PGIM India Mutual Fund

Market Outlook

May 2021

Equity Market

Growth, results better than expected

The market that was

Indian markets continued their upward journey with the Nifty Index up 6.7% in the month on the back of a decline in new Covid infections (down 60% from its peak) and the possibility of return to normalcy gathering pace. The broader markets outperformed with BSE Midcap 150 Index up 6.6% and BSE Small Cap 250 Index up 9.1%. Earnings so far have been optically good (though base was very favorable). Banks, autos, realty, infra, energy and utilities outperformed while Pharma, IT and FMCG were the relative laggards this month. Media reports suggested that the government was mulling a stimulus package for those sectors worst affected by the pandemic including tourism, aviation, hospitality along with SME businesses .

GDP grew 1.6% year-on-year in Q4FY21, beating market forecasts of 1%. 4QFY21 GDP data showed that the economy was on a gradual recovery path. However, the momentum has slowed down as states re-imposed restrictions in Q1FY22 to counter the second Covid wave. Even though the active cases are moderating, lockdowns have been extended into June. In FY21, the economy contracted 7.3%, less than earlier estimates of an 8% drop. Consensus estimates for FY22 GDP growth are in the 9-10% range.

Infrastructure output jumped by a record 56.1% YoY in April on a low base of -37.9% last year. On a 2-year CAGR basis, infrastructure output declined 1.5% in April.

The fiscal deficit for FY21 stood at 9.3% of GDP, below the government's revised target of 9.5%. On February 1st, the government revised its fiscal deficit target for FY21 to 9.5% of GDP, instead of its original target of 3.5% of GDP as the coronavirus pandemic led to lower tax collection and higher spending. FY22 budgeted target of 6.8% of GDP may need a rejig given the current situation.

Headline CPI Inflation fell 123 bp MoM to 4.3% in Apr 2021, lower than consensus estimate of 4.4%. As in previous months, much of the fall was driven by food.

RBI announced a few specific measures such as relief for small borrowers including a new restructuring window, special LTRO for Small Finance Banks and PSL status for lending by SFBs to smaller MFIs.

FIIs turned net buyers again in May at $370mn after seeing an outflow of $1.5bn in April while DIIs buying continued ($283mn vs $1.5bn in April) albeit at a moderate pace. In CYTD FIIs/DIIs flows stand at +$6.2bn / -$1.4bn respectively.

Going Forward

All eyes seem to be on normalcy returning to the economy as infections are on the way down, even though the possibility of a third wave cannot be totally ruled out. Vaccination is the most important tool against the virus, which has been sluggish till date but picking up with the government targeting the vaccination of the majority of the population by year end. Markets though have been buoyant led by liquidity and hopes of growth returning sooner rather than later. At this juncture we believe the market is factoring a lot of positives such as steady growth, margin expansion, low interest rates etc. At the start of FY21 expectation of a washout year did not hold true. Similarly at the start of FY22, even with a higher number of cases, markets are viewing the impact (if any) as transitory in nature.

Q4FY21 Earnings season has been in line with estimates so far. Nifty companies with over 95% in the index have reported numbers, with weighted average profit growth of ~64% yoy. However, some downgrades are seen in FY22 estimates to account for the second wave-led lockdowns and restrictions.

Covid has led to a change in working models and cost cuts for companies, some of which are here to stay and hence likely to improve the earning potential for companies with strong balance sheets, competitive advantages and clean managements. We continue with our philosophy to judiciously choose companies meeting the above criteria in order to generate long-term wealth for investors.

Debt Market

A Tale of Two lockdowns

Inflation

CPI for April 2021 declined expectedly to 4.3% vs 5.5% in March 2021. There was a sequential growth of 0.7% in CPI in April over March 2021. Core CPI declined to 5.2% vs 5.7% in March. However, it may be noted that due to a virtual complete lockdown witnessed in April / May 2020, data collection and gathering was severely impacted last year. As a result, most of the index calculation for the period was through backfitting and implied workings.

April 2021 also witnessed a series of localized lockdowns which impacted both supply (logistics movements were partly impacted) and consumption - both discretionary and non-discretionary. Shortages in equipment, medicines and critical care / hospitalization have all started reflecting in higher medical expenditure for April / May 2021.

As such, a direct comparison with April 2020 for base is misleading given both inadequate data for the previous period as well as the onset of the 2nd wave starting April 2021.

IIP (released with a one-month lag) for March 2021 grew by 22.4% vs -3.4% in February 2021 and -18.7% in March 2020. For FY 2021, IIP contracted by 8.7% vs a contraction of 0.8% in FY 2020. Similar to inflation, IIP numbers are also not strictly comparable given the varied and general lockdowns witnessed both in 2020 and in 2021 during March and April.

GDP numbers – Q4 FY 2021 and the full year

Real GDP for FY 2021 printed at -7.3%, the worst contraction in multiple decades caused by the ongoing pandemic. Nominal growth (after adding inflation) also was negative at -3.0%, implying a contraction even in absolute terms (at current prices). However, the economy certainly gained momentum in H2-FY 2021, compared to the first half when the economy practically shut down.

Contraction in H1-FY 2021 was -16%, followed by a meagre growth of 0.5% in Q3 and 1.6% in Q4 (this was partly helped by base effect as lockdowns had commenced from the third fortnight in March 2020). GVA growth in Q4 was higher at 3.7%, reflecting a pickup in overall economic activity.

For the full year, agriculture performed the best (+3.6% GVA), staying positive each quarter. Services was the worst impacted (GVA at -8.4%) as consumer facing industries (such as travel, tourism, entertainment, hospitality, food and restaurants etc.) operated well below their optimal capacities for most of the year. Industry also had a dismal year degrowing (-7.0%) impacted by supply chain and logistics issues, weak demand and import restrictions.

Full year GVA numbers were clearly buoyed by Govt consumption (+28% in Q4) and gross fixed capital formation (+10.9% in Q4), even as Private consumption remained weak (+2.7% in Q4).

Rates and liquidity

Liquidity in May 2021 remained in surplus mode though it started to fall starting the second fortnight. RBI, as part of its liquidity normalization, had decided to roll back the CRR cut of 1% effected in March 2020 back to the earlier 4% in a two-step process. While the first increase of 0.5% was done in March 2021, the second was concluded in May 2021. Daily net LAF surplus of INR 5.49 trillion as on May1 fell to INR 4.8 trn by the middle of the month and INR 3.95 trn by May 28. Average liquidity in May 2021 as a result was markedly lower compared to April 2021.

Short-term yields moved up in response as a result, albeit not by a big gap. 91-day T-bill yields moved higher by 4 bps between the end of April and May, while 364d T-bill yields went by 6 bps. Movement was higher in three-month CPs which rose by 12 bps.

Notably, most of the movement was at the front end in the 3-6 m segment. There was hardly any movement in the 1 year CP / CD yields.

Outlook

The onset of the second wave has impacted an incipient recovery that was being witnessed since the third quarter (Oct- December) of FY 2021. Ground-level activity and micro-frequency data had all started to turn positive recording a pullback to pre-covid levels in a few cases and beginning to surpass as well, given the pent-up demand and impact from the stimulus.

Starting early April 2021, most regions / states have re-entered a lock-down. While production has been less impacted this time around, as the Govt has been careful to avoid shutting down industry, the stay-at-home regulations have softened demand and consumption across discretionary, non-discretionary and industrial capex.

Consumer data for May 2021 is clearly showing a pile-up in inventory in most consumer goods (such as ACs, 2W, refrigerators, mobile phones, electrical appliances and 4W as well).

RBI has its bi-monthly meeting coming up later this week. However, there are certain challenges for RBI in being unable to lower rates any further as savers have been practically squeezed out in the current rate cycle. With inflation still hovering around 5% with some likely upside given supply side and logistics issues, 1-year T-bill yields (@3.70%), the real rates are already negative by more than 100 bps. Given these issues, monetary policy will have limited ability and impact in being able to revive demand.

Fiscal support will be needed beyond whatever has already been offered during the first wave and in successive rounds thereafter. Given the record fiscal deficit of 9.2% (final) for FY 2021, the government has limited headroom as well. While stimulus in the first round was being offered with expectations of a one-time support to be followed by a gradual recovery and healing of the economy, the second wave has upset fiscal calculations. Already, post the Q4 GDP prints, there have been multiple downgrades of GDP forecasts for FY 2022, with amounts ranging from 300-400 bps. Further stimulus will be needed especially for the weaker and vulnerable parts of the economy and population.

With debt / GDP now running close to 90%, the Govt 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.

We expect the RBI to continue with its G SAP program, offering additional bond buying with a view to anchor benchmark yields. There have been 2 rounds under GSAP 1.0 wherein RBI has mopped up INR 60,000 (in bn/ trn? For consistency) in April / May 2021. This has helped to keep yields anchored thus far.

Given that the "durable growth" that RBI aims for has been pushed back by a few more quarters owing to the second 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 as well. RBI is unlikely to make alterations to its GDP growth forecast of 10.5% for FY 2022, given that we are only 2 months into the new financial year.

However, the road ahead for fiscal consolidation is a long one and a lot depends on vaccinations being speeded up with utmost priority so that growth can be offered a clear unhindered path. Natural demand for G Secs in FY 22 will be lower compared to FY 2021, as recovery gathers ground and bank balance sheets grow slower. RBI will undoubtedly have to step in and take up the slack.

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 with an ability to handle some volatility seeking duration gains.

Investors with a shorter time horizon of up to 6 months should also look at the PGIM 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

	April 2021	May 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.43%	3.39%	-4.00
1 yr CD	3.90%	4.15%	25.00
10 yr GOI Yield	6.03%	6.02%	-1.00
USD/INR	74.06	72.61	-145 paise
IIP (Monthly with 2 month lag)	-3.40%	22.40%	2580.00
CPI (Monthly with 1 month lag)	5.52%	4.29%	-123.00
5 Yr AAA PSU spread (bps)	20	15	-5.00
5 Yr OIS	5.20%	5.10%	-10.00
US 10 Yr yield	1.63%	1.61%	-2.00
CRR	3.50%	4.00%	50.00
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 – 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