

# Market Outlook

August 2022

## Equity Market

### Stable macro and resilient earnings growth support premium valuations

Indian markets continued their momentum in the month of August, ending up 2.4%. This compares favorably to some of the developed markets which were down for the month, on the back of a hawkish stance of the Fed. Midcap and smallcap indices outperformed the Nifty, returning 6.2% and 4.9% for the month. Amongst sectors, Auto, Banks, Energy and FMCG were key outperformers, while Pharma and IT underperformed.

On the macro front, India's GDP rose 13.5% (lower than RBI estimates) in Q1FY23 vs 20.1% growth registered in Q1FY22, helped by low bases. Growth in GDP was aided by private consumption growth of 25.9% and investment growth of 20.1%. CPI Inflation too eased to a five-month low at 6.71% in July (vs 7.01% in June), while WPI Inflation came at 13.93% (vs 15.18% in June). The RBI also raised repo rates by 50 bps to 5.4% and was in line with global Central banks' actions and signals wherein rates are being hiked to combat inflation. GST collections rose 28% YoY at Rs 1430 BN, higher than the average run rate required to meet budgetary estimates. Monsoons have been 9% above normal for the country though parts of North/Central India have seen a deficit. Crude ended the month at \$95/b (down 3.5% MoM) while INR appreciated 0.2% despite the dollar index being up 3% in Aug.

The Q1FY23 result season while being slightly below estimates, was reasonable in light of the challenges being faced. Sales/EBITDA/PAT for Nifty 50 companies grew 35%/14%/23% (again a low base helped).

After nine months of selling by FIIs, July was the first month of buying in the recent past, and FIIs continued their buying trend in Aug and bought equities to the tune of \$6.8bn while DIIs turned sellers to the tune of \$890mn during the month.

### Going forward

While Indian markets rallied last month as well, there are increasing noises about globally tighter monetary policies and rate hikes to combat inflation, at least in the short term. We believe inflation should see a downward trajectory led by tightening liquidity and is already being witnessed in commodity prices. Further, High Frequency Indicators like GST collections, power demand, retail sales, capacity utilization point towards limited impact on demand so far, and higher pricing has helped in general. Monsoons too on an aggregate level has been good and should help rural demand going forward. The upcoming festive season should be an impact-free festive season since the pandemic and would provide a truer sense of the demand environment and sentiments across various consumer segments.

With two successive months of gains, valuations are not cheap and NIFTY is trading at 18.5x FY24 earnings, a slight premium to longer term averages and is reflective of the growth potential that is in the offing led by margin expansion due to normalized inflation.

When compared to emerging market peers, India stands favorably not only in terms of a strong & stable economy and markets environment, it also offers better long-term growth, earnings saliency and a better international standing (more visible after recent geopolitical events) when compared to many emerging economies and hence premium valuations are likely to sustain.

We continue to stick to our philosophy of "Growth At Reasonable Price" and while near-term volatility is not ruled out, however, in the longer term we are positive on the India growth story.

## Debt Market

### Rate hikes may continue despite moderating inflation

The yield curve moved down with a flattening bias in the month of August 2022. The yields at the longer end of the curve came down while the short end of the curve remained flat. The RBI hiked the policy repo rate by 50 bps which was above market expectations of a

35 bps hike. The RBI acknowledged that Indian inflation had peaked and that RBI expected inflation to moderate going ahead. Fall in commodity prices, especially crude, has led to Indian policymakers expecting inflation to moderate going ahead.

Inflation in the developed economies, however, remained a concern as it exceeded expectations both in the UK and Europe while the US Fed continued to maintain a hawkish stance on rates. The US and European bond yields rose by around 50 bps during the month.

In the last week of the month, unconfirmed news reports of Indian government bonds being included in one of the global benchmark indices supported bond yields. INR was also well behaved though other emerging market and Asian currencies weakened as the US dollar gained strength with DXY touching multiyear highs.

We continue to expect the RBI to take the policy repo rate to 6.00%/6.25% by the end of this financial year, though we think that the risk can be on the upside as globally central banks are still sounding hawkish.

The Credit / Deposit ratio of the banking system continued to widen with credit growth @15.3% and deposit growth@8.8% YOY, putting pressure on short-term deposit rates.

The CPI Inflation for July (released in August) came in line with expectations @6.71%.

INR ended the month at 79.46 depreciating 0.24% during the month though off from its lows of 80 to a dollar.

We expect the yield curve to flatten further as RBI continues to hike rates.

The inclusion of Indian government bonds in one of the global benchmark indices is expected to lead to inflows of USD 15- 20 bn over a period of time and can have a soothing impact on yields in the short term. Over the medium term it will be neutral for yields as the banking system is running excess SLR which can be run down to bridge the widening credit /deposit gap. So apart from the initial flow-led adjustment in yields we do not think that this can lead to major downside in the yield curve though such an inclusion will deepen the Indian G-Sec market and will be structurally positive over the longer term.

We will look to tactically add duration at yields above 7.40% on the 10yr bond.

## Fixed Income Market

	July 2022	August 2022	Change (in bps)
Overnight rate (NSE MIBOR)	5.25%	5.34%	9
1 yr CD	6.60%	6.73%	13
10 yr GOI Yield	7.32%	7.19%	-13
USD/INR	79.27	79.46	19 paise
IIP (Monthly with 2 month lag)	19.60%	12.30%	-730
CPI (Monthly with 1 month lag)	7.01%	6.71%	-30
5 Yr AAA PSU spread (bps)	15	10	-5
5 Yr OIS	6.34%	6.44%	10
US 10 Yr yield	2.65%	3.20%	55
CRR	4.50%	4.50%	0
REPO	4.90%	5.40%	50
SDF (Standing Deposit Facility)	4.65%	5.15%	50

Source: RBI Weekly Statistical Supplement & Bloomberg

**Note:** IIP has been revised lower for the previous reading.

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Source: BSE, RBI & Bloomberg

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