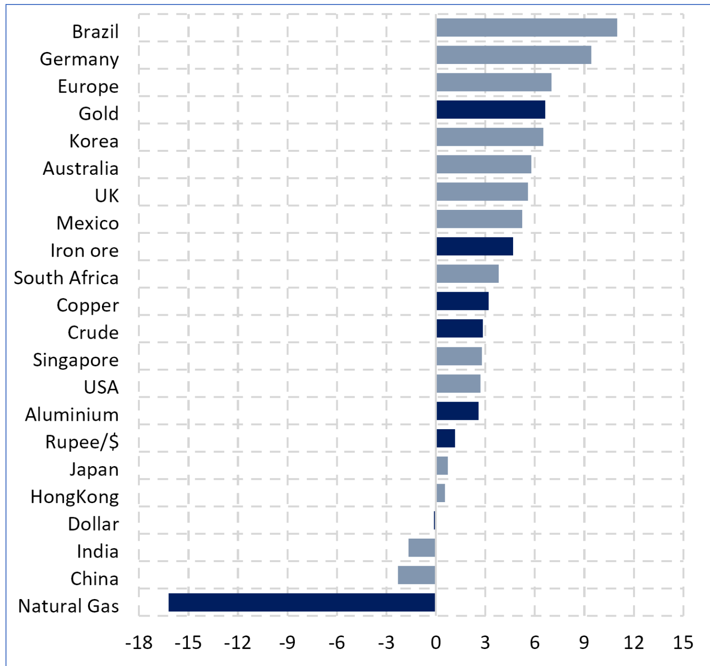
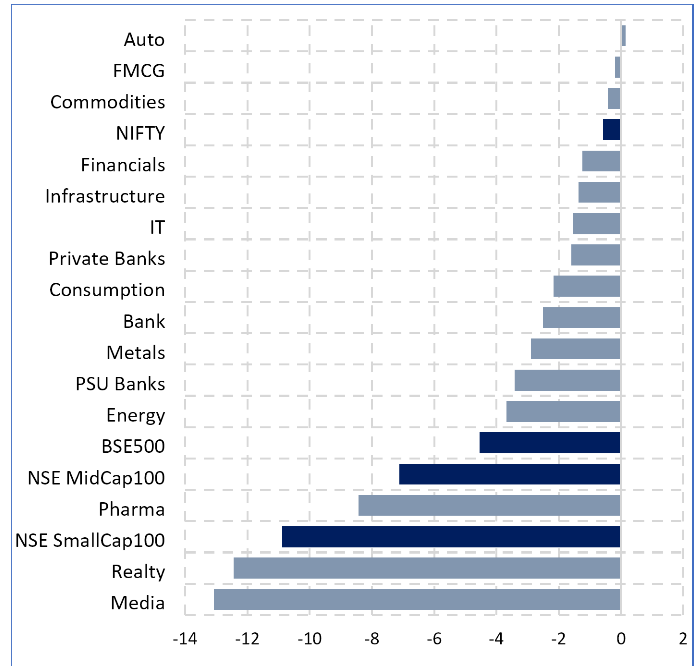
Brazil, Germany topped returns in January (% m/m, in USD)



Most developed market equities delivered strong returns after tariff narratives from the Republican administration, were not as negative as expected. Emerging market returns on the other hand remained mixed. Tariff-related uncertainties pushed gold prices higher, while milder-than-expected weather conditions in the US led to lower demand and a fall in natural gas prices.

The key focus of the month was the swearing in of the Republican President Donald Trump. Given the strong tariff narratives in the run-up to his Presidency, markets were anxious and were expecting a sharp barrage of tariffs soon after Mr.Trump took oath; and were pleasantly surprised to witness relatively muted narratives, post. Even the tariffs imposed on Mexico and Canada in early Feb'25, were paused soon after, for a month, following negotiations. The first few weeks of Mr.Trump's Presidency, saw a broad focus on withdrawal from the Paris accord, actions that would increase US' crude supply and a review of existing trade policies. Tariffs apart, US macro data continued to hold up and China was seen in liquidity support and measures to boost its stock market.

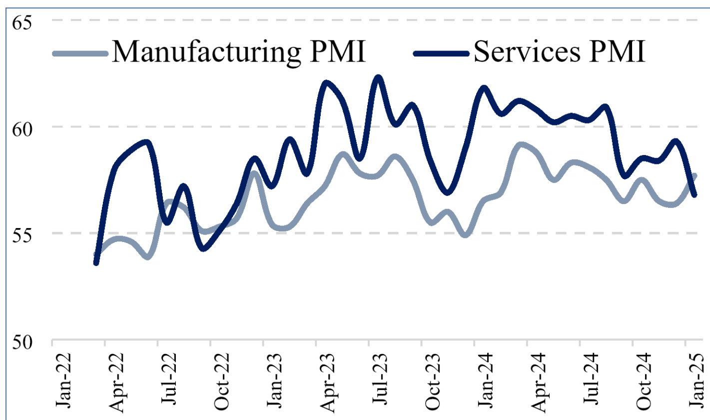
Auto, FMCG, Commodities relative O/P in January (% m/m)



NIFTY witnessed a more moderate contraction of 0.6% in rupee terms in January. Automobiles, FMCG and Commodities were the three relative outperforming sectors, while Media, Realty and Pharma were the key u/performers. Small Caps, Midcaps and the broader BSE500 were strong underperformers to the NIFTY. After a pickup in FII equity inflows, the month saw sharp outflows to the tune of $8.4bn from equities. Debt inflows resumed, to the tune of $1.4bn.

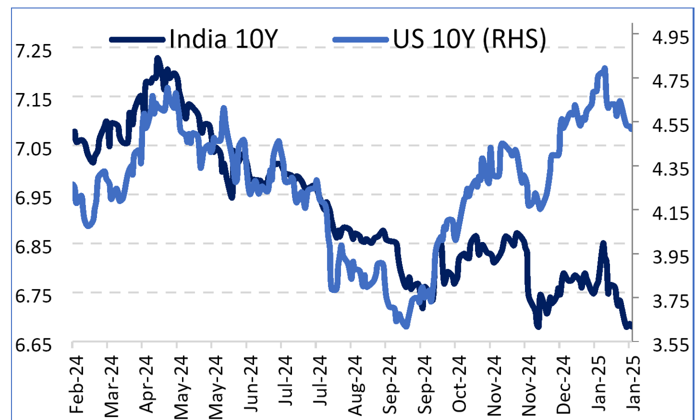
Domestic macros continued to broadly hold up, with strong GST collection growth, increase in fuel demand, growth in UPI transactions and FASTag collections. Retail inflation eased on lower food prices and trade deficit witnessed some moderation from elevated levels. RBI announced liquidity measures through OMO purchases and FX swaps to ease tight domestic liquidity. Other indicators saw weak core sector growth, alongside normalisation in credit growth. Towards FY24 state of the economy, the government's household consumption expenditure survey showed a narrowing urban-rural gap.

Services PMI moderates, while Manufacturing inches up



Services PMI saw its slowest rise in in 2Y, while manufacturing PMI was seen at a 6M high. Services saw a muted growth in outstanding business, while new orders continued to grow, with a faster pace of increase in foreign sales. Input cost inflation was seen rising to an 18M high and seen passing on to output cost; and sentiment appeared weak on competition. Manufacturing saw the strongest gain in six months on strong global orders, alongside robust employment growth.

US Treasuries and Crude prices help pull down India yields (%)



The structural direction of India yields continue to tag US10Y yields, followed by softer brent crude prices. Recent rupee pressures have pushed hedging costs higher and this has sharply reduced spreads between US10Y and hedged-India-10Y yields, to negative. Negative spreads would mean that a foreign investor would make more money investing in US Treasuries, rather than invest in India, after adjusting for hedging costs. Therefore, direction and magnitude of US yields would remain important for continued FII inflows into

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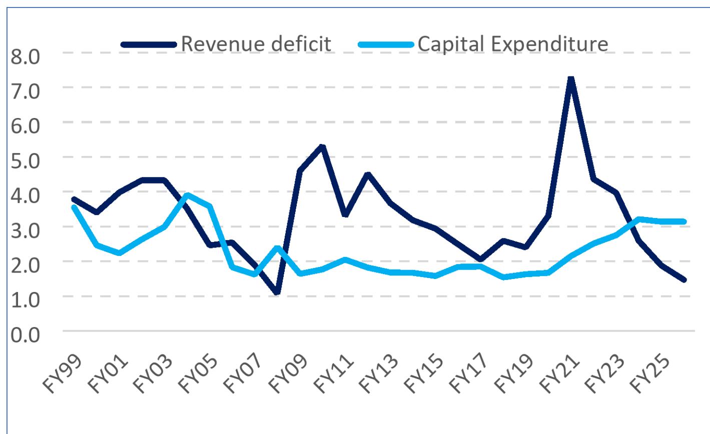
India debt, assuming continued Rupee pressures into 2025.

Centre's revenue deficit, making way for Capex ahead (% GDP)



The budget delivered a fine balance between consumption and capex support, while walking the talk on continued fiscal conservatism. The fiscal deficit saw a surprise for both FY25 (4.8%, 10bps below budget estimates) and FY26 (4.4%, 10bps below market expectations). Fiscal math continued to remain realistic with nominal GDP estimated to grow at a realistic pace for FY25 (9.7%) and FY26 (FY26). Immediate implication of continued fiscal conservatism boils down to contained net market borrowing. (**Our note on the budget**)

Most importantly, the budget delivered a welcome and unexpected boost for consumption, through changes to IT slab rates. Income tax slabs under the new tax regime were widened, alongside better progression in tax rates. While all income brackets are set to benefit, market estimates suggest that individuals in the Rs.12-50lakh brackets, would benefit the most, with a drop in effective tax rates in the range of 2.5-5%. 70% of the tax cut benefits are expected to get passed through to middle-income households. This is therefore expected to give a boost to discretionary consumption across various segments.

Markets were disappointed by the budget numbers on Capital expenditure. FY25 saw a drop in Capex spending projection at Rs.10.8tr, below the projected Rs.11.1tr. And FY26 saw a marginal increase in capex to Rs.11.2tr. However, It is important to always look at total Capex that includes the Capex spending of quasi-PSUs. Internal and Extra Budgetary Resources (IEBR) capex spending of quasi-PSUs are expected to grow by 13% to Rs.4tr. This takes the total capex for FY26 to Rs.15.2tr, a growth of 11%.

Apart from the above marginal positive, structurally, the Centre continues to lower its revenue deficit, which in the years to come would work to be a structural positive for Capex spending during better phases of growth. One must recall the strong narrative from the Economic Survey (**here**) that called for the private sector to increasingly shoulder the lion's share of capex. The Centre has maintained a strong Capex bias in its spending, despite continued fiscal consolidation. Lower fiscal deficits always mean a reduced impulse from the Centre towards growth. With states witnessing an increasing bias towards populist spending, there does appear some possibility of state capex moderation. Private sector capex has fared quite well over the years, but is yet to get broad based into the listed space. Do take a read of this very narrative we wrote about in our November E.M.I.

Equity Market Outlook

Valuations

India's 1Y forward price-to-equity remain above their long-term averages (LTAs), even as valuations were seen to moderate in January. We continue to stress the need for a balanced asset allocation in portfolios with shorter term horizons.

The ongoing Dec'24 quarter earnings are set to see continued moderation along expected lines. Auto, IT, Pharma and Retailing are expected to hold up earnings with growth in low double digits. Sequential improvement in volume trends expected across discretionary consumption segments. Banks, Capital goods and Staples could see more moderate single-digit growth rates, while Building materials and real estate are expected to report a soft earnings print on the back of weak volume trends.

Outlook

The Union Budget for FY26 is positive for bond yields into the years ahead. The budget laid out a fiscal path until FY31, with a shift towards debt/GDP based consolidation. Centre would maintain fiscal deficit such, that the Centre's debt/GDP would touch 50% (+/-1%) by end-Mar'31. Under a moderate pace of debt consolidation, the fiscal deficit would practically remain flat. And for bonds markets, where the focus is largely on supply, this gives a great amount of transparency and visibility into the years ahead.

However, in the near term, the focus for equity and bond markets would fall on the pace of FII inflows into both equity and debt. *(Read our Market Insights [Pg.2,3] where we focus on FII bond inflow determinants **here**)*

Post Oct'24, FII inflows have come under pressure and as a result, the Rupee. A pickup in FII inflows into both equity and debt would therefore remain crucial. FII flows appear to be directly linked to global uncertainties stemming from US tariff narratives. This reflects in both the dollar index and the movement of US Treasury yields, through the channel of inflation and Fed rate-cut expectations. FII flows and US tariffs apart, the direction of crude prices need to be closely watched. Any appreciable drop in crude prices could turn a game-changer for Emerging Markets, India in particular.

While a pickup in government capex is important for domestic growth in the immediate term, we appear to be closely dependent on external narratives for the time being. And for this very reason, while some segments of the markets expect a rate cut from the RBI in its monetary policy on 7th Feb'25, we feel the start of the rate cut cycle would be more appropriate into FY26, when global uncertainties would become clearer. Further, there would be a better sense on the pace of domestic growth with resumption of government spending (capex in particular) into the months ahead. One must remember that at a time when domestic liquidity faces continued pressure due to the RBI's forex intervention, cutting policy rates and increasing that very pressure could be an unlikely move from the RBI, especially in the new Governor Mr.Malhotra's maiden monetary policy.

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