PGIM
India Mutual Fund

Market Outlook

July 2023

Equity Market

A mixed bag of corporate results

Indian equities continued their upward trajectory, led by strong FII buying and risk-on sentiment in the market in July with the Nifty50 Index gaining 2.9% for the month. The NSE Midcap100 Index and NSE Small100 Index outperformed with returns of 5.5% and 8.0% respectively for the month. Indices for Healthcare, Energy and Metals outperformed the broader market during the month, while indices for IT and FMCG underperformed.

The earnings season till now is mixed with disappointing numbers reported by IT services, cement companies and domestic consumption related companies; in line earnings reported by Banks and Auto beat by Pharma companies and Industrials sector. On the macro side, the India manufacturing PMI fell to 57.8 in June vs 58.7 in May, and CPI for June increased to 4.8% mainly driven by food inflation. The IMF raised India's growth forecast for 2023-24 to 6.1% in the year to March, up from 5.9% projected earlier. The monsoon, after a slow beginning in June, picked up pace in July and narrowed the cumulative deficit for the season. Amongst key global developments, the US Fed raised interest rates by 25 bps in July, citing persistently high inflation as a rationale and the accompanying policy statement left the door open for another increase. On 1st August 2023, Fitch downgraded the long-term sovereign rating for the US to AA+ from AAA citing expectations for a deterioration in the medium-term fiscal outlook, rising public sector debt and erosion of governance in relation to political standoffs over debt ceiling extensions.

FIIs were net buyers in the month of July to the tune of US$ 4.1bn while DIIs turned net sellers to the tune of US$ 1.1bn. Over the last four months, FIIs have invested US$ 15.9bn into Indian markets.

Going forward

We remain cautiously optimistic on the market from a medium-term perspective. Our cautious stance stems from the fact that markets are trading at a premium to their current fair value. However, this fair value is likely to grow at a strong pace in the medium term, hence we remain optimistic. Globally, many developed and developing economies are seeing a growth slowdown in an inflationary, high interest rate environment, and an uncertain geopolitical scenario. While India too is not totally immune to global growth tantrums and is likely to see some slowdown, it is still likely to be one of the fastest growing economies. Near term, corporate India is expected to see some softening of earnings growth on the back of weakness in demand outlook driven by a tighter monetary policy and a global economic slowdown. However, the structural growth drivers would ensure that the earnings growth revives over the medium term. We expect markets to remain volatile, as always, six months before and after India's general elections, which are due in May 2024. We are positive on sectors which are linked to domestic consumption and manufacturing as compared to sectors which are dependent on global growth. Accordingly, we are more positive on Financials, Healthcare and consumer discretionary sectors.

Debt Market

Yields impacted by global pressure, domestic concerns

Indian bond Yields hardened for the second straight month as global Central banks continued to hike rates while signaling that they will be data dependent going forward. The big surprise came towards the end of the month when the Bank of Japan tweaked its Yield curve control (YCC) by increasing the flexibility of the target yield range though it kept status quo on the policy rates. The BOJ stated that it will conduct YCC with greater flexibility thereby increasing the upper threshold of the YCC policy targeting the 10-yr bond yield to 1%. The US Fed and the ECB hiked rates as expected and kept the door open for further rate hikes depending upon incoming data.

Apart from the rise in global bond yields which put pressure on domestic yields , domestic concerns on food Inflation, rising commodity and crude prices also impacted yields. Money market yields remained stable as banking sector liquidity improved with continuous forex flows and the return of the Rs 2000 denomination notes to the banking system. As per a RBI communication, 88% of the Rs 2000 denomination notes have come back to the banking system till 31st July 2023, thereby improving the banking sector liquidity.

The monsoon position improved with the cumulative rainfall at 6% above the long period average as of 30 July 2023. East and North East India still have a rainfall deficit. Crop sowing was in line with the previous year though pulses and cotton sowing has been lower so far. Reservoir levels were also above the long-term average. India banned rice exports triggering a price spike in global markets. Russia also refused to extend the Black Sea grain deal.

The risk of El Nino still persists, with food Inflation a concern. Given the rise in vegetable prices, India's CPI inflation is expected to come above 6% for the next couple of months and we expect the RBI to be on a long pause. After the hike by the US Fed the policy rate differential between the US and India has narrowed to historically low levels. India's strong and stable macroeconomic variables and narrowing of inflation differentials with the US have been the underlying reasons for the narrowing of spreads. For the spreads to sustain at lower levels we need to make sure that we remain on a solid macroeconomic footing. The yield curve remained flat and the AAA corporate curve outperformed the sovereign curve on favorable demand supply dynamics.

Indian and global growth looks to be faring much better than anticipated at the start of the year, and given the current growth inflation dynamics, we think that we are in the last leg of the global monetary tightening cycle which began last year, and Central banks are likely to be on a long pause from next quarter onwards.

Brent crude rose by 12% for the month as the production cuts by OPEC+ took hold. Also, the US crude stocks, including SPR, are at multi-year lows and we believe it would be difficult for the US to drain more reserves from the SPR. The Indian Rupee depreciated marginally during the month as the dollar strengthened, even as our Forex reserves topped US$ 600bn. Portfolio flows continued to be strong.

We believe that the RBI is in for a long pause and the rate-cutting cycle in India will start only when the developed market Central banks have addressed the challenge of inflation effectively, which in our view will happen from 2024 onwards.

We expect the 10-yr Benchmark bond to trade in a range of 7.00% to 7.25% over the next one month.

Fixed Income Market

	June 2023	July 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.90%	6.60%	-30
1 yr CD	7.40%	7.40%	0
10 yr GOI Yield	7.11%	7.17%	6
USD/INR	82.04	82.25	21 paise
IIP (Monthly with 2 month lag)	4.20%	5.20%	100
CPI (Monthly with 1 month lag)	4.25%	4.81%	56
5 Yr AAA PSU spread (bps)	34	30	-4
5 Yr OIS	6.31%	6.51%	20
US 10 Yr yield	3.84%	3.96%	12
CRR	4.50%	4.50%	0
REPO	6.50%	6.50%	0
SDF (Standing Deposit Facility)	6.25%	6.25%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg