Message to Investors,

Dear Investors,

We believe that as India moves into the post-pandemic phase, economic growth will be on an optically stronger footing. Expectations are building up for a multi-year high-growth cycle even as we are more tempered in our estimates, waiting for a credible execution. We expect GDP growth to be impressive even in FY23E at 8.1% followed by a more normal print of 6.5% in FY24E after 9.5% in FY22E. The consensus is building around an investment revival across (1) government (choosing growth over consolidation), (2) private sector (stronger bank and corporate balance sheets, hopes of higher capacity utilization, new economy manufacturing), and (3) household real estate (low interest rate regime, aspirational shifts). GDP growth would be primarily investment driven given that the external sector may not be supportive for long, and consumption prospects may not be bright given sustained and unequal Covid impact on household income.

There are two major risks that will continue to weigh on global and domestic growth in FY23E: Firstly, Covid waves as is being seen in various economies and further mutations to the virus and secondly supply-chain issues believed to be continuing for another 6-9 months weighing on global trade and growth.

With expectation of impressive GDP growth, we expect RBI to tighten its policy framework as follows: (1) normalizing the policy corridor (from February 2022), (2) sterilizing incremental durable liquidity surplus, (3) changing monetary policy stance to neutral, and (4) 50 bps repo rate hike (from late-H1 FY23). We expect 10-year yield around 6.5% by end FY23E.

In terms of earnings, we expect net profits of the Nifty-50 Index to grow 34.5% in FY22E, 16.0% in FY23E and 13.3% in FY24E.

Reading of high-frequency indicators including GST collection, e-way billing, ILP, freight & consumption across sectors for recent months are also encouraging which bodes well for the markets. Currently Nifty 50 is trading at a valuation of 24.8x FY22E, 21.4 FY23E and 18.6 FY24E earnings. Though valuations look rich in isolation, the strong earnings growth in many stocks and sectors provide investment opportunity. Also the recent market correction provides investment opportunities in quality large-cap and mid-cap stocks.

We expect Nifty EPS of Rs 722 in FY22E, Rs 840 in FY23E and 959.5 for FY24E and Nifty/Sensex Target: Best Case is 21109/69600 (22x FY24E); Base Case is 19190/63800 (20x FY24E) and Worst Case is 17271/59500 (18x FY24E).

I am glad to present the Market Outlook for 2022 with our experts sharing their projection and views on the stock market, commodities and currency.

Wishing you a great year ahead!

Jaideep Hansraj
MD & CEO– Kotak Securities
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Market Overview

Calendar Year 2021 was a year full of surprises. Some of the most unexpected major events unfolded with positive surprises during the year. Many events closed on positive notes as well. There were very few expectations from the Union Budget this year but overall it turned out to be a positive one and the RBI focused on spending and capex, rather than just on the trade deficit. During the CY21 the market rose from 14000 to 18600 without any major economic or earnings improvement. In the worst case scenario, the correction lasted 40 days and was less than or equal to 10 per cent. Our market was extremely concerned about the potential impact of the second wave of Covid 19, however, it proved to be less adverse for India as compared to the developed markets.

After a better-than-expected Q1 results, the market took a real take-off and intensified after the Q2 results. At the beginning of August 2021, the Nifty and Sensex hovered around 15500 and 51800 respectively and before Diwali, they touched a high of 18604.45 and 62245.43 respectively, an unprecedented move of approximately 20 per cent.

It was also a unique year for FII/ FPI investments. From April to the first week of December 2021, FIs sold Rs 1,200 billion, while domestic companies bought more than Rs 1,000 billion. The flow of FPI in equities and debt markets continued, helping the Indian market in the long-run.

We also saw a massive fall behind due to several headwinds in November 2021. The market fell nearly 10 per cent on the back, because of growing cases of Covid 19 in developed markets, concerns over the new Omicron variant, withdrawal of incentives from the US and expectations of accelerating rising interest rates.

We expect Nifty EPS of Rs 722 in FY22E, Rs 840 in FY23E and Rs 959.5 in FY24E.

Based on PE bands, we can arrive at the following targets for the Nifty/Sensex

Best Case is 21109/69600 (22x FY24E) (if the market enters in the euphoric mood)

Base Case is 19190/63800 (20x FY24E) (In the normal circumstances) and

Bear Case is 17271/59500 (18x FY24E) (If economy or earnings fails to improve)
International Economy

Real GDP Growth
After the initial turbulence due to Covid-19, both advanced as well as emerging economies are signaling signs of stable GDP growth for the last two quarters. The IMF expects 2.2%/1.7% GDP growth for developed markets and 4.6%/4.5% GDP growth for emerging markets in CY23E/CY24E.

Growth-Inflation Trade Off
Handling the pace of inflation is the focus of policy-makers. They are tracking the pace of growth. Also, they are keeping a close watch on the reasons for rising inflation. Policy-makers are trying to ascertain whether real demand or supply disruption is the cause behind the rising inflation.

Labor Markets
Labor markets are once again nearing to the pre-pandemic levels, which is a positive sign. However, it perhaps is just one of the causes for increasing inflation. In the basket of major economies like US, CHINA, EUROZONE, UK and JAPAN, the US is recovering better as compared to others in terms of IIP, Retail Sales and GDP.

Inflationary Pressure
Inflationary pressure is to persist in the near-term, mainly due to Supply chain disruption, high energy prices, and robust revival in global demand. Average inflation for last six months is above the inflation target of 2.00 for all the major economies namely UK, EUROZONE (EZ) and US except Japan. It should start moderating at the starting of H2 CY22.
We feel that, the following developments will help to drive the economic growth:

- Growth during the pandemic driven by investments **reflecting government capex growth**, with gradual recovery in consumption.

- Government aims to bring down glide path by reaching fiscal deficit of 4.5% by FY26, compared to 3% in pre-pandemic period.

- This will open up an additional fiscal space of Rs 40 tn over the next few years.

- **Near-term risks:**
  - Spread of the new Covid variant
  - Supply chain shortages lasting another 6-9 months which will weigh global trade and growth
  - Consumption recovering gradually, on the back of significant build-up in savings.
  - However, **middle and bottom of the pyramid is affected**; medium-term consumption could be at risk.
  - **Ramping up vaccination across** the eligible population remains key; ~45% of eligible population is fully vaccinated.
  - **Reopening of the economy after the second wave**, combined with good vaccination pace, has helped in resumption of service sector activities.

- **Trade, transports, hotels, restaurants etc. will lead the recovery.**

Expectations are building up for a turn in real estate cycle. Affordability is increasing and as a result, the inventory is decreasing.

### Employment to low-wage jobs worrying from medium term perspective

<table>
<thead>
<tr>
<th>Industry</th>
<th>Urban (employment change)</th>
<th>Rural (employment change)</th>
<th>Total (employment change)</th>
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<td>Services</td>
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<tr>
<td>Others</td>
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<td>(0.2)</td>
<td>(0.1)</td>
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<tr>
<td>Total</td>
<td>(2.5)</td>
<td>3.5</td>
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*Source: CMIE, Kotak Institutional Equities*
Inflation risks remain high

- We see near-term inflation above RBI target rate of 4%
- Inflation risks remain from global and domestic sides
- Aggressive RBI action will be a risk, if growth surprises on the upside and inflation remains well above the 5% mark

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<td>2021E</td>
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<td>FY23</td>
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<td>Nifty.50 Index (ex-energy)</td>
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<td>849</td>
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<td>Nifty.50 Index (ex-banks)</td>
<td>1461</td>
<td>735</td>
<td>33.5</td>
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Source: Kotak Institutional Equities Estimates

**FY22 incremental earnings growth:**

- Three sectors to contribute: 79%
  - BFSI: 26% (mainly corp banks)
  - Metals & Mining: 36% (mainly Tata Steel)
  - Oil & Gas: 17% (mainly ONGC)

**FY23 incremental earnings growth:**

- Four sectors to contribute: 95%
  - Automobiles: 28% (mainly TAMO)
  - BFSI: 38% (mainly SBI)
  - IT Services: 15% (Top 3 cos.)
  - Oil & Gas: 14% (mainly RIL)

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**Nifty 50 FF EPS: Strong CAGR of 21% (FY21 to FY24E)**

![Nifty EPS Estimates Graph]

Source: Kotak Institutional Equities Estimates
**Observations:**

- Composition of Nifty-50 has changed to high P/E stocks.
- Valuations have started to factor in earnings growth of 34.5% in FY22E, 16% in FY23E & 13.3% in FY24E.
- Most stocks & sectors are already discounting FY23E.
- Recent correction offers opportunity.
- Strong earnings momentum and underlying economic growth offer investment opportunities.

**Policy Normalization:** The risks of global and domestic inflation persist, which is why we see near-term inflation above the RBI’s target rate of 4%. Aggressive RBI action will be a risk if growth surprises on the upside and inflation remains well above the 5% mark.

The current liquidity flush is higher than that during the demonetization period and that is the reason for the surplus liquidity in the system.

We expect the RBI to gradually normalize policy over the coming quarters with following steps and suggestions:

- Normalize the policy corridor in two steps (beginning February 2022).
- Withdraw liquidity surplus through more durable tools like MSS, FX swaps (likely in 1QFY23).
- Change the monetary policy stance to neutral (likely in 1QFY23).
- Increase repo rate (likely in late 1HFY23/early-2HFY23).

**Surplus liquidity in the system:** We expect the RBI to gradually normalize policy over the coming quarters.

Liquidity remains ample and massively in surplus. The current liquidity flush is higher than that during the demonetization period.
Steps for Policy Normalization:

1. Increase in quantum and tenure of VRRRs
2. Gradually sterilize incremental liquidity surplus (spot USD sales to ease USD-INR volatility could offset the forward delivery related liquidity infusion)
3. Normalize the policy corridor in two steps (beginning February, 2022)
4. Withdraw liquidity surplus through more durable tools like MSS, FX swaps (likely in Q1 FY23)
5. Change the monetary policy stance to neutral (likely in Q1 FY23)
6. Increase repo rate (likely in H1 FY23 – early H2 FY23)

Source: CEIC, RBI, Kotak Institutional Equities

Key takeaways: Q2 FY22 earnings

- Q2 FY22 earnings of Nifty-50 were marginally ahead of expectations (37% YoY Vs exp of 30% YoY).
- Adjusted earnings of BSE Sensex increased by 42% YoY (up 20% QoQ).
- KIE Universe earnings grew by 39% Vs expectations of 33%.
- Raw material inflation was visible in most manufacturing sectors – leading to margin pressure.
- Adj. EBITDA of Nifty-50 increased 24% YoY (in line with expectations).
- Banks reported lower slippages and provisions – thereby boosting profitability.
- Capital Goods companies saw strong increase in order inflows in Q2 FY22 (up 98% YoY).
- Earnings: Expect Nifty-50 earnings to grow 34.5% in FY22E, 16% in FY23E & 13.3% in FY24E.
KIE universe: Sectors with positive/negative surprises

<table>
<thead>
<tr>
<th>Companies</th>
<th>EPS growth (%) #</th>
<th>Adj.mcap. (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PAT: Sectors posting positive surprises</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Automobiles &amp; Components</td>
<td>25</td>
<td>26</td>
</tr>
<tr>
<td>Gas Utilities</td>
<td>5</td>
<td>46</td>
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<tr>
<td>Oil, Gas &amp; Consumable Fuels</td>
<td>7</td>
<td>366</td>
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<tr>
<td>Capital Goods</td>
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<td>37</td>
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<td>Construction Materials</td>
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<td>PAT: Sectors posting negative surprises</td>
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<td>Electric Utilities</td>
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<td>Speciality Chemicals</td>
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<tr>
<td>Fertilizers &amp; Agricultural Chemicals</td>
<td>6</td>
<td>13</td>
</tr>
</tbody>
</table>

Source: Kotak Institutional Equities Estimates

Nifty-50 companies that outperformed estimates:
BPCL, IOC, Dr.Reddy’s, Auto Cos., ITC, ONGC, SBI, Shree Cement, Sun Pharma, Tata Steel and Titan

Nifty-50 companies that underperformed estimates:
Adani Ports, Asian Paints, Divi’s Lab, Maruti Suzuki and NTPC

Automobiles, Gas utilities, Oil, Gas and Consumable fuels, Capital Goods and Construction materials did positive surprises in the Q2 FY22. However, Real Estate, Commodity chemicals, Specialty chemicals, Fertilizers and Agriculture chemicals posted negative surprises.

FY22 incremental earnings growth:
We are expecting, following three major sectors are going to contribute 79%: BFSI = 26% (mainly corp banks), Metals & Mining = 36% (mainly Tata Steel) and Oil & Gas = 17% (mainly ONGC).

FY23 incremental earnings growth should be from following four sectors that should contribute 95%: Automobiles = 28% (mainly TAMO), BFSI = 38% (mainly SBI), IT Services = 15% (Top 3 cos.) and Oil & Gas = 14% (mainly RIL).
### KIE universe = Q2FY22 net profit beat estimates: Q2FY22 net profit beat estimates

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<th>Sep-21E</th>
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<td>1,524</td>
<td>1,481</td>
<td>2.9</td>
<td>45</td>
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Source: Kotak Institutional Equities Estimates
Q2FY22 (YoY earnings growth):
Expectation = 33%
Actual = 39%

High growth sectors in Q2 FY22:
Capital Goods = 62%
Cement = 29%
NBFCs = 25%
Gas Utilities = 62%
Metals & Mining = 438%

Market Outlook - CY22
- **Bond Yields**: Domestic and global bond yields to rise over next few months.
- **Inflation**: To persist and remain on the higher side till the first half of 2022.
- **Monetary Policy**: RBI to normalize its current loose monetary policy over the next few quarters.

- **Central Banks** will exit their ultra-loose monetary policies over the next few months.
- **Markets** to go through some form of correction and consolidation in 2022.
- Expect gradual de-rating of **Equities** as bond yields and equity earnings yield converge.
- Phase of **high returns** is reaching to an end. Making money in CY22 will be challenging.
- Have higher preference towards large caps. Be selective for mid & small caps.
- Promising themes and high growth sectors to outperform in next 2-3 years.
- Buy on dips or accumulation is ideal strategy at this point of time.
- Keep an eye on bond yields and Dollar Index - for FPI flows into India.

### Market | Themes & Sectors: Mix of recovery, visibility and earnings growth &
Sectors: Mix of recovery, visibility & earnings growth

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<tr>
<th>Themes and Sectors</th>
<th>Top Picks from the Sectors</th>
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<tr>
<td>Technology - Most promising</td>
<td>Infosys, TCS, Tech Mah and HCL Tech</td>
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<td>Real Estate - Most promising</td>
<td>Oberoi Realty and Suntek Realty</td>
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<td>Corporate Banks - Under Valued</td>
<td>ICICI Bank, SBIN and AXIS Bank</td>
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<td>Telecom - Futuristic</td>
<td>Reliance and Bharti Artl</td>
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<td>Metals - Inflation Sensitive</td>
<td>Tata Steel, Hindalco and JSPL</td>
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<td>Auto - Inflation Sensitive</td>
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<td>Infra - Inflation Sensitive</td>
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<td>Insurance - Defensives</td>
<td>SBIN LIFE, ICICI PRU and HDFC LIFE</td>
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<td>FMCG - Defensives</td>
<td>HUL, MCDOWELL and JUB FOOD</td>
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<td>Pharmaceuticals - Defensives</td>
<td>Cipla and Sun Pharma</td>
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</table>

*Source: Kotak Securities*
Highlights for 2021

- Commodities edged up in 2021 amid supply issues and improving demand outlook; gold and silver fall on stronger dollar
- The best performer was natural gas as prices almost doubled amid tightness in the global market
- Copper touched a record high level above $10000/ton on robust demand outlook
- Energy crisis in China and Europe pushed commodities like Aluminium and Zinc to 2008 and 2007 highs respectively
- Cotton rallied to decade high on strong demand recovery against lower stocks
- BMD CPO hit record high level on supply disruption in Malaysia, against higher Indian and Chinese demand
- Weather challenges associated with la Nina supported edible oils
- Inflation pressure rising globally aggravated by rising energy prices and commodity prices; US inflation reached to a decade high
- From Nov 2021, Fed announced tapering of bond purchases to control inflation
- Brazil central bank has increased interest rates this year, by 575 basis points from 2% to 7.75%
- LME intervened in the copper market, as cash-3month spread widened to record high level
- China crackdown on coal prices amid rally to record high level
- For the first time ever, US and other consumers coordinated to release crude oil stocks from emergency reserves
- Indian government reduced import duty on edible oils to tackle higher prices; Mustard seed and Chana trading were restricted to curb speculation
- A new variant of coronavirus termed Omicron was reported in late November in a reminder that virus concerns are far from over
- Increasing emphasis on booster shots across the globe set to increase vaccine inequity
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<tr>
<th>Commodity</th>
<th>Last Price</th>
<th>YTD gain/loss (%)</th>
<th>Deviation from high</th>
<th>Deviation from low</th>
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<tr>
<td><strong>Precious Metals</strong></td>
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<tr>
<td>COMEX Gold (USD/oz)</td>
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<td>MCX Gold (Rs/10 gram)</td>
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<td><strong>Base Metals</strong></td>
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<tr>
<td>LME Copper (USD/ton)</td>
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<td><strong>Energy</strong></td>
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<td>NYMEX crude oil (USD/bbl)</td>
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<td>ICE Cotton (USDc/pound)</td>
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<tr>
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<td>NCDEX Soyoil (Rs/10 kg)</td>
<td>1194.5</td>
<td>0.37</td>
<td>20.51</td>
<td>16.29</td>
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</tbody>
</table>

Source: Bloomberg

Date as of Dec. 14, 1:40 PM IST
While commodities at large have rallied this year, it has been a lackluster year for gold prices. Gold rallied to record high level of about $2080/oz in international market and about Rs.56000/10 grams in Indian market last year. However, in 2021, gold traded largely within a broad range and currently is down about 5% on the year. Domestic prices have also been impacted amid Indian Rupee’s depreciation against the US dollar and government’s decision to lower import duty.

Gold rallied sharply last year as COVID-19 rattled global economies forcing central banks and governments to take unprecedented monetary and fiscal easing measures. The momentum however came to a halt late last year as start of the vaccination process reduced gold’s safe haven appeal. Additionally, with increasing expectations of global economic recovery, market players expected central banks and government to halt the support measures and normalize monetary and fiscal policy.

While gold started the year on a weaker note, price has largely been in a broad range of $1650-1950/oz. A mixed bag of factors kept prices in a range while investors chose to remain out. While concerns about the pandemic eased with pick up in vaccination process, market players remained nervous owing to resurgence in virus cases. Global economic recovery continued but at an uneven pace while outlook was challenged by rising supply chain issues and inflationary pressure. Central banks also took a patient approach on monetary tightening as focus remained on boosting growth rather than taming inflation. Investor interest in gold took a hit with equities continuing to hit fresh highs. Gold ETFs saw sharp outflows as investor chose to exit from the metal and invest in growth-linked asset classes. However, consumer demand recovered as lower prices and improving economic activity attracted consumers. Central banks also became net buyers as they diversified their portfolio amid increased volatility in financial markets. As per the World Gold Council report, year-to-date till

### Inflation Trend in Major Economies (y-oy) (%)

![Inflation Trend in Major Economies](chart_url)

Source: Bloomberg; KS Commodity Research
Q3, gold demand was 9% lower. A doubling of central bank buying and 50% growth in jewellery demand over the first three quarters only partly offset the decline in ETF demand.

In last few months, gold has been stuck in a range largely, as rising inflationary pressure is countered by increasing debate amongst central banks to start monetary tightening. Central banks, until now have played down inflation concerns stating that it is due to transitory factors and may not continue for long. However, as inflation data continued to confirm rising price pressure, central banks were forced to acknowledge inflation concerns though most still believe that situation may be much better in coming months. To exemplify the inflation situation, US consumer prices rose 6.8% on the year in November, the fastest pace in decades. UK inflation rose 4.2% in October, highest in almost a decade. Euro-zone consumer prices are rising at the fastest pace since 1992. Emerging markets are also facing similar pressure. China’s consumer prices rose 1.5% in October, the fastest pace in more than a year, while factory prices jumped at the fastest pace in 26 years. While price pressure is building up, forecasts indicate that situation may improve. Despite central bank’s optimism that, inflation situation may change soon, market confidence is waning and this has caused increased volatility in larger markets and gold has benefitted from it.

The question is that if inflation is becoming a serious issue and gold is an inflation hedge, why is it struggling? Gold is an asset that yields no interest and tends to benefit during low interest rate period. Gold rallied last year as central banks cut interest rates and started buying bond to keep liquidity high and boost growth. With economic activities picking up, central banks moved to sidelines. However, with increasing inflationary pressure, central banks started debating monetary tightening measures. With strong economic recovery and rising price pressure, the Fed

![Spread between 10-year and 2-year bond yield](image-url)

*Source: Bloomberg; KS Commodity Research*
announced tapering of its monthly bond purchases. The US Fed started tapering of its monthly bond purchases that will conclude by mid-2022. With rising inflationary pressure, some Fed officials have hinted towards possibility of fastening bond tapering or even considering an early interest rate hike. While Fed has so far maintained that it will raise interest rates gradually, market players are expecting a move next year. With more central banks discussing monetary tightening, gold has struggled to build on to its momentum.

Another challenge for gold is persistent strength of the US dollar. The US dollar index has been on a rise since start of the year, as US economy is seen spearheading the global economic recovery because mass vaccination helped reopen economy while huge stimulus measures boosted economic activities. The US currency struggled briefly as Fed maintained a cautious tone despite signs of strong growth and rising price. The US dollar has regained momentum amid diverging monetary policy stance of major central banks. The outlook for US dollar remains upbeat with growth optimism and expectations for Fed’s tightening, however the pace of gains may slow down if US economy struggles to build momentum or if other central banks also shift towards monetary tightening.

Overall, gold has seen a lacklustre year and there is little reason for it to move out of its current range. Gold may continue to remain supported by the slow, uneven economic recovery besides persisting virus challenges that may force central banks to take a gradual approach to reduce stimulus. The rally in equity markets has also stalled and any correction may shift some investors towards safety of gold. Rising inflationary pressure may also keep investors invested in the metals. Any major upside might be challenged by firmness in US dollar, weaker investor interest and slowdown in Chinese economy that may affect consumer demand.

Gold in international market expected to trade in a range of $1650-1980/oz. with a sideways to positive bias. Domestic gold prices expected to trade in a range of Rs.43000-52500/10 grams. The key factors to watch will be Fed’s monetary policy stance, inflation situation globally and trend in equity markets.
Silver

Silver was the talk of the town in 2020 with a rally of over 40%, as it benefitted from concurrent gains in gold and industrial metals. Silver’s dual role of being a precious metal as well as industrial metal however turned from a boon to bane in 2021 and prices continued to remain volatile and directionless. Gold that rallied to record high level last year has struggled for direction this year as central banks and governments worked to reduce support measures in wake of economic recovery. Industrial metals have been largely higher but witnessed huge volatility as market players assessed the demand and supply side response to higher prices. While silver takes its cues both from gold and industrial metals, it has a very close relationship with gold and unless we see a major move in gold, silver is likely to remain stuck in a range, too.

Similar to gold, silver also struggled this year as optimism about US economy and expectations of Fed’s monetary tightening kept US dollar higher. Additionally silver was pressurized by slowdown in manufacturing activity globally and slowdown in Chinese economy. Silver is a precious metal however its usage in industrial sector is more than 50%. Industrial activity has slowed in last few months owing to rising raw material costs and surge in energy prices, and this has dented demand outlook to some extent. Manufacturing activity was impacted by the demand supply mismatch caused by the sharp surge in demand seen with easing of virus related restrictions and pickup in economic activity against supply bottlenecks. Rising raw material and energy costs further exacerbated the situation while labour shortage also became an issue.

The biggest factor that has kept a check on silver price is lack of investor interest. Silver rallied sharply in 2020 coupled with a sharp rise in ETF holdings. Huge liquidity infusion by central banks led to a sharp rally across asset classes while sharp rise in gold price shifted investor interest towards silver. Silver holdings with iShares ETF saw a net inflow of about 5500 tonnes. The trend has however changed significantly in 2021. After the brief rise in holding to a record high level in late January, ETF holdings have been dwindling reflecting drop in investor interest. The persistent rally in equity markets has led to a shift out of safe havens like gold and silver.

Gold Silver Ratio

Source: Bloomberg; KS Commodity Research
While silver has failed to perform, long-term demand outlook remains positive with increasing use of silver in industrial application as well as increasing emphasis on clean energy and electric vehicles. Solar industry, one of the key industries for silver demand, has already witnessed a sharp recovery post 2020 slump. The US Federal Energy Regulatory Commission (FERC) data shows solar led a new generating capacity with 8,410 megawatt (MW) added through the first three quarters of 2021. Renewable energy now represents 25% of total U.S. available generating capacity. As per Bloomberg data, electric vehicles (EV), including battery electric and plug-in hybrids, made up 7.2% of global car sales in the first half of 2021, up from 2.6% in 2019 and 4.3% in 2020.

Demand supply situation has also improved because of the sharp demand growth. As per Silver Institute and Metal Focus report, global silver demand is set to reach 1.029 billion ounces, the first time it has exceeded 1 billion ounces since 2015. Demand is expected to be led by a sharp growth in physical investment and modest growth in industrial demand as global economic activity picked up pace. Higher imports from India, China, and strong US coin and bar sales reflect improved demand. On supply side, mine production expected to have risen in 2021 as production activity was hurt amid resumption of pandemic related restrictions.

Overall, the silver market is expected to record a physical deficit in 2021, albeit modestly. At 7 million ounces, this will mark the first deficit since 2015 (Metal Focus report). Going ahead, demand outlook remains dependent on recovery in major consuming countries like US, China and India and general outlook for industrial sector. Supply expected to improve as higher prices may boost mining activity. A large part of silver supply comes from by-product mining and since prices of industrial metals have risen substantially in last few months, mining activity may pick up pace, and more supply may come online.

We may continue to see silver trading in a broad range unless there is a major up move in either gold or industrial metals. However, the long-term demand outlook for silver remains firm with its increasing usage in industrial application and more emphasis on renewable energy; therefore, investors may remain interested in the metal and this may keep prices supported. Silver may trade in a range of $21-29/oz and we may see fresh buying interest only at lower levels. Silver in domestic market may trade in a range of 55000-74000/kg.
Crude Oil

After the historic fall into the negative territory for the first time ever in 2020, crude oil witnessed a relatively quaint move in 2021 but still managed to remain in headlines. Crude oil has been on a rise since late last year as vaccination process went underway. On a monthly basis, crude oil has risen for eight out of eleven months this year. NYMEX crude tested 2014 highs while Brent crude tested the highest level since 2018. Crude oil has witnessed strong upward momentum however; a sharp sell-off in November was a kind reminder that the commodity remains challenged by virus uncertainty. Market players also became cautious as consumers coordinated to keep a check on prices.

The pandemic upended financial markets however crude oil is one of the most directly impacted assets. Crude oil plunged as virus related restrictions led to demand destruction and supply was slow to respond. Production cuts and slow demand growth helped crude recover. The rally however picked up pace late last year as companies reported success in vaccine trials and countries like UK, US started vaccination process. The success on vaccine front fueled expectations that the pandemic may be controlled soon and reopen of economies may boost demand. The inequitable vaccine distribution, emergence of new variants and waves of infections across the globe kept virus concerns high, however, it failed to have any major impact on price as countries avoided imposing stringent restrictions similar to those imposed in first leg of the pandemic and countries who managed to get the spread under control reopened their economies. The huge stimulus support given by central banks and governments also helped economies to recover further, aiding demand growth. The strong growth in manufacturing sector globally led by China also boosted demand for crude oil and other commodities.

Apart from steady but challenged demand recovery, crude oil also benefitted from slower supply growth. In response to the sharp crash in prices last year, OPEC and allies decided to announce unprecedented production cuts. As crude oil prices recovered and demand started picking up, OPEC and allies began the process of normalizing production cuts. However, with persisting price volatility and virus uncertainty, OPEC and allies maintained an open-ended approach and assessed demand-supply outlook before taking a decision. However, OPEC’s approach kept market players guessing over their moves and it actually added to price volatility. Saudi Arabia unilaterally announced 1 million barrels per day cut for Feb-March period to keep market balanced and allow some non-OPEC producers to boost output. The voluntary cut was further extended in April and was reversed gradually over next few months. This situation has however changed in last few months and OPEC+ have been raising output gradually and not altering their stance despite price movement and wavering demand outlook. Since August, OPEC and allies have raised production gradually by 400,000 barrels per day irrespective of demand-supply challenges and despite pressure from US and other consumers to boost output. OPEC now faces another
challenge as consumers led by US have decided to act to keep prices under check while demand growth is challenged by virus concerns. Apart from OPEC and allies, other major producers like US, Canada, Norway also cut production last year in response to lower crude oil price. With robust price recovery, production has started picking up in non-OPEC countries as well, however, at a much smaller pace. As per US EIA monthly data, crude oil production bottomed near 9.711 million barrels per day in May 2020 and was last reported near 11.14 million bpd but still way off the record high level of 12.96 million bpd set in Nov.2019. Crude production has been slow to recover as producers have kept investment low in sector and focused more on improving investor return. Overall, slow and steady demand recovery and slower supply growth pulled global market from excess supply to a deficit and this has been the major reason which has kept crude oil prices higher this year.

The recent leg of rally in crude oil can be attributed to external development. A sharp rally in China’s coal prices and European gas prices led to an energy crisis, fueling expectations that market players may switch to crude oil and petroleum products to meet their requirements. China’s coal prices surged to record high level as slower production and imports could not meet the robust demand production and imports could not meet the robust demand recovery resulting in dwindling stocks. European gas prices also surged to record high level amid constrained supply from Russia, below average stocks and expectations of tighter market during the winter season when heating demand picks up. International Energy Agency predicted that fuel switching may cause crude oil demand to rise further by 0.5 million barrels per day. The sharp up move was however short-lived amid increased efforts to curb natural gas and coal prices. China’s coal prices corrected sharply as China boosted production and curbed speculative and hoarding activity. Price has been corrected.

Trend in Global Demand and Supply (million barrels per day)

Source: US EIA; KS Commodity Research
more than 50% from the highs set in mid-October as China’s coal production surged to fresh record high level. European gas prices were also corrected nearly 20% from the highs as Russia promised to boost supply to the region after filling its own storage. While coal and gas prices have been corrected, there are still challenges. China’s coal supply is improving however demand may pick up pace as winter sets in. Standoff between Europe and Russia over the Nord Stream 2 pipeline has also kept uncertainty high about Russian supply.

Going ahead, if we look at US EIA estimates, global market is expected to switch from a deficit in 2021 to a modest surplus in 2022 as supply growth picks up pace while demand growth slows. Output from OPEC and other producers is set to rise in response to sustained higher price seen this year. Demand growth is expected to slow as economic recovery slows with normalization of stimulus measures while virus concerns force countries to take a measured approach on reopening. A surplus market may turn out negative for crude price, however, we are set to see high volatility as standoff between producers and consumers may continue. OPEC and allies are still holding back production and if prices tank too sharply, they may adjust supply accordingly. Consumers may be forced to act to get inflation under control. Amid high volatility, crude oil is expected to trade in a range of $60-85 per barrel but a sharp fall is unlikely as demand growth may continue with countries focusing more on vaccination. Meanwhile, OPEC and allies may also avoid an oversupply situation. In domestic market, crude oil is likely to trade in a range of 4600-6400.

Source: Bloomberg; KS Commodity Research

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**Trend in China Coal and European gas price**

- China thermal coal (yuan/ton) (LHS)
- Europe Dutch TT gas price (euro/MWh) (RHS)

Source: Bloomberg; KS Commodity Research
Copper

Will Copper make a hat-trick of ~25% gains in 2022?

So far, all the base metals on the LME have traded with a positive bias in 2021, and Copper is no exception either with year-to-date gains of 25%. The leader metal extended gains from 2020 as LME 3M and MCX Copper touched a record high of $10,747.5/tonne and Rs 812.6/kg respectively, in May 2021.

In the first half of 2021, optimism regarding the improving global health and accelerating pace of vaccination boosted Copper to an all-time high, as is normally regarded as a good indicator for the state of the global economy. Not only this, ultra-loose monetary policy stance weighed on the dollar index providing further support to the dollar denominated commodities.

Prices retreated from those levels though, as weak Chinese factory output, property market debt woes and energy crisis in China in the subsequent months weighed on global risk sentiments. Contribution of real estate and related industries to China’s gross domestic product is roughly 30% and the sector accounts for a large share of copper consumption. So,
$300 billion debt crisis at China’s once top-selling developer Evergrande and similar tensions in few other developers in the last 3-4 months hurt by unprecedented liquidity squeeze due to regulatory curbs on borrowing, spelled big trouble for the world’s second biggest economy.

As a result, China’s GDP expansion slowed to 4.9% YoY in Q3 2021, from 7.9% in Q2 2021 and a record 18.3% in Q1 2021 according to the National Bureau of Statistics (NBS), as manufacturing activity contracted in September for the first time in nearly two years was hurt by property sector curbs and electricity shortages. Industrial production declined in all the seven months from March to September and the pace only accelerated in the last 3-4 months. Retail sales has seen a similar trend but improved in October, thanks to China’s week-long National Day holiday. Fixed asset investment growth slowed to 6.1% YoY in the first 10 months, lower than the 7.3% rise in January-September.

**Outlook**

Copper prices may continue to extend gains, as backwardation structure on both LME and Shanghai exchange indicates near term tightness. Although LME Cash to 3M futures premium has eased sharply from above $1,000 to below $100 at present, persistent supply disruptions and decline in inventories at exchange warehouses will provide a cushion amid macro-economic distress. Shanghai inventories at present stand at 34,918 tonnes, lowest level seen since 2009, while LME stocks are 50% lower compared to same period last year.

Given that Copper finds applications across the spectrum of construction activities, passage of the long awaited US Infrastructure Bill’s $1 trillion with its focus on upgrading transport systems and homes could boost the country’s copper demand significantly in the coming years.

We expect copper to trade in a range of Rs.620 – 820 in 2022 on the MCX.
LME Copper Cash to 3M spread

Source: Bloomberg; KS Commodity Research
**Nickel**

**NICKEL - Nickel to find positive trigger in new demand drivers**

Similar to other non-ferrous metals, Nickel too extended the positive momentum buoyed by optimism on the revival and upbeat demand outlook of Stainless Steel coupled with increased global risk appetite spurred by signs of vaccination progress.

However, Nickel took a beating in March after China’s Tsingshan Group, one of world’s top nickel producers said, it intended to produce battery-grade nickel at its Indonesian mines, which was bought in 2017 for pumping nickel pig iron (NPI) into a local stainless steel plant. This dented prospects of a tighter market for the battery-quality metal, pushing Nickel to a low of $15,830/tonne, sharply 25% lower from $20,110/tonne seen in February 2021.

However, prices recovered in May in line with increase in Shanghai Steel prices after Chinese finance ministry announced cancellation of export tax rebates for 146 steel products from May 1, hiked export tariffs for ferroalloys as well as high-purity pig iron, and exempted temporary import tariffs for some primary steel products. These measures were perceived as a preparation to support more policies on curtailing domestic steel output. As a result, Chinese Stainless Steel Output fell 2% QoQ in the second quarter though production in the first half of 2021 surged 20.8% YoY as per the International Stainless Steel Forum. World stainless Steel output surged by 24.9% year-on-year to 29 million tonnes in the first half of 2021 while output remained flat QoQ.

China, the world’s biggest importer of Nickel Ore, had shipped 23.8 million metric tonnes from Indonesia in 2019, 43% of its total import quantity. In 2020, Indonesia, one of the world’s top exporters of nickel, banned exports to develop a full nickel supply chain, starting from extraction, processing into metals and chemicals used in batteries, all the way to building electric vehicles. As a result, Indonesia Nickel imports into China tumbled 85.8% in 2020 to 3.4 million metric tonnes, out of which 1.8 million were shipped in January 2020 itself. In December 2020, imports fell to 78,245 metric tonnes and the trend has continued in 2021 with just 0.64 million metric tonnes shipped in the first ten months.

![Price move in Nickel 2021 (YTD)](source: Bloomberg; KS Commodity Research)
As a result, second biggest supplier Philippine tried to step up exports to cover up for Indonesian void and hence shipments to China increased from 30 million metric tonnes in 2019 to near 32 million in 2020 and 34.2 million in the first ten months of 2021. Still, the combined output from the two biggest exporters fell sharply by 34% in 2020 compared to 2019 figures. Further, Philippine Nickel Industry Association and the country’s second largest ore producer Global Ferronickel Holdings Inc., Dante Bravo feel that the country may see decline in Nickel output this year, due to unfavorable weather, adding that the downpour this year is particularly disruptive.

Coupled with this, Vale SA, one of the top nickel producers, cut its Nickel production guidance for this year to 165,000 to 170,000 tons, down from a previous projection of 200,000 tons, mostly due to labor disruptions at its Sudbury mine in Canada. Russian mining giant Norilsk nickel output too fell 23% to 129,858 tons in the first three quarters from the same period, a year earlier. This pushed LME Nickel 3M prices to $21,425/tonne, highest since May 2014.

Nickel Sulphate, key ingredient in the lithium ion batteries widely used for EV, has already added yet another dimension to Nickel demand story. This coupled with recovery in Chinese Steel market is only going to add in the market tightness.

On a year to date basis, Nickel stockpiles at LME and Shanghai warehouses are down by 54% and 66%, respectively. On warrant LME inventories are currently standing at 58,998 tonnes, lowest since December 2019. As a result, LME Nickel cash-to-three-months spread remains in a backwardation of $100 per tonne, though the premium has slipped from $180 seen recently.

**Outlook**

Nickel is likely to continue to gain traction going forward as markets are increasingly optimistic regarding the significant growth in Nickel demand to be used in batteries in the coming years. The Nickel institute states that, 39 percent of lithium-ion batteries contain nickel, and the number expected to increase to 58 percent by 2025, while the battery industry currently represents 7%, or 250,000 tonnes, of annual nickel demand.
LME and Shanghai stocks both declined sharply in 2021

On a long-term basis as well, IEA in its latest report stated that shift to a clean energy system is set to boost Nickel demand by 60-70% over the next two decades and that EVs and battery storage may even displace Stainless Steel as the largest end user of Nickel.

The metal is following a backwardation structure on both LME and Shanghai, and it is likely to continue given brighter demand prospects and lingering supply disruptions. So, Nickel is likely to extend gains this year as well and may trade in a range of 1350 – 1800 in 2022 on the MCX.

Source: Bloomberg; KS Commodity Research
Domestic Cotton Prices Touched Historical High Level This Season

Since the beginning of this year, domestic cotton prices have posted positive returns in eight out of last eleven months. MCX Cotton first month futures during first eleven months of this year surged by around 50% or Rs.10,000 following rising demand in home country, attractive export outlook, falling inventories with Cotton Corporation of India (CCI) and strong cues from ICE Cotton futures, which rose by around 35% since the start of this year. Expectation of recovery in consumption this year as COVID effect continues to fade around globe and record high edible oil prices have doubled cotton prices in last five consecutive quarters. In addition, huge monetary support offered by central banks across the globe to combat economic downfall led by pandemic have also helped commodity prices to scale at unforeseen level in November (MCX Cotton hit an all-time high of Rs.33,850/bale level, while ICE Cotton hit a decade high of 121.6 cents last month). However, concerns over new variant of COVID (Omicron) along with recent hawkish comments from Fed’s Chairman have dragged ICE Cotton prices by over 10% since the second half of November.

World Cotton Stock to Decline for the Second Year in a Row in 2021-22 Season

Highest ever global surplus crop in 2019-20 (Production at 121.4 million bales against Demand at 103 million bales) along with COVID fever have dragged ICE Cotton futures to 12-year low level (48.50 cents) in March 2020. However, reduced surplus crop in last couple of years due to loss of farmer’s interest in Cotton cultivation against improving demand worldwide have dragged world cotton inventories considerably lower in 2020-21 season. USDA expect global cotton stocks, which fell by 8.5% in 2020-21
season at 89 million bales, may again fall by around 3% this year and reach below 87 million bales. Falling world Cotton stock estimates have been the primary reason for three-fold rise in Cotton prices in last one and a half year. Having said that, recent appearance of the new COVID variant may compel USDA to revise and lower the world’s Cotton consumption demand in the coming months, as many countries have resorted to movement restriction to curb proliferation of the virus.

**Indian Cotton Output to Reach to a Record High This Season, in spite of Lower Acreage**

Despite the robust returns provided by Cotton last season, overall sowing of Cotton reduced last year by 6% due to sharp drop in acreage in largest cotton producing states, namely Maharashtra and Gujarat. As per the Ministry of Agriculture data, cotton sowing in Maharashtra reported lower by 7% by the end of last kharif season, over 1% down in Gujarat and over 10% lower in Telangana and Andhra Pradesh each. Indian Cotton acreage, which reached to historic high levels in 2020-21 kharif season at 129.5 lakh Ha, has declined this season due to uneven rainfall

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**Fig. 2 - World Cotton Stock Position (in 000 Bales of 480 lbs)**

Source: USDA & KS Commodity Research
in key Cotton producing states. Increase in area under crops like Rice, Pulses & Maize also took a toll on Cotton acreage this year.

In spite of lower acreage, Cotton output expected to increase this season amid estimates of 9-13% rise in productivity from last year. Record high prices are likely to make farmers wait for third or even fourth picking this season, which will boost overall yield of the crop. Considering yield in the range of 2.97-3.08 bales/ha, we expect Cotton production to reach near 357-370 lakh bales this season. Ministry of Agriculture in their first advance estimates for 2021-22 season, has pegged Indian Cotton production near 362 lakh bales (all-time high output) this season, up from 354 lakh bales produced last year. Similarly, Cotton Association of India (CAI) also forecasted, Indian cotton output to reach near 360 lakh bales this season, compared to 353 lakh bales last year.

**Chinese Cotton Import Persistently Falling since the Beginning of This Year**

China, which imported over 4 lakh tons of cotton (all-time high monthly import) from world market in the first month of this year, reduced the same to less than 1 lakh tons in August, September & October, in spite of record high domestic cotton prices. Apart from decade high cotton prices in world market, selling from state reserves and increased imports of yarn have also affected total imports of Cotton from China. Though overall share of U.S. Cotton has improved in Chinese imports, China’s cotton imports from U.S. has also considerably shrunken since the beginning of this year, as shown in adjacent chart. As per USDA, while Chinese end-users favor the quality and reliability of U.S. cotton, exports from Brazil, Australia and India are increasingly competitive.

**CCI Intervention Unlikely in Procurement unless Prices Dip near MSP Level**

After procuring record high Cotton from open market in last two straight years due to weak prices, Cotton Corporation of India (CCI) is likely to stay away from aggressive buying this season as raw cotton prices are already ruling significantly higher in all the major mandis across the nation. During the global pandemic in the last two cotton seasons (2019-20 & 2020-21), CCI procured around one third of the cotton production in the country.
i.e. about 200 lakh bales (in 2019-20 season all time high procurement) (Source: commodities control news).

For ongoing cotton season (Oct.2021- Sept.2022), CCI has already made adequate arrangements in all 11 major cotton-growing states by opening 474 procurement centers in 143 districts, to meet any eventuality of MSP operations. The Government extends full price support to CCI for undertaking MSP operations in cotton.

**Price Outlook**

Looking at China continuing sale of Cotton from state reserves and diminishing imports since last eight consecutive months are likely to keep cotton prices under check for the near future. Besides, re-emerged virus concerns, which have compelled many countries around the globe to impose movement restrictions and recent crash in crude oil prices, are also suggesting some correction in natural fiber in the coming months. Prospects of good crop from India, U.S. and Brazil, and peak arrival season in home country may also keep Cotton prices under pressure in the coming months. As market prices rule at higher than the MSP of Kapas in all the key mandis, procurement from CCI is not likely to be as aggressive as it was in last couple of years, which may also give some room for correction when supply of cotton increases in the coming weeks in home country. Having said that, the prospects of lower global cotton stock for the second straight season and multi-year low inventories left in India and China, may limit losses in Cotton to some extent.

**Fig.4 China Monthly Cotton imports ('000 Tons)**

![Graph showing China Monthly Cotton imports ('000 Tons) from Jan-21 to Oct-21 with imports from U.S. and total imports indicated.]

*Source: Bloomberg & KS Commodity Research*
Currency Outlook
The USDINR is on track to score four consecutive years of appreciation but volatility has been quite low in 2021. Have a look at the two charts below.

**USD/INR - % return in that year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>2.64%</td>
</tr>
<tr>
<td>2017</td>
<td>-6.15%</td>
</tr>
<tr>
<td>2018</td>
<td>8.84%</td>
</tr>
<tr>
<td>2019</td>
<td>2.28%</td>
</tr>
<tr>
<td>2020</td>
<td>2.33%</td>
</tr>
<tr>
<td>YTD-21</td>
<td>2.64%</td>
</tr>
</tbody>
</table>

*Source: TickerPlant*

Year to date Rupee has been an average performer, when compared to its peers around the world. This is largely due to:

- Strong capital flows and carry trade related inflows into Rupee assets
- RBI intervention

RBI has been an active player in the market, selling when volatility rises and buying when volatility cools off. RBI has bought close to $50 billion (net) using the spot and forward route. At the same time, low virus cases and improving growth have led to increased foreign inflows into India. Though FPI flows have been missing in action over the past two months, they have been robust so far. High interest differential has kept the carry trade related inflows high as well.

It has been seen that, after a year of low volatility, volatility tends to pick up. Therefore, the question remains what can cause volatility to rise in 2022.

- *Persistently higher inflation may lead to money market pricing up to 2/3 hikes next year from the US Central Bank.*
- *Historically, when US Fed goes for a rate hike, volatility picks up in the emerging markets.*
- *In India, real rates are negative. At a time when US is looking to normalize interest rates, negative real rates can become a headwind for the Rupee.*
- *2022 is also the year of major state elections in India, which are critical from the perspective of 2024 LS polls. Focus will be on Gujarat, Punjab and UP state assemblies.*
Annual volatility in USDINR over 20 years

Source: investing.com
Technical Outlook:

USDINR is coming out of one of the longest consolidation phases since 2008. The longer it can sustain above 75.25 the bigger the possibility is for a breakaway move towards all-time highs near 77.00 levels. If it can sustain above 77, then the next target is 78.00/78.30 levels on spot. Bias remains bullish as long as the pair holds above 75.00. Nevertheless, in case of a sustained trading below 75.00, bullish bias will be negated, and the pair will be back in its consolidation mode.

USDINR monthly spot chart since 2007

Source: TickerPlant

USDINR daily spot chart since 2020

Source: TickerPlant
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