PGIM
India Mutual Fund

Market Outlook

June 2021

Equity Market

Markets get the growth boost

The market that was

While the broader markets were largely rangebound in June 2021 and closed marginally higher (NIFTY +0.9%), there was a strong surge in the midcaps/smallcaps space with the indices up ~5% in the month. The BSE SmallCap 250 Index has given positive returns for 15 straight months – something never before witnessed by the market (the previous record was 8 months). While hawkish signals by the Federal Reserve did cause some jitters mid-month, the Indian markets recovered along with its global peers. IT and consumer durables sectors were broad gainers while banks, oil & gas and power sector were laggards. The Covid situation too seems to be improving with daily cases below 50,000 and vaccination gathering pace.

On the macro front, May CPI increased sharply to 6.3% YoY. For the two months of FY22, fiscal deficit came at 8% of full year Budget vs pre-Covid average of 47% primarily on the back of robust direct tax collections. The RBI MPC maintained status quo on rates while FY22 growth forecast was cut to 9.5% and inflation revised up by ~25bps to 5.1%. The Finance Minister announced a few Covid relief measures with a focus on improving health infrastructure in tier 2-3 towns and on the stressed segments.

The FY21 current account recorded a surplus of USD 24.0 billion or 0.9% of GDP compared with a deficit of USD 24.6 billion or 0.9% of GDP in FY20. Bank Credit growth continued to remain at modest sub-6% levels. India's crude oil imports in May rose 18.2% YoY, up the most since February 2016, to 17.3 million tonnes – early signs of growth recovery. As per CMIE, India's unemployment rate dropped to 9.2% in June compared to 11.9% in May.

Capital markets saw 13 deals worth ~$4bn executed in June. FIIs were net buyers to the tune of $1.4bn, while DIIs continued the buying in June to the tune $0.9bn. YTD FII/DII inflows stand at +$8bn/-$0.5bn respectively.

Going Forward

While things seem to be coming back to normalcy with some lockdown easing seen in many states, vaccination gathering steam and monsoons being healthy so far (10% above normal till 30-Jun), markets are also factoring the same to a large extent. Active cases have declined over 85% from peak levels seen in May'21. However, a few risks remain – a) Risk of a third wave/variant causing economic hiccups, ii) Possible slowing of QE impacting markets globally and iii) rising inflation and sustained high commodity prices leading to cost pressures.

Q4FY21 earnings have seen healthy growth, however, some of it is attributable to the low base of last year, while some of it is due to genuine cost rationalization. With Q1 likely to see some impact of interspersed lockdowns and restrictions, we reckon the economic impact of the second wave should be milder than first wave.

We believe, for markets to sustain momentum - growth should come back strongly (and not only on low bases), covid situation easing out further along with vaccinations gaining more coverage and inflation/cost pressures to come under control are key variables. We continue to focus on companies with growth visibility and sound financials.

Debt Market

Signs of recovery, but inflation a worry

Inflation

After a brief fall in April (4.3%), the CPI for May 2021 overshot market expectations, printing 90 bps higher at 6.3%. There was a secular rise in prices of most items in the month. On a sequential basis, food prices rose by 1.71% following a 0.8% rise in April. The broad-based increase was concerning and partly caused by supply-side issues caused by lock-downs in April / May.

Core inflation also continued its upward march, rising sequentially by 1.45% in May after a 0.54% rise in April. Again, the rise was broad-based percolating to most items of regular household use, healthcare (linkages to the second wave – there has been a record consumption of medicines in the month of April and May), personal products, clothing, transportation (driven by fuel impact) etc.

CPI has now printed at over 4%, the mid-point of the CPI band of 2-6% for 20 straight months. The sticky and steady upward bias in CPI remains a matter of concern. Even after stripping out the spike that can be attributed to supply-side and lock-downs, CPI prints remain worrying.

Headline WPI also came in at a record high of 12.9% for May 2021 up from 10.5% in April. The impact of higher fuel costs was more pronounced in WPI. WPI, which largely represents producer prices, also reflects the rising input pressures being faced by producers. Manufactured product prices rose by 10% YoY. Core WPI at close to 10% should also concern the Central Bank.

Rates and liquidity

Although liquidity remained easy in May 2021, it tightened a bit, reflected in declining LAF balances through the month. The monthly average was in excess of INR 4.5 trillion, though lower than the close to INR 5.48 trillion in April 2021. Part of the reason for the decline was the reversal in CRR to 4% from 3.5% at the start of the month. Overnight rates remained steady with a slight upward bias, though continued to print below 3.5%.

T-bill yields have been witnessing some upward pressure, on the back of expectations in an early resumption of liquidity normalization in the wake of high inflation prints and a faster return to normalcy.

Short-term yields moved up in response as a result. 91-day T-bill yields rose by 4 bps over the month to end at 3.44%, while the 1-year T-bill yields rose by 13 bps to close at 3.85%. The 1-year CD yields also rose by 7 bps to 4.10%, and 3-month CD levels were almost unchanged given the liquidity and modest issuance volumes.

At the longer end, the 10-year benchmark remained practically unchanged, given the RBI's active intervention in the security as part of its yield control program. As a result, RBI now holds over 2/3rd of the security which has also led to extremely low trading activity in the stock. The 5-year G-Sec yields (2026) on the other hand rose by 12 bps in the month to close at 5.72%, being more reflective of underlying pressures in the market.

Outlook

Micro-frequency data led by mobility indicators and electricity consumption reflect a normalization, though yet to hit the pre-Covid levels. Recovery trackers are pointing to a rebound in June. Auto dispatch data for June, also indicates improvement in output in response to better demand.

As the second wave recedes and the pace of vaccination rises, there is certainly more optimism on recovery and a more robust Q2. However, it is important that there is no third wave and the vaccine pace does not slacken after the recent pick-up witnessed in the last 10 days of June.

Global recovery meanwhile is doing well, with most large economies/regions such as USA, Europe and China recording good economic numbers for the month and quarter.

A synchronized pickup in demand and recovery has however raised inflation worries. There has been a sharp pickup in demand for most hard and soft commodities viz. metals, crude, home building material and agri products. While the US Fed continues to believe that the recent CPI print of 4.9% is led by a sudden opening up of the economy and is transient, the large and continuing stimulus programs have a tendency of causing sticky and stubborn inflation prints which tend to become generalized over time. The Fed at its June meeting indicated that rate hikes could happen in the second half of CY 2023.

Locally, the government granted a further stimulus (just at the end of the first wave) as the second wave has started receding. However, actual cash outgo is much lower at INR 1.6 trillion (0.7% of GDP) with most of the sops being in the nature of credit / loan guarantee schemes for MSMEs and extensions of existing schemes (food subsidy) offered last year. The focus again has been on the vulnerable sections and the most affected. With debt / GDP now running close to 90%, the government will be very watchful of offering additional income support / subsidies / fiscal spending keeping one eye on global rating agencies and their recent views which have been concerning.

There is a fear that with rising inflation and pickup in activity, the pro-growth stance projected by the MPC thus far may undergo a change.

We expect the RBI to continue with its GSAP program, offering additional bond buying with a view to anchor benchmark yields. GSAP size at the June policy meeting was raised by 20% to INR 1.2 trillion for Q2.

Although inflation remains a worry, we expect RBI to look through CPI prints for now, hoping that the favorable base effect starting September will cool off the headline readings. Besides, recovery is still patchy given the fears of a third wave.

We expect RBI to remain on an extended pause on rates and retain its accommodative stance, keeping liquidity well in surplus mode.

Liquidity normalization has probably been pushed to Jan to March 2022. RBI has lowered its FY 2022 GDP forecast to 9.5%. If there is no further resurgence or a third wave, it is likely that the pent-up demand, triggers from the stimulus (I and II) and favorable financial market conditions of plentiful liquidity and low rates can trigger both an investment capex and stronger demand.

However, the road ahead for fiscal consolidation is long and yet uncertain. RBI will have an active role to play and take up the slack. Besides, inflation remains a challenge.

Given this environment, wherein bond supply is daunting, and inflation is still sticky, we prefer the Short / mid-end products such as the Corporate Bond (PGIM India Premier Bond Fund) and PGIM India Banking & PSU Debt Fund. PGIM India Dynamic Bond Fund is an option for investors seeking duration gains with an ability to handle some volatility.

Investors with a shorter time horizon of upto 6 months should also look at the PGIM India Ultra Short Term Fund, a high-quality fund that invests predominantly in the 3–12-month segment to maintain duration under 6 months.

Fixed Income Market

	May 2021	June 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.39%	3.36%	-3.00
1 yr CD	4.15%	4.16%	1.00
10 yr GOI Yield	6.02%	6.05%	3.00
USD/INR	72.61	74.33	172 paise
IIP (Monthly with 2 month lag)	24.10%	134.40%	11030.00
CPI (Monthly with 1 month lag)	4.23%	6.30%	207.00
5 Yr AAA PSU spread (bps)	15	20	5.00
5 Yr OIS	5.10%	5.40%	30.00
US 10 Yr yield	1.61%	1.45%	-16.00
CRR	4.00%	4.00%	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.

CPI has been revised lower 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 – LOW TO MODERATE

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

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 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

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

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