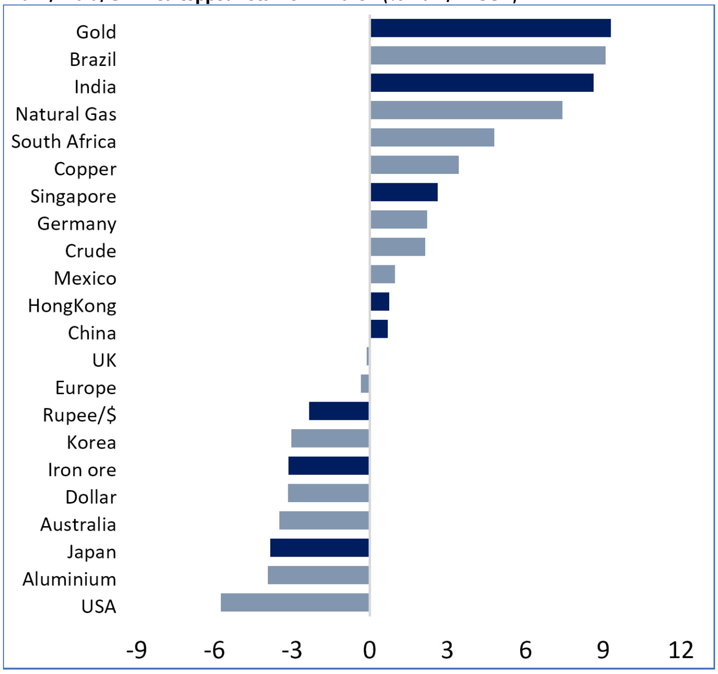
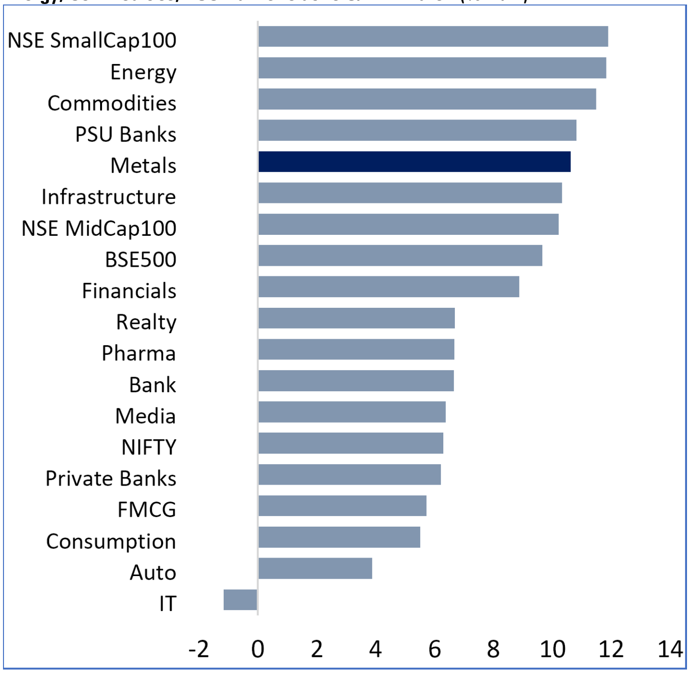
Brazil, India, S.Africa topped returns in March (% m/m, in USD)



Brazil and India equities stood out clearly during the month. Commodities was the common segment that helped push up returns for these two emerging markets. Europe (Germany in particular) continued to outperform within developed markets, driven by the political shift witnessed in its Feb'25 elections. Gold's fourth rally that we wrote about last month ([here]) continued, led by increased tariff-related and geo-political uncertainties.

Tariff concerns prevailed in March with the US announcing more tariffs on China, alongside tariff imposition on Canada and Mexico. Global bonds witnessed a brief sell-off after the incumbent German coalition announced its intent to increase fiscal spending on infrastructure and defence. US inflation was seen moving lower on easing energy pressures; even as broad US macros continued to hold up. The US Federal Reserve left rates unchanged, raised its inflation forecasts on tariff uncertainties and lowered its growth projections. Fed also cut back on its pace of Balance Sheet contraction which was received positively from the point of view of liquidity for the markets. China macros also held up well during the month and the government was observed exhibiting a more positive approach towards its private sector companies. China announced a 30-point program to boost consumption. Price pressures remained weak, with the country still in deflation.

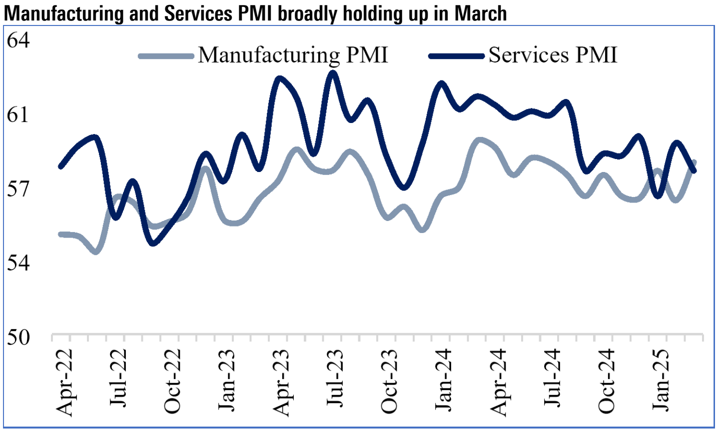
Energy, Commodities, PSU Banks relative O/P in March (% m/m)



NIFTY saw a sharp 6.3% jump in rupee terms for the month of March. Energy, Commodities and PSU Banks were the three relative outperforming sectors, while IT, Auto and Consumption were the key underperformers. Smallcaps, Midcaps and the broader BSE500 turned outperformers to the NIFTY. FIIs turned net buyers in March with a modest $0.2bn net equity inflow, after nearly $14bn of outflows in the first two months of the year. Debt inflows continued and witnessed a sharp increase to $3.7bn, well above the $2.8bn garnered during the first two months of 2025.

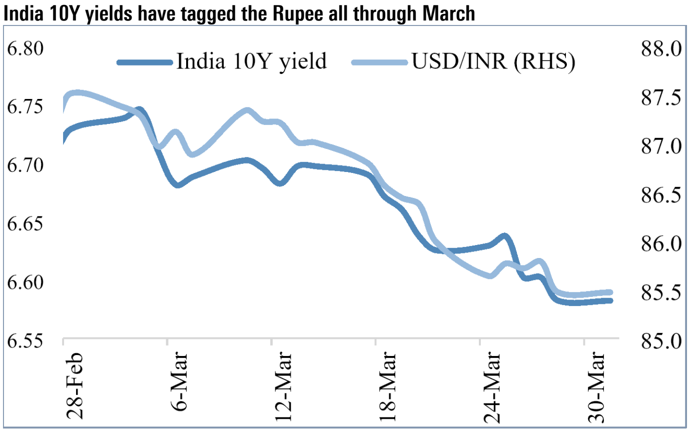
CPI inflation was seen well below market expectations on the back of a sharp drop in vegetable inflation. This was seen to greatly increase the probability of an RBI rate cut in the eyes of the markets. India also saw a sharp drop in its trade deficit to muti-year lows on lower-than-expected imports. Further, India's current account deficit for the Dec'24 quarter was seen well contained, removing one layer of risk for the currency into the near term. Fiscal accounts for the centre however were seen weak with a sharp drop in capital expenditure growth during the month of Feb'25. State fiscal however, saw a host of state budgets, with many states projecting strong capex spending for FY26 (Bihar, MP, TN, Haryana, Delhi and Punjab), even as some projected a sharp drop in capex growth (Maharashtra, Karnataka).

Manufacturing and Services PMI broadly holding up in March



Composite PMI numbers moved marginally lower in March, but broadly holding up. Services activity was seen easing, while manufacturing output touched an 8M high. Manufacturing saw both new orders and output rise, alongside a solid increase in employment. Input cost inflation touched a 3M high, and sentiment remained optimistic. Services saw a continued increase in employment, while outstanding business grew softer. Business sentiment remained positive, though weaker.

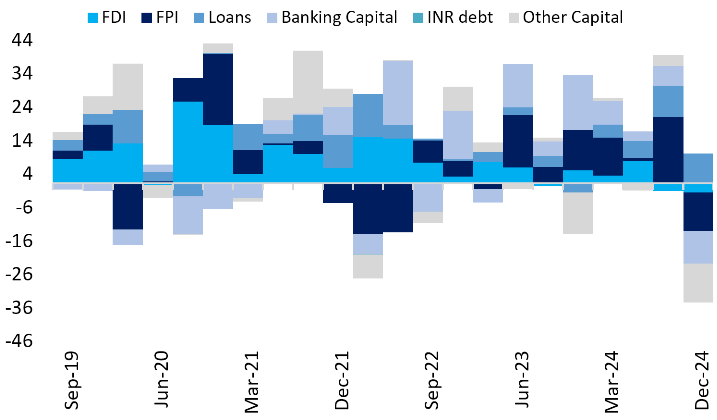
India 10Y yields have tagged the Rupee all through March



India 10Y yields moved lower all through the month on the back of strength in the Rupee, that appreciated by just over 2%. Rupee apart, domestic liquidity turned into a surplus after strong RBI measures in the form of FX swaps and OMO purchases. Another positive for India yields have been the gradual drop in US10Y yields on growing concerns around US growth and risk-off sentiment in the US markets, ahead of tariff announcements.

Break-up of India's capital account by segments (USD Bn.)

Equity Market Outlook



India's current account deficit for the Dec'24 quarter stood at 1.1% of GDP, down from 1.8% in the Sep'24 quarter. The CAD at $11.5bn, was below market expectation of $12bn and the full year CAD for FY25 is expected well under 1% GDP. The moderation in the CAD was largely on the back of higher exports; even as invisibles surplus remained flat. However, the balance of payments (current a/c + capital a/c) stood negative at $37.7bn, on the back of a capital a/c deficit of $26.8bn. The capital deficit was mainly because of outflows from FDI, FII, banking capital and other capital. Why is all this important? Recall our February'25 E.M.I where we wrote in detail about the problem of CAD financing.

Compared to what we had pencilled in for the Dec'24 capital account in the February'25 E.M.I, the numbers seem more negative on the financing front. While FDI and FII outflows were expected, we appear to have seen outflows from banking capital and other capital as well. These heads broadly consist of foreign currency holdings, NRI deposits and funds held abroad. While the CAD is expected to remain in check, it is the financing of the CAD that stands out and warrants scrutiny. Why? because like we have been constantly highlighting, it is the financing of the CAD that has a direct impact on the Rupee. It is this financing mismatch that finds its way into currency pressures, with the RBI having to intervene heavily to remove any undue volatility.

With a sharp increase in US tariffs on most countries in early April, investment flows into India (equities in particular) could come under pressure and in turn exert an undue influence on the currency, through this very channel of CAD financing.

Valuations

After moderating over the last few months, India's 1Y forward price-to-equity valuations saw an inch-up in March. Valuations continue to remain well above their long-term averages (LTAs) for Midcaps and Smallcaps (Page 9). We continue to stress the need for a balanced asset allocation in portfolios with shorter term horizons. As always, long-term investors must use market corrections as an opportunity to add equities to their portfolios.

Outlook

Early April witnessed the US impose significant tariffs across its key importers, with a marked bias towards Asian economies. The key question at hand is how the tariffed economies and the global economy as a whole would respond to these tariffs. Markets appear to probably be expecting that the announced tariffs can get changed soon through negotiations. However, if these announced tariffs sustain, it would have a much stronger-than-expected impact on both US inflation and on global growth. We touched upon this in our October E.M.I (Pg.4,5) where we saw how both global exports and industrial production registered a sharp drop during the 2018 tariff-phase. During the 2018-19 period, the extent and depth of tariffs were contained and relatively smaller. Given that the tariffs are larger and broader this time around, the impact would depend directly on whether the announced tariffs remain unchanged for long, without any significant downward revision through negotiations. Remember here that while the blanket tariffs of 10% was broadly digestible to the markets, the individualised tariffs over and above this, has come as an unpleasant shock, well above what any market analyst had in mind. What lies key in the months ahead is how the Emerging markets respond to these tariffs.

Negotiations apart, countries tariffed can respond in two key ways: through fiscal packages and currency tweaks. Countries can announce large fiscal packages to help offset this negative tariff impact on their companies and can also look at weakening their currencies to help offset the impact of these tariffs. Recall our detailed October E.M.I from last year where we explained how China (in 2018-19) was barely impacted by US tariffs (Pg.5), with its export market shares hardly dented. Export/product diversification apart, China used a combination of fiscal support and currency depreciation to achieve this, where its domestic distributors were reported to have absorbed almost all of the tariff impact.

While the above would be for the medium-to-long term, for the near term, the US tariffs could be positive for FII debt inflows into India. Remember we wrote about FII inflows into India debt (here) and mentioned that there was a very low probability of FII inflows into debt unless either/or two variables saw a drop: crude and US10Y yields. US yields have been easing gradually, leading to strong FII debt inflows into India debt, to the tune of $3.7bn. Post the US' 2nd Apr'25 announcement on tariffs, yields saw a shaper drop. India yields have followed suit and currently traded well below 6.5% in early Apr'25. The yield gap we wrote about between US and India (hedged) 10Y appears to remain positive and have opened up more. Therefore, structurally this could mean more and continued flows into India debt. Strong debt inflows could help stabilise the Rupee (in the near-term though), just like it did in 2024, helping offset the sharp and sudden FII equity outflows witnessed late last year.