PGIM India Mutual Fund

Market Outlook

February 2022

Equity Market

Geopolitical concerns cause upheavals

In tandem with global markets, Indian markets also fell (NIFTY down 3.1% during the month) on the back of geopolitical tensions soaring amidst Russia-Ukraine crisis. Brent Crude topped $100/barrel after a seven year hiatus. Sectorally, while Metals (+9.9%) was a notable sector in the green, sharp cuts were seen in Realty (-9.1%), Telecom (-7.7%) and Oil & Gas (-6.7%). Midcap and Small caps underperformed, returning -6.5% and -11.3% respectively during the month.

Real GDP growth in 3QFY22 surprised on the downside at 5.4% yoy vs expectations of 5.9%. This implies only 3% real GDP annualized growth in last 3 years. FY22 estimate of GDP growth has been revised down to 8.9% from 9.2% earlier.

The government has achieved 73% of its budgeted (FY22RE) capex target till Jan'22 – lowest in 3 years. As a result of the strong growth in receipts vis-à-vis slower growth in expenditure, fiscal deficit over Apr'21-Jan'22 stood at 59% of FY22RE.

Consumer inflation rate increased to a 7-month high of 6.01% in January of 2022. Food inflation soared for a 4th consecutive month to 15-month high of 5.43%. The inflation stayed at the top of the Reserve Bank of India's target of 2%-6% for the first time since June 2021. The Wholesale price inflation fell to 4-month low of 12.96% in January 2022. However, this was 10th straight month of double digit wholesale inflation – for the first time in about 30 years.

India's trade linkages with Russia and Ukraine are limited, but it faces significant inflationary risks from the recent run up in commodity prices. Crude oil prices have breached $100 per barrel, edible oil prices are up 15% since mid-February, fertilizer prices are up 30% from last week and gold prices are up 6% since Feb. 1. This poses further upside risks to consumer price inflation that climbed to the Reserve Bank of India's upper tolerance level of 6% in January. Brent crude is at $117, while retail prices were last revised when Brent was ~$82.

Capital markets saw 12 deals worth ~$1.5bn executed in Feb. FIIs continued their selling spree and sold Indian Equities to the tune of $5bn, while DIIs continued the buying in Jan to the tune $5.6bn. MFs and insurance were buyers of $1.4/4.2bn of equities respectively.

Corporate earnings for 3QFY22 came in line with expectations. However, sectors reported a wide divergence. Few sectors were impacted by sharp raw material inflation - Autos, Cement, Consumer Staples and Durables, Specialty Chemicals and Healthcare. BFSI was the standout sector in this quarter aided by improvements in loan growth and disbursements, while asset quality improved sequentially propelled by moderation in slippages as well as healthy recovery and upgrades. For 3QFY22, the Nifty universe posted in-line numbers with top line growth of ~30% yoy and net income growth of ~25% yoy.

Going forward

With Union budget advocating pragmatism in government finances, healthy GST collections and fiscal deficit at 58.9% of FY22 target, India seems to be on the right path with balance between growth and prudence. However, risks such as i) High inflationary scenario persistency, ii) High energy costs (especially crude) and iii) possible fallouts of the recent geopolitical issues, remain. Taking cognizance of the above, markets too have corrected a bit (more so midcaps and small caps) and valuations are much more palatable than before (Nifty one year forward P/E of 19x).

As pockets of value are emerging and offer healthy risk reward, we are making changes in portfolios accordingly keeping mind our investment philosophy of Growth At Reasonable Price.

Debt Market

Fiscal, geopolitical concerns roil bond market

The Indian Bond markets were very volatile in February. The month started with the presentation of the Union Budget which negatively surprised the markets as the fiscal deficit and the borrowings for FY23 were higher than market expectations.

As a result, yields rose with the 10-yr yield touching a high of 6.92%. Subsequently, the government cancelled two auctions leading to yields cooling off. The MPC meeting also turned out to be dovish with the RBI refraining from raising the reverse repo rate as was widely expected by the markets. The stance and tone of RBI projects a lower for longer rate scenario. Overall, with the exception of the 10-yr segment, where the yields were higher by 9 bps over the course of the month, the yields at other segments of the curve were lower.

Corporate bond spreads narrowed on the back of lower supply. Towards the end of the month, geopolitical concerns over the Ukraine issue led to risk off and steep rise in crude oil prices and also put INR under pressure. INR depreciated by almost 1% against USD during the month, ending the month at 75.32 compared to the month opening level of 74.62. PFI flows into debt were marginally positive at USD 100mn.

Going ahead we expect the curve to remain steep over the next quarter on the back of the RBI's dovish stance, which along with abundant liquidity, will support the shorter end of the curve while the longer end will remain under pressure on the back of a higher fiscal deficit.

Fixed Income Market

	January 2022	February 2022	Change (in bps)
Overnight rate (NSE MIBOR)	3.40%	3.43%	3
1 yr CD	4.83%	4.87%	4
10 yr GOI Yield	6.68%	6.77%	9
USD/INR	74.62	75.34	72 paise
IIP (Monthly with 2 month lag)	1.30%	0.40%	-90
CPI (Monthly with 1 month lag)	5.59%	6.01%	42
5 Yr AAA PSU spread (bps)	15	0	-15
5 Yr OIS	5.68%	5.77%	9
US 10 Yr yield	1.79%	1.92%	13
CRR	4.00%	4.00%	0
Reverse REPO	3.35%	3.35%	0
REPO	4.00%	4.00%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg