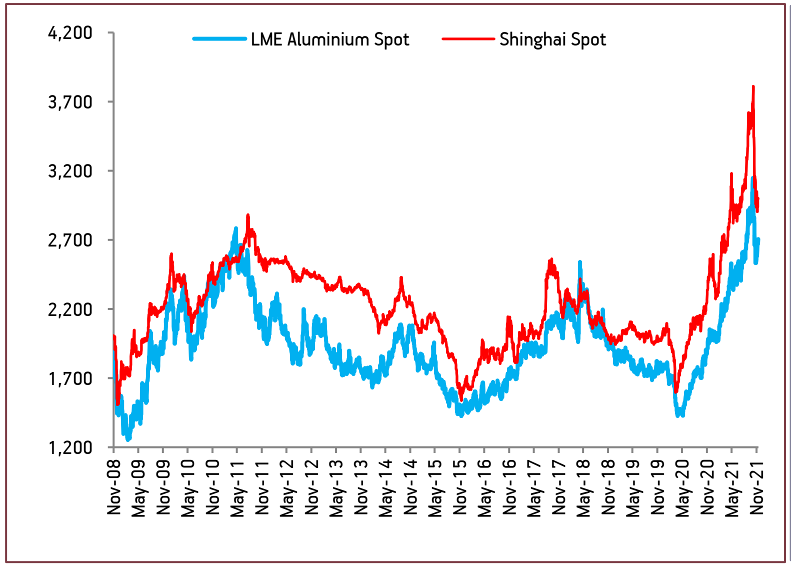
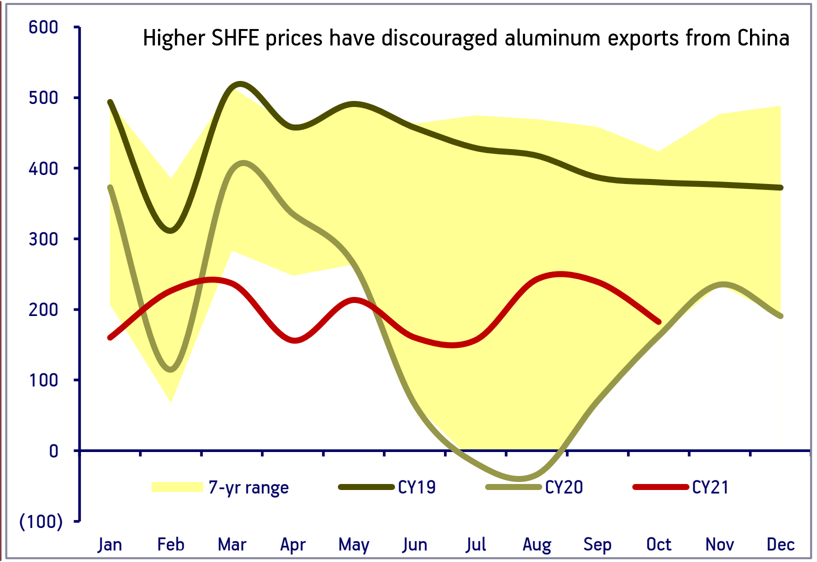
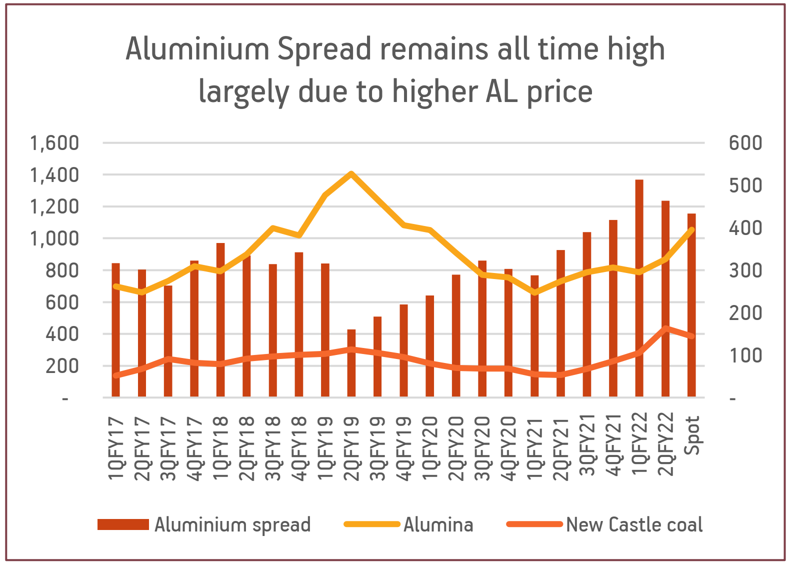




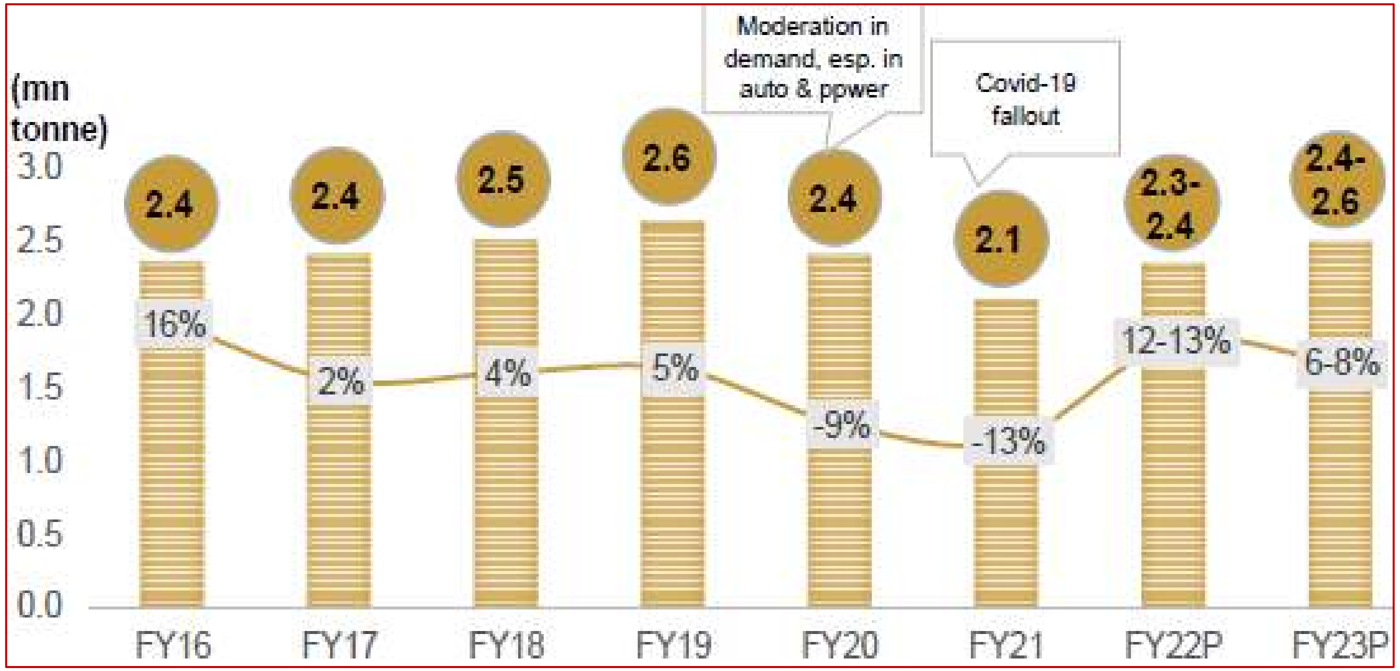


- Aluminium prices have stabilized back to US$2,600-2,650/ton range after a 20% see-saw led by power shortages in China.
- Proportion of Aluminum usage in real estate sector is low compared to other materials like steel, cement, etc. Hence, slowdown in China real estate market may not impact demand as much.
- Spread remains high inspite of higher raw material prices supported by higher aluminium prices. We believe that Aluminium fundamentals are strong given its lower dependence on China for demand, rigid supply and demand tailwinds which would keep the prices at elevated level for longer term. We don’t foresee any major downside risk to the prices of aluminium.

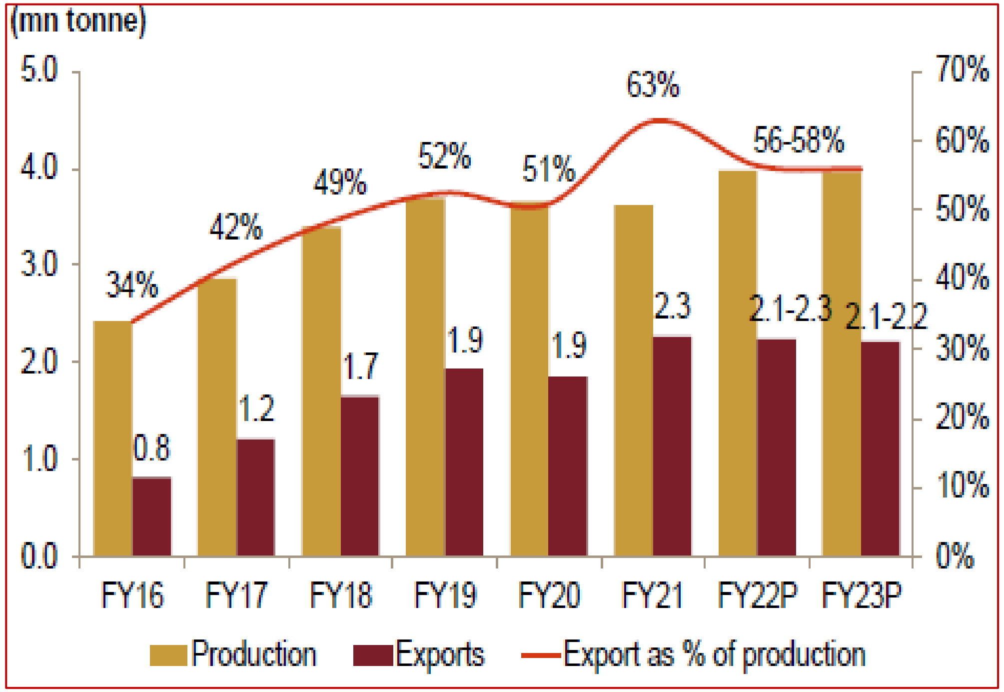
Source: CLSA, Philip Capital, ABSLAMC Research

Al: Domestic demand to reach near Pandemic levels; Strong global demand to support utilisationn rate and export

Strong domestic demand recovery



Rising export due to lack of downstream capacity at primary players

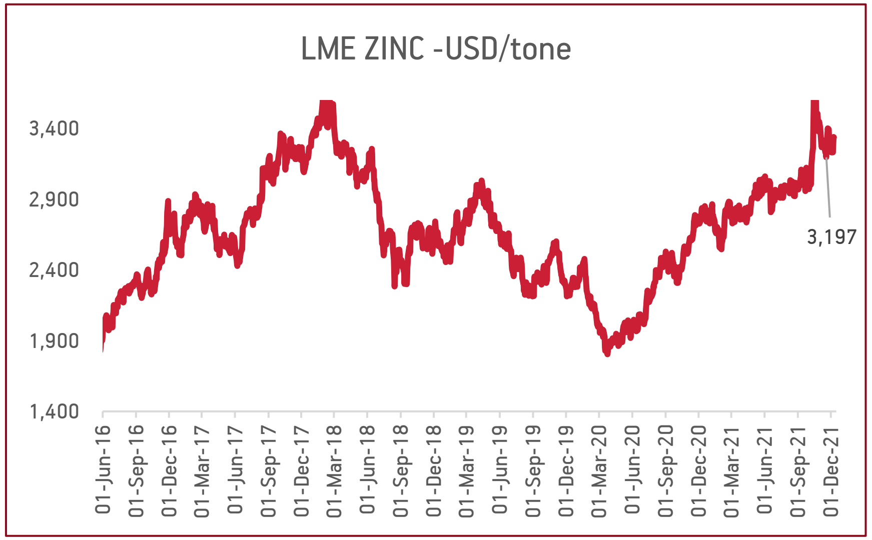


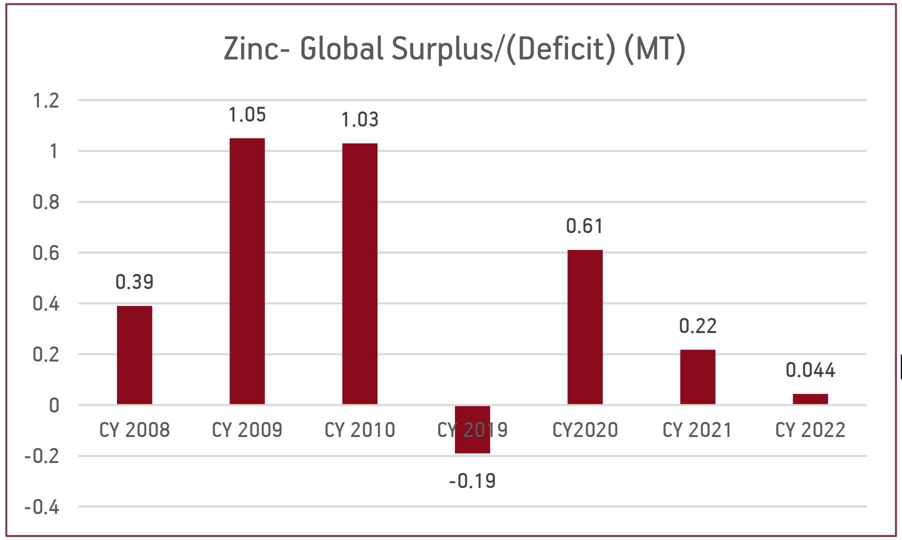
- Indian Aluminium demand is expected to reach pre-pandemic level in FY 22 with strong recovery on low base in FY 21. CRISIL expects that medium term growth of 6-8% would be mainly driven by renewable projects, social infrastructure and increasing thrust on EV/ESG front. Capacity utilisation of primary aluminium players is expected to increase to 93-94% in FY23 compared to ~87% in FY 21.

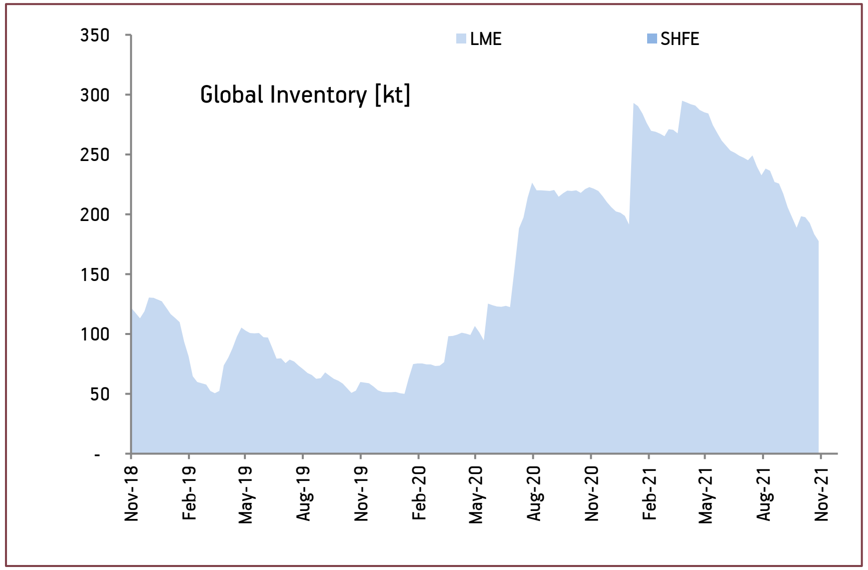
- Healthy global demand coupled with cost competitiveness would keep the export of semis like ingots at an elevated level.

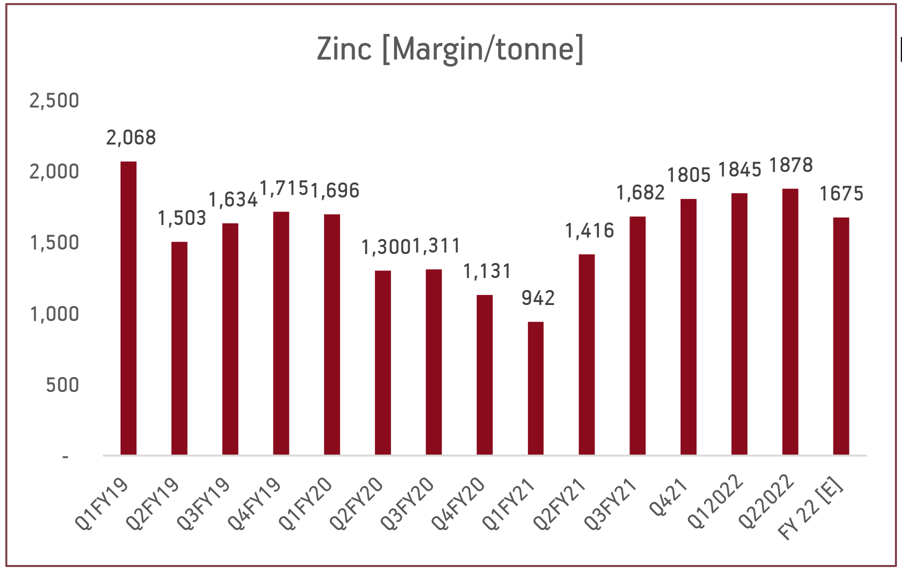
Source: CRISIL, ABSLAMC Research

Zinc –Surplus to reduce; prices to moderate in near term









- The Zinc market fundamentals remain strong for the short term led by supply-side restrictions in China on safety/ environment protection, a strong sequential demand recovery in world ex-China.
- According to International Lead and Zinc Study Group (ILZSG), overall surplus is expected to reduce from 0.22 mt in CY 21 to 0.04 mt in CY 22.
- During CY21, higher metal prices, kept the spread at elevated level. During CY22, we expect that price would moderate in near term due to continued surplus expectation and benign cost, which is would impact margins of Zinc players marginally.

**quarterly LME minus COP*

Source: ILZSG, Philip Capital, ABSLAMC Research

Metals – Outlook & View on Asset classes

Views on asset class

Ferrous

- Spread of primary Steel producers is expected to moderate due to expected moderation in steel prices from the prevailing elevated levels although expected lower raw material prices would limit significant corrections in spreads from current levels. Integrated players would benefit more than that of non-integrated one.
- Industry Margins & credit matrix is expected to witness significant improvement due to improved profitability and reduced leverage.
- We would be selective basis leverage position, raw material integration, liquidity, conversion efficiency, regional dominance etc.

Non -Ferrous

- We expect that aluminium prices would remain high in CY 22 due to expected deficit market, improved demand dynamics with Green cycle & ESG in play and tepid supply response due to stricter emission norm & capacity cap in China.
- Zinc prices to moderate from current level considering the expected surplus expectations and prevailing cost structure.
- Operating profits of non-ferrous players is expected to witness healthy increase due to sharp increases in metal prices and reduction in operating cost.
- Would continue to prefer medium term exposure over long term in this segment.

Real Estate

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Residential Real Estate –Trend of Sales

Units	2019	2020	2020				2021			QOQ	YOY	YTD
			Q1	Q2	Q3	Q4	Q1	Q2	Q3			
Bengaluru	26,453	10,440	4,186	1,977	1,742	2,535	2,382	3,500	5,100	46%	193%	39%
Hyderabad	16,025	9,926	3,027	1,207	2,122	3,570	3,709	3,160	4,415	40%	108%	78%
Pune	18,867	9,246	3,728	851	1,344	3,323	3,745	3,540	5,920	67%	340%	123%
Chennai	13,967	6,983	2,453	460	1,570	2,500	3,200	600	1,500	150%	-4%	18%
Kolkata	7,463	2,568	1,259	481	390	438	1,320	580	1,972	240%	406%	82%
Delhi NCR	29,010	15,743	5,941	2,250	3,112	4,440	5,448	2,440	6,689	174%	115%	29%
Mumbai	32,138	19,545	6,857	3,527	4,135	5,026	5,779	5,820	6,757	16%	63%	26%
Total	**1,43,923**	**74,451**	**27,451**	**10,753**	**14,415**	**21,832**	**25,583**	**19,640**	**32,353**	**65%**	**124%**	**47%**

- The growing need for home ownership supported by all time low mortgage rates, stamp duty waivers in certain states and stagnant prices is helping housing demand recovery.
- Sales Volume during Q3 2021 grew by 65% sequentially as compared to 34% sequential growth during Q3 2020 indicates recovery post second wave has been faster than expected.
- Sales got boost from factors like lower covid-19 cases in 3rd Quarter, good progress on vaccination front and cautious unlocking of economy in various states.
- Mumbai, Delhi NCR and Pune account for 60% of Sales

Source: JLL

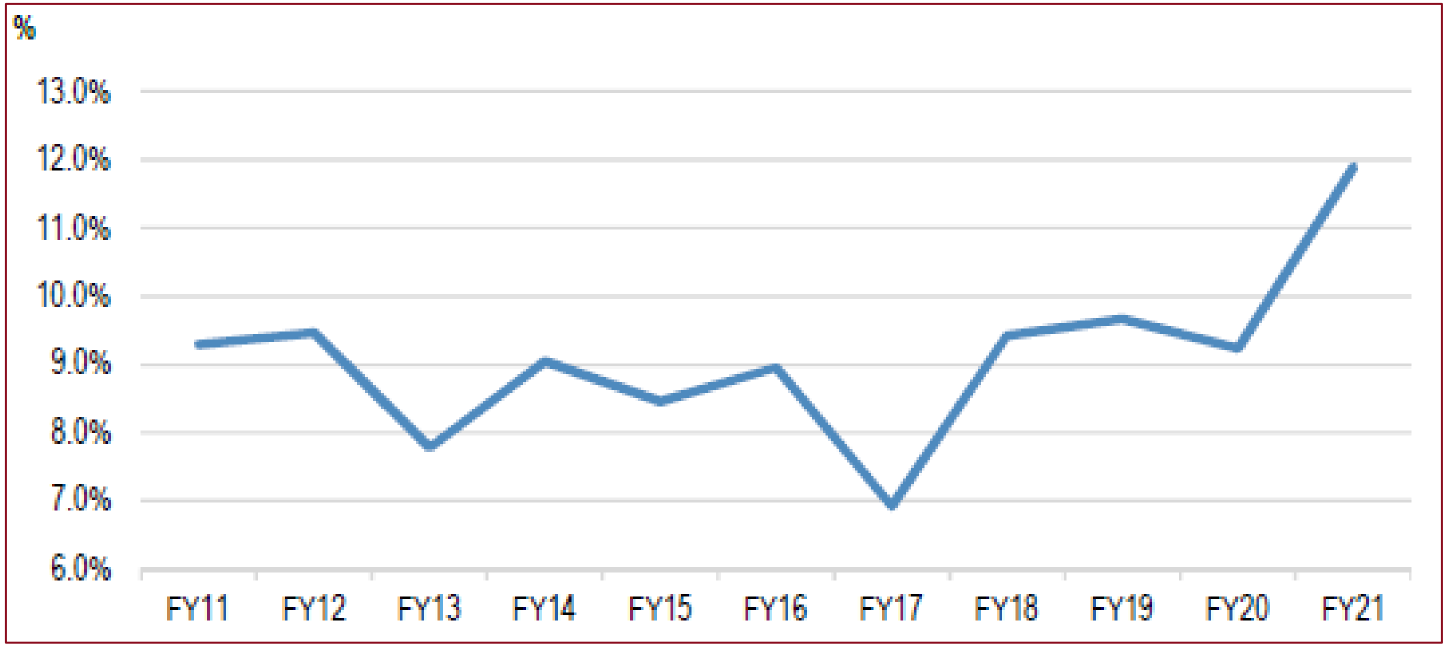
Residential Real Estate – Prices remained Stagnant

Avg. Prices (Rs./Sq.Ft)	2019	2020	2020				2021			QOQ	YOY
			Q1	Q2	Q3	Q4	Q1	Q2	Q3		
Bengaluru	5,134	5,117	5,129	5,112	5,116	5,110	5,110	5,110	5,110	0.0%	-0.1%
Hyderabad	4,275	5,023	5,000	5,000	5,000	5,090	5,100	5,150	5,380	4.5%	7.6%
Pune	6,612	6,646	6,652	6,652	6,643	6,637	6,633	6,633	6,633	0.0%	-0.2%
Chennai	4,585	4,585	4,585	4,585	4,585	4,585	4585	4585	4585	0.0%	0.0%
Kolkata	4,015	3,965	3,969	3,965	3,963	3,963	4,304	4,300	4,290	-0.2%	8.3%
Delhi NCR	4,769	4,752	4,769	4,769	4,729	4,741	4,741	4,741	4,800	1.2%	1.5%
Mumbai	11,116	11,144	11,116	11,140	11,159	11,159	11,221	11,300	11,400	0.9%	2.2%
Avg. Rates (7 Cities)	**5,787**	**5,890**	**5,889**	**5,889**	**5,885**	**5,898**	**5,956**	**5,974**	**6,028**	**0.9%**	**2.4%**

- ❑ In Q3 2021, prices remained largely stagnant when compared to the previous quarter.
- ❑ In Hyderabad Mkt, Prices increased across all sub-markets during the quarter as the city is witnessing robust demand. The launch of new projects at higher prices has also led to an overall rise in capital values.
- ❑ Prices increased marginally in Noida and Gurugram but remained stable in Delhi, Faridabad and Ghaziabad.
- ❑ Prices in Mumbai Mkt expected to rise marginally over next 12 months on the back of strong demand.
- ❑ Price recovery in Pune mkt is expected if recovery continues.

Source: JLL

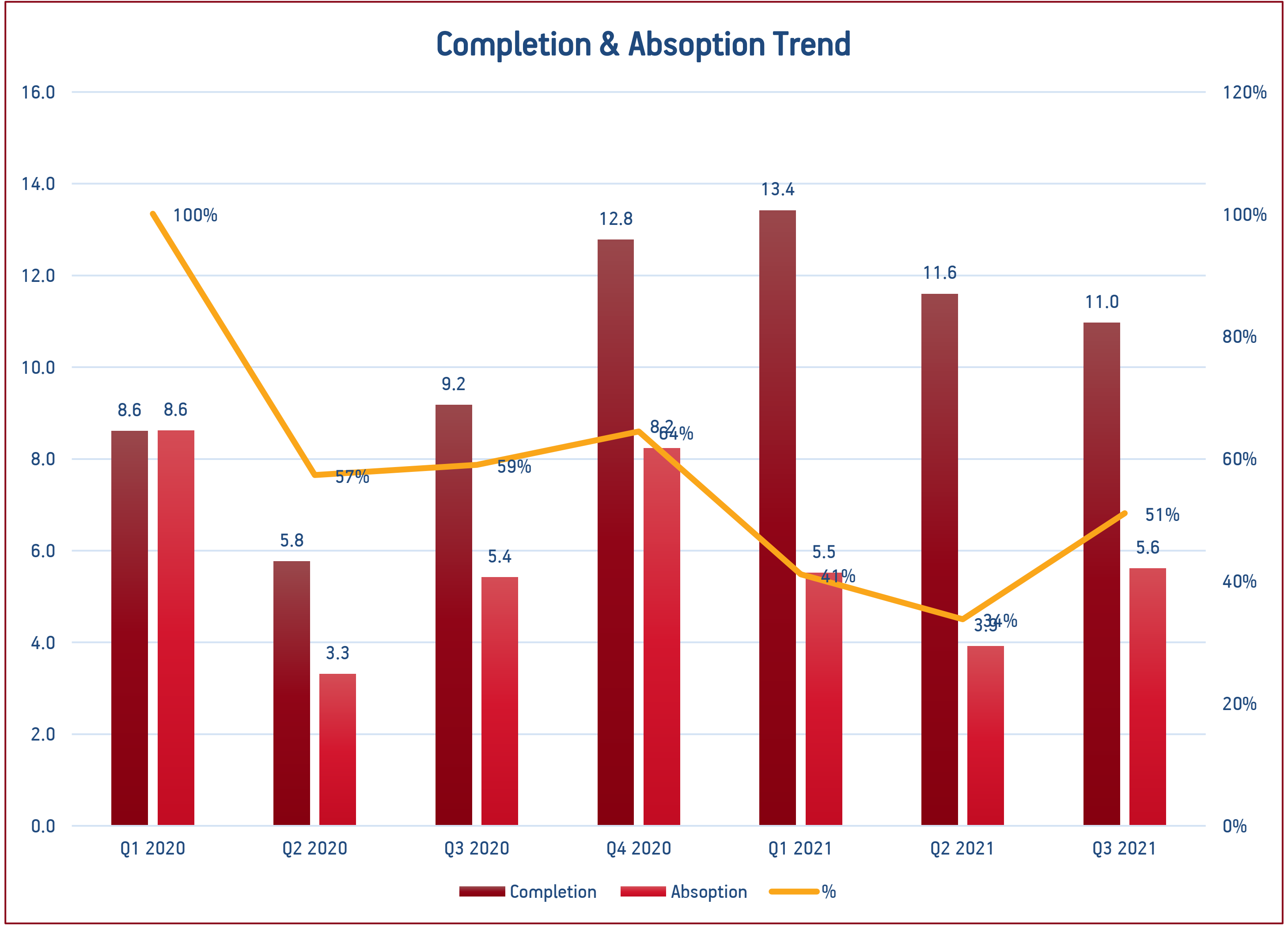
Increase in market share of large listed players



- Market share of Top 9 listed developers further improved in FY21 to 11.9% (+270bps) and is now at an all-time high. Even as Top city sales were down 4% in FY21 on impact of the lockdown, Top 9 developer sales went up by 23% and highlights the start performance differential.
- Sales patterns across developers show that nearly 40%-50% of sales came from inventory monetization and the balance from new launches.
- Top developers in the country account for merely 8-9% of the overall country sales, and 12-14% of the market share in the key cities. This leaves enough headroom to increase their market share.

Source: J.P. Morgan report

Commercial Real Estate – Update on Absorption & Completion



Source: JLL

- The quarter witnessed a net absorption of 5.6 million sq ft of Grade A office space across the top seven cities in India, up by 48% q-o-q and highest in the year 2021, indicating improved market sentiments and growing confidence of occupiers.
- The office market has registered a total net absorption of 15 million sq ft YTD (Jan-Sept) 2021 which is a 13% dip compared to the same period last year. While both Q2 and Q3 in 20021 were better than their corresponding last year periods. The subdued net absorption recorded in Q1 2021 due to the cautious approach adopted by occupiers has kept YTD 2021 slightly lower.
- Although the leasing activity has gained momentum in Q3, 2021, it is yet to reach the pre-pandemic levels in terms of the quarterly average seen in 2019 and Q1 2020.

Commercial Real Estate – Rent

	Q1' FY20	Q2' FY20	Q3' FY20	Q4' FY20	Q1' FY21	Q2' FY21	Q3' FY21	QOQ	YOY
Bengaluru	76.0	79.2	79.1	80.4	80.8	80.5	81.2	0.9%	2.7%
Hyderabad	59.4	59.4	60.2	60.7	61.5	61.9	62.0	0.2%	3.0%
Pune	74.8	74.2	73.9	74.6	74.6	74.5	75.0	0.7%	1.5%
Chennai	63.2	63.2	63.4	64.2	63.9	63.8	64.0	0.3%	0.9%
Kolkata	51.8	52.0	51.7	51.6	51.4	51.3	51.4	0.2%	-0.5%
Delhi NCR	77.9	78.5	78.8	78.7	78.2	78.0	78.0	0.0%	-1.0%
Mumbai	124.4	127.3	128.0	128.6	128.7	127.8	127.0	-0.6%	-0.8%

- On a q-o-q basis, rentals across the major office markets saw limited movement.
- On a y-o-y basis, average office rentals in the markets of Bengaluru and Hyderabad increased by 2.7% and 3%, respectively.
- Rents are expected to remain range-bound as landlords continue to offer flexibility in terms of space as well as value.

Source: JLL

Outlook

- **Residential Real estate**
  - With the increased focus on health, sustainability and wellness, importance of owning a home is getting re-established.
  - Demand from End users are driving demand for home.
  - Credible developers, who are customer-centric and possess proven execution capability as well as quality products will survive and emerge stronger in the 'next normal'.
  - The preference of buyers for such developers with a proven track record will drive further consolidation and increase transparency in the sector.
- **Commercial Real Estate**
  - The demand for office space is expected to be resilient as going forward, a hybrid model including work from home and work from office will characterize a future-fit organization.
  - Demand for office space is expected to come from sectors like healthcare, e-commerce and data centres apart from IT, which will remain main demand driver for the sector.
  - Large institutional Asset owners / aggregators (REITs) are expected to benefit due to their size, availability of world class infrastructure, large floor plates, ability to provide discounts to big tenants due to low leveraging and professional management.
  - With the completion of ongoing construction of commercial space, there would be pressure of Vacancy
  - Net Absorption in CY 2021 is expected to be ~ 21 mn sp ft. Demand is likely to show green shoots in 2022 in the near to mid term as business plans become firm.

Automobile Sector

Aditya Birla Sun Life AMC Ltd.
(A part of Aditya Birla Capital Ltd.)

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Recovery: YTD FY22 [Apr – Nov] vs YTD FY19, YTD FY20, YTD FY21

	YTD [FY22/FY19]	YTD [FY22/FY20]	YTD [FY22/FY21]
PV	83%	101%	126%
2W	60%	71%	95%
3W	31%	33%	137%
Tractor	106%	119%	104%
CV@	56%	73%	165%

- YTD basis, 2W, 3W and CV domestic volumes are falling behind FY19 and FY20 levels; 3W is worst affected
- Tractors followed by PV show the best recovery Vs previous years' corresponding period

42 days festive period in 2021: Total vehicle retails were down by -18% YoY. All the categories were in red except 3W [~53%↑] and CV [~10%↑]

This was the worst festive season in a decade for Auto Dealers as chips shortage in PV and low demand for entry level 2W segment kept the celebrations at bay

42 Days Festival Period

CATEGORY	Festival 2021	Festival 2020	Festival 2019	YoY % (2020)	YoY % (2019)
2W	15,79,642	19,38,066	20,35,341	-18.49%	-22.39%
3W	52,802	34,419	86,390	53.41%	-38.88%
CV	77,066	70,361	89,922	9.53%	-14.30%
PV	3,24,542	4,39,564	3,79,988	-26.17%	-14.59%
TRAC	56,841	73,925	49,107	-23.11%	15.75%
Total	**20,90,893**	**25,56,335**	**26,40,748**	-18.21%	-20.82%

Source: FADA Research

Source: SIAM, FADA; @ = Apr-Sept

42 day Festival period: 2021 [Oct 7 to Nov 17], 2020 [Oct 17 – Nov 28], 2019 [Sept 29 – Nov 9]

Outlook: Projected domestic growth

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	FY22 [P]	FY23 [P]
Passenger Vehicles	~9% – 12%	~12% – 16%
Two wheelers	~(1)% – (3)%	~6% – 10%
Commercial Vehicles	~19% – 22%	~13% – 18%
Tractors	~(1)% – (5)%	~3% – 8%

Please note: Projections do not include any probable impact of future covid 3rd wave

- Exports demand projected to grow ~24-26% [FY22], ~10-12%[FY23] for PV; and ~36-38% [FY22], ~8-10% [FY23] for 2W
- OEMs would continue to focus on achieving a leaner cost structure and better capital allocation. Margins are likely to decline marginally because of the lag in passing on increased cost of raw materials (which would be partly set off by increase in volumes), higher sourcing cost amid supply chain challenges [port congestions, high ocean freights, container availability etc.]
- The National Vehicle Scrappage Policy will be applicable in a phased manner i.e. applicable to the vehicles owned by govts. and PSUs from April 2022, MHCVs [>15 yrs] from April 2023 and PVs [>20 yrs] from June 2024. This may contribute to demand from FY24 onwards.

Source: CRISIL Research, India Ratings, ICRA, ABSLAMC Research

Fixed Income Outlook : India

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- Policy Normalization: Volatility will be higher than what we have seen over the last 12months
- Key Question: PACE of HIKES & TERMINAL RATES?
- Markets baking in a “picture-perfect recovery” which is a rare phenomenon
- Yield curve: Steep curves
- Bond Indices: Unlikely to be a Game Changer
- Fixed Income Investors
  - Carry will compensate for potential duration losses adequately
  - Can take benefit of steep curves
  - Investment horizon has to match volatility profile
  - Demand & Supply mismatch more in longer term - Bear Flattening
  - Credit pick up is the key
  - Yield maximization to continue
  - 10 year G-sec range: 6.40%-6.90%

Fixed Income Funds Portfolio Snapshot

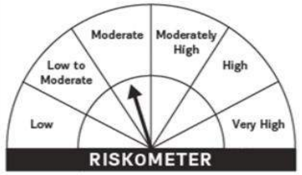
Fund Name	Modified Duration (Years)	Current Asset Class Distribution (As on 31st December 2021)
Aditya Birla Sun Life Liquid Fund	0.12	Sovereign and A1+ rated
Aditya Birla Sun Life Money Manager Fund	0.35	Sovereign and A1+ rated
Aditya Birla Sun Life Savings Fund	0.62	>90% in Sovereign, AAA and A1+
Aditya Birla Sun Life Low Duration Fund	0.63	>90% in Sovereign, AAA and A1+
Aditya Birla Sun Life Floating Rate Fund	0.84	100% Sovereign, AAA and A1+
Aditya Birla Sun Life Short Term Fund	1.76	>90% in Sovereign, AAA, AA+ and A1+
Aditya Birla Sun Life Corporate Bond Fund	2.16	>95% in Sovereign, AAA and A1+
Aditya Birla Sun Life Banking & PSU Debt Fund	1.94	>95% in Sovereign, AAA and A1+
Aditya Birla Sun Life Government Securities Fund	3.38	100% Sovereign
Aditya Birla Sun Life Income Fund	3.76	100% Sovereign and AAA
Aditya Birla Sun Life Credit Risk Fund	1.91	Credit Risk Fund

Asset Allocation

Investment Horizon	Fund Proposition
3 Months +	Aditya Birla Sun Life Savings Fund and Aditya Birla Sun Life Money Manager Fund
6 Months +	Aditya Birla Sun Life Low Duration Fund
9 Months +	Aditya Birla Sun Life Floating Rate Fund
1 Years +	Aditya Birla Sun Life Short Term Fund, Aditya Birla Sun Life Corporate Bond Fund and Aditya Birla Sun Life Banking & PSU Debt Fund
3 Years +	Aditya Birla Sun Life Government Securities Fund, Aditya Birla Sun Life Income Fund, Aditya Birla Sun Life Debt ETF / Index Funds and Aditya Birla Sun Life Credit Risk Fund

Aditya Birla Sun Life Government Securities Fund

An open ended debt scheme investing in government securities across maturity. A relatively high interest rate risk and relatively low credit risk.

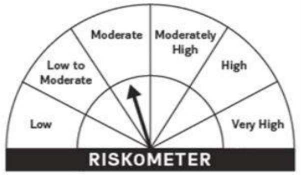


Investors understand that their principal will be at **Moderate** risk

Potential Risk Class			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)	A-III		

Aditya Birla Sun Life Income Fund

An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 4-7 years. A relatively high interest rate risk and moderate credit risk.

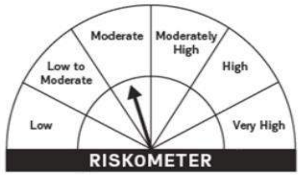


Investors understand that their principal will be at **Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Aditya Birla Sun Life Corporate Bond Fund

An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds. A relatively high interest rate risk and moderate credit risk.

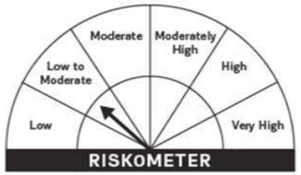


Investors understand that their principal will be at **Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Aditya Birla Sun Life Banking & PSU Debt Fund

An open ended debt scheme predominantly investing in debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds. A relatively high interest rate risk and moderate credit risk.



Investors understand that their principal will be at **Low to Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Aditya Birla Sun Life Floating Rate Fund

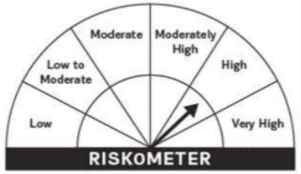
An open ended debt scheme predominantly investing in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps / derivatives). A relatively high interest rate risk and moderate credit risk.

Investors understand that their principal will be at **Low to Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Aditya Birla Sun Life Credit Risk Fund

An open ended debt scheme predominantly investing in AA and below rated corporate bonds. A relatively high interest rate risk and relatively high credit risk.

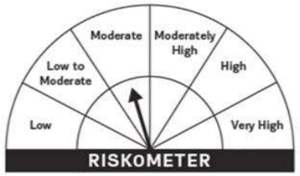


Investors understand that their principal will be at **High** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)			C-III

Aditya Birla Sun Life Short Term Fund

An open ended short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 1-3 years. A relatively high interest rate risk and moderate credit risk.

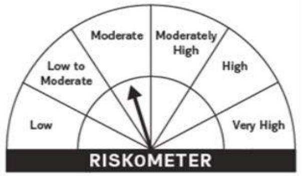


Investors understand that their principal will be at **Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Aditya Birla Sun Life Savings Fund

An open ended ultra-short term debt scheme investing in instruments such that Macaulay duration of the portfolio is between 3 months and 6 months. A moderate interest rate risk and moderate credit risk.

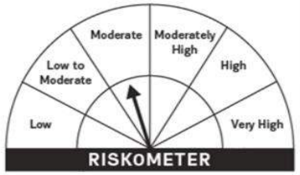


Investors understand that their principal will be at **Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)		B-II	
Relatively High (Class III)			

Aditya Birla Sun Life Money Manager Fund

An open-ended debt scheme investing in money market instruments. A relatively low interest rate risk and moderate credit risk.

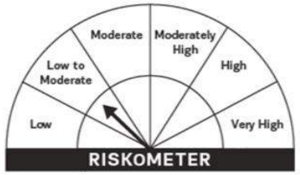


Investors understand that their principal will be at **Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)		B-I	
Moderate (Class II)			
Relatively High (Class III)			

Aditya Birla Sun Life Low Duration Fund

An open-ended low duration debt scheme investing in instruments such that Macaulay duration of the portfolio is between 6 months and 12 months. A relatively high interest rate risk and moderate credit risk.

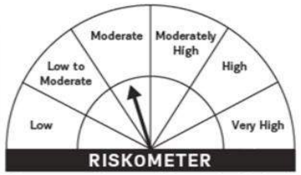


Investors understand that their principal will be at **Low to Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)			
Moderate (Class II)			
Relatively High (Class III)		B-III	

Aditya Birla Sun Life Liquid Fund

An Open Ended Liquid Scheme. A relatively low interest rate risk and moderate credit risk.



Investors understand that their principal will be at **Moderate** risk

PRC Matrix			
Credit Risk→ / Interest Rate Risk↓	Relatively Low (Class A)	Moderate (Class B)	Relatively High (Class C)
Relatively Low (Class I)		B-I	
Moderate (Class II)			
Relatively High (Class III)			

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