Biggest Fed rate hike in 28 yrs jolts stocks

Premium

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Mumbai: Indian benchmark indices Nifty and Sensex witnessed a sharp turnaround on Thursday, starting the day in the green but ending the trading session 2% in the red, tracking a sharp slump in the European markets, as demand slowdown and recession fears gripped investors in the wake of the 75 basis points hike in interest rates by the US Fed.

Sensex and Nifty fell 2.12% and 2.28% from their intraday high on Thursday to close at 51,495.79 and 15,360.30 points, respectively. So far this week, the Sensex and Nifty have lost 5.17% and 5.19%, wiping out Rs12 trillion worth of investor wealth in the last four days.

“Global markets slumped during the day over recessionary fear after the US Fed raised interest rates by 75bps - the biggest increase since 1994. Further the Fed Chair Jerome Powell signalled another big move (50-75bps hike) next month, intensifying its fight to contain rampant inflation. It has sharply increased the interest rate target to 3.4% for 2022 and 3.8% for 2023," said Siddhartha Khemka, Head - Retail Research, Motilal Oswal Financial Services Ltd.

Khemka added that going ahead, markets are likely to stay under pressure amidst worry over significant economic slowdown, while a delay in monsoon is also denting sentiments as it might further push the rural demand recovery.

Economists expect the latest Fed rate action to push up FII sell-off from emerging markets such as India, keeping the rupee under pressure. So far this year, FIIs have sold Indian equities worth Rs1.96 trillion or $25.7 billion, data shows, while DIIs have bought equities worth Rs1.85 trillion.

“This would mean two things for India. First, the investment flows will be impeded further with higher interest rates making US markets more attractive than EMs. Second, currency volatility will be here to stay and the rupee will move down," said Madan Sabnavis, Chief Economist, Bank of Baroda.

“The extent will depend on how the RBI manages the same. So far the rupee has depreciated at about the median rate and is hence not out of sync with what is happening to other currencies. But our monetary policy will largely be driven by domestic inflation trajectory while keeping an eye on fallout of Fed rate hikes," Sabnavis added.

Analysts at UBS expect the rupee to weaken to 80 against the dollar in the next three months.

“Our EM strategist expects the INR to weaken to 80 against the USD in the next three

months, with risks skewed to the upside. Our bearish view on the rupee is a reflection of:

a) the deteriorating current account deficit; b) rich Nifty valuations‘ impact on equity

outflows; and c) very low risk premia in USD:INR derivatives vis-à-vis the rest of the EM," UBS noted in a report on Thursday.

“We also expect India’s consolidated fiscal deficit to remain elevated at 10.2% of GDP (central government: 6.7%, states: 3.5%) in FY23. This would keep government borrowings elevated and pressure bond yields. We retain our 10y IGB (India government bond) yield target of 8% by end-FY23," the report added.

The rupee closed at 78.08 against the dollar on Thursday, marginally lower than its previous close of 78.07, while the yields on the 10 year government bonds inched up 3 bps to 7.62.

Economists believe that the Fed action will likely push other central banks to frontload their policy actions.

“An aggressive US hike cycle puts considerable pressure on the Asian central banks to follow suit, as their policy dashboard broadens from being focused on domestic growth and inflation path, to also include financial stability and outflow risks. The need to anchor domestic inflationary expectations and to preserve financial market stability, are likely to nudge regional central banks to undertake timely and frontloaded action even if they don’t seek to match the quantum or pace of the US hike cycle," said Radhika Rao, Senior Economist and Executive Director at DBS Bank.

Marzban Irani, CIO, LIC Mutual Fund added that the current global situation may force RBI to consider an intermittent rate hike ahead of the next policy meeting in August.

“There may be an intermittent hike by the RBI in July. We may have to hike rates in tandem with US Fed, else it may affect our currency. We do not want to import inflation at this time. Monsoon may remain uncertain and if oil continues to remain above $120/bbl, then inflation might remain high," he said.

To be sure, some experts believe that the 75 bps rate hike by the Fed may not spur any near term action by the RBI, but another large hike in the next Fed meeting could make the Indian central bank look at another 50 bps hike.

“Today’s rate decision by the FOMC is unlikely to sway RBI’s thought process in the near-term. That said if the FOMC delivers additional 75-bp hike in July meeting, then odds of a 50-bp hike in August MPC will rise, in our view. Recent jump in cut-off yields of 364-day T-Bill to 6.28% probably indicates increased market expectations of Terminal Repo Rate above 6% in next 12-15 month," said Dhawal Dalal, CIO-fixed income, Edelweiss AMC