Market Outlook

January 2021

Equity Market

Budget boost to stock market

The market that was

After a strong December, Indian markets corrected sharply in the second half of January, leading to a 2.5% decline for the month. This was primarily due to weak global markets, risk-on sentiment, and FIIs selling. While Auto and Telecom sectors were outperformers, Pharma and Metals were the laggards.

India started its course for the world's most extensive vaccination program, and Covid cases have been on a declining trend, with active cases now ~83% below September highs.

On the Macro front, the advance estimate suggested GDP growth of -7.7% in FY21, in line with RBI's -7.5% estimate. Inflation also eased to 4.6% in December and is at more palatable levels than seen in the near past (6%+). GST revenues showed buoyancy, coming in at Rs1.2tn (up 8% YoY). On the political front, protests continued against new Farm Laws in January.

FIIs were net buyers of ~$1.8bn (vs net inflow of ~$7.3bn in Dec) in January, but the momentum faded as they sold ~$1.6bn worth in the last week. DIIs were net sellers of ~$1.6bn during the month, majorly from Domestic MFs (-$2.1bn).

Growth Oriented Budget

The stock market has been pleasantly surprised by the Budget proposals. Four key highlights are:

- Increase capital expenditure
- Continue reforms
- No negatives
- Transparency & conservative projections.

The FY22 Union Budget focused on growth and has relaxed the government's medium-term fiscal consolidation targets. The government rationalized expenditure from high FY21 levels while providing meaningfully higher support versus FY20 levels. The government's more significant focus remains on supply-side reforms to kick-start the investment cycle, critical for India's medium-term growth prospects. The government set a significantly higher fiscal deficit target of 9.5% of GDP in FY21 and 6.8% in FY22 to support the economy. However, part of this reflects the government's move towards greater transparency (shifting below-the-line food subsidy to above-the-line).

The government's decision to accelerate spending reflects its view of higher multiplier effects during the unlock phase and higher growth as a pre-condition for debt sustainability. Its revised targets suggest government spending will be frontloaded and rise by 55-60% y-o-y in the final quarter of FY21 (Jan-Mar 2021). Higher deficits resulted in higher-than-expected market borrowings for both this fiscal year (INR 800bn) and next (INR 12tn). Much of the consolidation in FY22 occurs in the backdrop of higher nominal GDP growth of 14.4% y-o-y and gross tax revenue growth of 16.7% y-o-y, both of which are reasonable assumptions, given a weak base. The disinvestment assumption (0.8% of GDP) may prove aggressive, but dividends and telecom auctions seem attainable.

Increased allocation towards Health (0.16% of GDP for vaccines and 0.3% of GDP for centrally sponsored schemes), focus on Infrastructure (funding via asset monetization and setup of a development financial institution), plans to set up an asset management company to take over stressed debt from Banks' balance sheets, a cess to fund agriculture infrastructure and higher customs duty (to protect domestic firms as part of the self-reliant India strategy) bode well for these sectors.

Going Forward

We believe liquidity drives the stock market in the short term and corporate earnings growth rate in the medium term. The recent rally can be attributed to both these factors; now, even sentiment has turned favorable, so this rally can go on. We remain positive on the medium-term outlook for equities. However, one should be prepared for increased volatility and correction after such an upmove. Overall, we are cautiously optimistic as a) Direction of FII flows can be tricky b) Budget – announcements are good; real test is in implementation.

Q3 results announced so far have delivered better than estimates. Sectors such as real estate, home improvement are making a comeback after reporting sluggish earnings in the past and hence point to a broader economic recovery. At the time of writing this note, 64% of Nifty companies (by weight) had reported earnings with total net profits up 24% YoY vs. consensus estimates of 15% YoY for these companies. We are headed for strong earnings growth in the coming quarters.

Debt Market

Budget takes positive steps

Macro Review

CPI for December 2020 finally receded, printing at sub 5% and showing some signs of easing. Most of the fall was led by food prices dominated by veggies and other perishables. The decline was sequential as well as on a year-on-year basis.

Fuel inflation picked up by 3.5% given the rise in brent crude prices. Besides, gradual return to normalcy is also reflecting in higher electricity and coal prices. Core inflation as a result remained almost unchanged at 5.51%.

CPI has stayed over the upper end of the inflation band of 6% for all of the months in the current fiscal underscoring the inflation pressures the economy is facing. Supply side issues are taking longer to sort, causing CPI decline to remain very slow. Besides, the economic rebound is much faster than expected causing an uptick in input prices from metals to electricity and coal.

Liquidity

In January 2021, RBI started the process of normalizing excess liquidity from the system. The excess liquidity had led to overnight rates fixing well below even the reverse repo threshold by 25-30 bps on an average. RBI commenced the first of its variable rate reverse repo auctions to drain out some of this liquidity for longer periods (14 days). This led to some uptick in short and front end yields. We expect this normalization to continue as we go along but organized in a non-disruptive fashion.

Liquidity conditions remained steady through the month, with durable liquidity in the band of INR 7.5-8.0 trn, including the amount mopped up through reverse repo.

The other positive development was the record GST collections in January touching INR 1.2 trn, the highest ever since GST was first introduced in July 2017. Rising GST collections, post the end of the festive season are reflective of a rebound in the economy with further easing and the onset of the vaccine. As inoculation continues through the next few quarters, we expect a faster return to normalcy.

Budget – 2021 (for FY 2022)

The Union Budget FY 2022, has a clear growth prescription. As the economy limps back to normative levels, post the most stringent lock-down, the Govt decided to unleash the necessary spending to fire the growth engine. The Budget has made spending on capex / infra, health, physical infrastructure its priorities while taking up hard reforms such as bank privatization and divestment of PSU stakes albeit at a faster pace.

To retain fiscal discipline, the budget also spelt out a glide path albeit with a relatively long runway. Budget deficit is expected to fall back to under 4.5% only by 2025-26. The Budget thus offers the economy a really long time within which to reflate seen as the cure for falling incomes in the wake of the pandemic and to create more jobs in the medium term.

Besides, the Budget has been more transparent with most off balance sheet items finding direct budgetary allocation (such as funding for FCI from the NSSF that was resorted to earlier), setting the arithmetic straight. Budget deficit for FY 22 is estimated to decline to 6.8%, way higher than the 5-5.5% market estimates.

Revenue estimates (tax plus non-tax revenues net of capital receipts) appear reasonable, with tax buoyancy assumed at 1.16 x on a nominal GDP growth of 14.4%. Given the recent momentum seen both on direct and indirect taxes and with further opening up of the economy and demand creation likely given the growth impulses, the revenue estimates appear plausible.

Capex outlay at INR 5.54 trn is the highest ever, rising over 31% from the budgeted estimates (BE) of FY 2021. Revised estimates for FY 2021 are higher than the BE, reflecting the ability to spend / dispense in the right areas. Capex of INR 5.5 trn is also likely to lead to a good growth multiplier.

Outlook

Consolidation in fiscal deficit in FY 2022 is lower than expected. However, given that India was one of the worst impacted by the pandemic given the stringent lock-downs, a growth revival was of utmost importance to cure the pain.

Fiscal deficit of 6.8% in FY 2022, is expected to decline along a glide path to under 4.5% by FY 2026. The net dated borrowing of INR 9.3 trn though will certainly place some strain on markets and need RBI support to go through.

The growth oriented fiscal policy will now necessitate some counter action from the RBI. We would call an end to the rate cut cycle in the medium term. RBI will now have twin jobs of managing inflation expectations from a higher than expected deficit and a slower return to sub 5% level on fiscal deficit. Besides it will need to manage the large gross borrowing levels in a non-disruptive fashion.

Fortunately, India's external situation remains robust and RBI's unwavering plan of amassing dollars in good times and building a FX reserve should help to maintain macro stability. Even as India is likely to end FY 2021 with a 2% Current Account surplus, faster pace of import growth is likely to push the Current Account into a deficit.

Recommended Products

In the backdrop of the Budget, we would call an end to the rate cut cycle. Given the growth impulses that are likely from the Budget, we expect the RBI to normalize liquidity to pre-Covid levels, sooner than we expected pre-Budget. While we expected the curve to flatten from RBI's actions, higher borrowing and inflation expectation is likely to lead to some steepening at the longer end again, leading to some overall steepening.

In this backdrop, we remain constructive on the shorter segment preferring the 2-4 year duration segment. For investors with a 1-3 year horizon, we prefer short term fixed income products viz. the PGIM India Banking & PSU Debt Fund and the PGIM India Premier Bond fund.

The PGIM India Dynamic Bond Fund which can assume tactical positioning across the curve is suggested for those with a higher risk appetite. Investors with a less than 1-year horizon can consider the PGIM India Ultra Short Term Fund (3-6 months duration) and the PGIM India Money Market Fund.

Fixed Income Market

	December 2020	January 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.51%	3.47%	-4.00
1 yr CD	3.78%	3.97%	19.00
10 yr GOI Yield	5.90%	5.95%	5.00
USD/INR	73.06	72.95	-11 paise
IIP (Monthly with 2 month lag)	4.20%	-1.90%	-610.00
CPI (Monthly with 1 month lag)	6.93%	4.59%	-234.00
5 Yr AAA PSU spread (bps)	24	15	-9.00
5 Yr OIS	4.62%	4.67%	5.00
US 10 Yr yield	0.91%	1.07%	16.00
CRR	3.00%	3.00%	0.00
Reverse REPO	3.35%	3.35%	0.00
REPO	4.00%	4.00%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

Note: IIP has been revised higher for the previous reading.

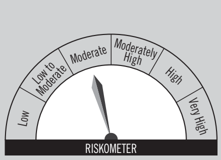
Riskometer

This product is suitable for investors who are seeking*:

PGIM India Premier Bond Fund (An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds)
- Income over the medium term
- Investments predominantly in AA+ and above rated corporate bonds including bonds
- Degree of risk – MODERATE

PGIM India Dynamic Bond Fund (An open ended dynamic debt scheme investing across duration)
- Regular income for short term
- To generate returns through active management of a portfolio of debt and money market instruments
- Degree of risk – MODERATE

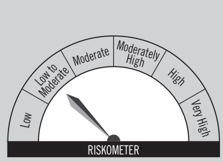
PGIM India Banking and PSU Debt Fund (An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds)
- Income over the short term
- Investment in debt instruments issued by Banks and Public Sector Undertakings, Public Financial institutions and Municipal Bonds
- Degree of risk – MODERATE



Investors understand that their principal will be at moderate risk

PGIM India Ultra Short Term Fund (An open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months)
- Income over the short term
- Investment in short term debt and money market instruments
- Degree of risk – LOW TO MODERATE

PGIM India Money Market Fund (An open ended debt scheme investing in money market instruments)
- Regular income for short term
- Investments in Money Market instruments
- Degree of risk – LOW TO MODERATE



Investors understand that their principal will be at low to moderate risk

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

Source: BSE, RBI & Bloomberg

The views of the Fund Manager should not be construed as an advice and investors must make their own investment decisions regarding investment/disinvestment in securities market and/or suitability of the funds based on their specific investment objectives and financial positions and using such independent advisors as they believe necessary. None of the information contained in this document shall be constituted as a recommendation to buy or sell any particular security.