PGIM India Mutual Fund

Market Outlook

August, 2019

Equity Market

EXPECT MORE REFORMS AND INITIATIVES AIMED AT RESOLVING STRESS

The market that was

Indian equity markets had another weak month (Nifty -1% and Nifty Midcap -2%), with most sectors under-performing. In response to the economic slowdown, FM Nirmala Sitharaman announced withdrawal of tax surcharge on FPIs along with relief measures that included upfront release of Rs700bn of PSU bank recap, quicker GST refunds to MSMEs, additional depreciation of 15% on vehicles acquired till Mar'20. FM also announced another round of consolidation wherein 10 PSBs would be merged into 4 entities. RBI announced that it would transfer INR 1.7tn surplus to GoI (about INR 1tn more than last year). Market responded positively to these announcements but new data pointing to worsening economy has led to reversal of initial gains.

1QFY20 real GDP growth fell to 6-year low of 5% yoy led by a sharp decline in private consumption. Nominal GDP growth at 8% YoY touched new post-GFC lows. As tax collections remain muted, July end fiscal deficit was at 78% of full year target.

Headline CPI fell slightly to 3.15% in July with core inflation accelerating to 4.3% and food inflation declining to 2.3%. In an unusual move, MPC decided to cut repo rate by 35bps to 5.40% while maintaining accommodative stance. July trade deficit narrowed to $13.4bn (4-m low) led by a sharp drop in oil bill (-22% yoy) and modest recovery in exports.

FII selling accelerated in Aug to ~$2.1bn (vs ~$1.9bn last month) reducing the YTD net inflows to ~$7.1bn whereas DIIs remained net buyers to the tune of ~$2.9bn (vs ~$2.9bn last month) taking the YTD net inflows to ~$4.8bn. DMFs were buyers in the month, with net inflows of ~$5.8bn YTD.

In recent weeks, govt announced slew of measured aimed at a) improving liquidity in the system b) incentives & tax concessions for stimulating demand c) reforms - government eased local sourcing norms for single-brand retail, providing relief to foreign brands including Apple Inc. and Ikea. They have also allowed 100% FDI in coal mining, contract manufacturing through automatic route and 26% FDI for digital media in news with government approval.

Going Forward

Pessimism is all around as major newspaper headlines are all about deteriorating economy, job losses etc. Though overall scenario looks challenging in the near term, there are few positives like a) normal Monsoon – which should lead to improvement in rural incomes b) interest rates are trending down c) lower crude prices – this is a major relief for the economy. Govt. has realized the severity of current slowdown and there is a mounting pressure on them to act. One can expect more reforms and initiatives aimed at resolving stress in specific sectors like real estate, power and autos.

Continuing stress in the NBFCs, poor credit flow, slowing global growth, escalation of global trade tensions and muted earnings growth are the key risks to Indian equity markets. Hence markets are expected remain volatile in the near term. In our equity portfolios, we continue to stick to high quality companies with strong cash flows and healthy balance sheets.

We continue believe in India growth story and remain positive on equities as an asset class with medium to long term view.

Debt Market

YIELDS HARDEN DESPITE RATE CUT AS FINAL CONCERNS EMERGE

Macro Review

CPI remained within RBI's projection for July 2019 (released in August 2019) printing at 3.15%. It was the eleventh consecutive reading below 4%, being RBI's medium term CPI target. Core CPI Inflation came in at 4.20%, slightly higher than last month. We expect Core Inflation to moderate further , given the continued weakness in the economy.

Liquidity and Rates

Liquidity conditions improved during the month with the Liquidity absorbed by RBI under LAF exceeding INR 2 trn at the start of the Month before higher CIC reduced the surplus. On back of the RBI surplus transfer to the government we expect liquidity conditions to remain quite easy. The market is awaiting the report on Liquidity Framework to gauge the RBI's stance on managing liquidity.

Crude oil prices fell by 7% during the month of August as excess supplies persisted and trade tensions between US and China took centerstage which helped ease the pressure on oil prices.

The rupee had one of its worst months as it depreciated by 3.77%. Though the INR was overvalued on REER terms, the steep depreciation was a result of broad based USD strength and Yuan depreciation which broke through the pivotal 7.00 levels against the USD. Generally emerging market currencies were under pressure during the month.

The yield curve steepened during the month as the shorter end of the curve outperformed the longer end of the curve as RBI cut the policy rates by 35bps and liquidity remained easy. Globally the bond yields softened across regions with expectation of easy monetary policy amid slowing growth and rising trade tensions.

Outlook

The yield curve steepened as we had been expecting with the shorter end outperforming the longer end of the curve. The benchmark 10yr Bond yield has come down by 75 bps over the last two months and we now expect the market to consolidate.

Given the slowdown in the economy, fiscal concerns can re-emerge in the second half of the financial year.

Currently the Core system liquidity is positive to the extent of INR 1 trn which will continue to support the yields.

Recommended Products

We recommend short duration products in the average maturity range up to 5 years, given the evolving macro backdrop.

We recommend the PGIM India Banking and PSU Debt Fund along with PGIM India Premier Bond Fund for investors seeking moderate duration exposure with a preference for high quality (AAA) portfolio.

PGIM India Dynamic Bond Fund is recommended for Investors with a higher appetite for Volatility.

Fixed Income Market

	July 2019	August 2019	Change (in bps)
Overnight rate (NSE MIBOR)	5.75%	5.45%	-30.00
1 yr CD	6.86%	6.50%	-36.00
10 yr GOI Yield	6.37%	6.56%	19.00
USD/INR	68.8	71.41	261 paise
IIP (Monthly with 2 month lag)	4.60%	2.00%	-260.00
CPI (Monthly with 1 month lag)	3.18%	3.15%	-3.00
5 Yr AAA PSU spread (bps)	70	60	-10.00
5 Yr OIS	5.40%	5.02%	-38.00
US 10 Yr yield	2.01%	1.50%	-51.00
CRR	4.00%	4.00%	0.00
Reverse REPO	5.50%	5.15%	-35.00
REPO	5.75%	5.40%	-35.00

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg

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Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.