PGIM
India Mutual Fund

Market Outlook

March 2020

Equity Market

Turbulent times

The market that was

Global equity markets plunged further in March as the coronavirus morphed into a global health crisis, rocked global financial markets and brought the global economy to a screeching halt.

NIFTY corrected 23% during the month – its worst calendar month since Oct 2008. Indian markets hit the 10% lower circuit twice during the month. India announced a 21-day lockdown from 25th March, with only essential goods and services remaining open, to contain the spread of the pandemic. At the time of writing this report, cases in India crossed 2,000 which is relatively better than some of the other large nations. However, we have only tested about 50,000 patients.

Brent crude fell to an 18-year low during the month, despite attempts by US to get a truce between Saudi Arabia and Russia. Falling crude is a blessing for Indian finances - it reduces the bill on a key import item, plus gives avenue to the government to keep some amount of fall in the form of duties. In India, sectors which did relatively well are IT (currency tailwind), ii) Pharma (Essential commodities) and iii) FMCG (basic necessities) whereas Financials, Realty, Metals and Autos were laggards.

The government announced INR 1.7trn (~0.75% of GDP) package to support the weaker sections of the society. In an unscheduled meeting, the RBI took several measures to improve liquidity and cushion the impact due to the current disruption. It cut repo rates by 75bps and reverse repo rate by 90bps to 4.4% and 4% respectively. Further, CRR was cut by 100bps which can inject liquidity of ~Rs1.37trn into the system. RBI permitted banks / NBFCs to allow a 3-month moratorium for term loans and deferment of interest in working capital facilities. It also signalled its accommodative stance and willingness to take necessary actions to stimulate the economy. Jan IIP came in at +2% and Feb headline CPI fell by 100bps to 6.58% driven by decline in food prices. With crude prices declining, India's trade deficit narrowed to $9.85bn in February (lowest deficit in 12 months) and may further fall in March. India's fiscal deficit for the first 11 months of the current FY touched 135% of the revised target of 3.8% of GDP.

The government sharply cut interest rates on small savings schemes by up to 140 bps for April-June after the rate cut by RBI to 16-year lows – thereby reducing the cost of financing the deficit.

Amidst a risk-off environment and recession fears, FIIs sold $8.3bn in March – the highest ever single-month selling by FIIs, almost double the previous high of $4.4bn in Jan'08. FII selling was largely countered by DII buying worth +$7.5bn.

Going Forward

Over a period, everything in life has moved into a fast pace, including market movements. Now, there is a complete lockdown. We are all waiting for gradual recovery of economic activity.

Assuming the pandemic can be controlled, India seems to be in relatively safer spot and according to a UN trade report, barring India and China, world economy will likely be in a recession this year. While growth would likely be lower, India stands to gain in the medium term as global supply chains rethink their dependence on China. With the current fall, valuations have become more reasonable (though it is difficult to forecast earnings in such a volatile environment). India's market cap to GDP has reached close to 50% mark – a level last seen at the bottom of 2008 correction. Nifty PE has corrected to 16x – over 20% lower than last 10-years'median valuation. We believe, companies with strong balance sheets and higher capital efficiency have definitive advantages over weaker peers and we are sticking to the same in our portfolios.

Debt Market

Fiscal sops and stimulus to push up long end yields

Macro Review

CPI for March 2020 printed at 6.58% which was higher than RBI's target of 4% but lower than market expectation of 6.72%. Core inflation (helped by petering off of mobile tariffs) also declined from 4.16% to 4.08%. Headline CPI fell by 73bps m/m compared to January's 13bps m/m, mainly from a steep decline in vegetable prices. The ongoing lockdown due to Covid 19 pandemic could lead to a sharp fall in inflation as demand collapses across the economy.

Liquidity and Rates

Liquidity conditions continued to remain buoyant in line with RBI's accommodative stance and the pledge to improve transmission of past rate cuts. Average daily LAF balances for March stood at INR 2.97 trillion compared to INR 2.99 trillion in February. Liquidity was infused to the tune of 40k Cr through OMO purchase in the month of March. Currency leakage in the first 3 weeks of March was around INR 61,000 cr compared to INR 37,000 cr in February.

INR depreciated by Rs. 3.15 Rs (4.2%) against the USD in March owing to heavy selling by FPIs in both Equity and Debt. In calendar year 2020, FPIs have sold equity INR 483 bio and debt of INR 670 bio, aggregating c. USD 15.3 bio. This is the highest since outflows seen post the global financial crisis in 2008/2009.

Crude oil continued to weaken on worries of falling demand from the coronavirus outbreak. Prices declined in the month closer to USD 25 / bbl from almost USD 55 / bbl a month earlier as the demand shrank due to corona outbreak and price war between Saudi and Russia increasing supply at a time of already weak demand.

RBI advanced the MPC meeting, originally scheduled for 3rd April 2020 and announced a series of measures on policy rate, liquidity and regulatory easing on 27th march 2020. Though this was a delayed response compared to other Central banks, RBI came out with heavy measures and surprised markets with a larger cut and other related measures.

MPC cut the policy rate by 75bps to 4.4% in a split 4-2 vote. In fact, the effective easing is even bigger, as RBI decided to widen the policy rate corridor. The reverse repo rate is now fixed 40bps below the repo rate (from 25bps spread earlier) even as the upper end of the corridor is still at 25bps above repo rate. Given the existing surplus liquidity conditions the effective policy rate has thus in effect got cut by at least 90bps. Other measures that RBI took were targeted LTROs with disbursal linked to deployment in corporate bond market that had no buyers in the midst of logistical issues as work from home initiated in lockdown scenario and heightened risk aversion in the market pushing the liquidity premia to the roof. In addition, RBI also lowered CRR by 1% to 3% from previous 4% for a period of 1 year which effectively releases 1.37 lac cr of liquidity in banking system. Further a dip of 1% in the MSF window for banks on top of exiting 2% were announced as part of liquidity enhancement initiatives. These measures will help market liquidity as well as improve provision of liquidity to any bank facing funding stress on account of risk aversion.

Also, in an attempt to ensure cash crunch at corporate and households on account of the lockdown doesn't affect the balance sheets and transforms into solvency issue, moratorium of 3 months was announced for term loans, provision was made for deferred payment of interest on working capital loans, asset classification norms were eased and migration to stricter liquidity and capital norms for banks as required by Basel were deferred. However, this time MPC did not provide any forecast on inflation and growth sighting extreme uncertainty.

To avert a sharp depreciation of rupee RBI announced a 'sell buy' swap to the tune of USD 2 billion. The corporate bond market saw very few takers and the yields rose sharply due to selling pressure from MF's due to redemption post the yes bank AT1 fallout which was further aggravated with Coronavirus scare leading to extreme risk aversion. RBI also announced OMO purchase to the tune of 40k cr in the month of march to calm the markets.

Outlook

We expect the domestic bond market to retain a positive bias due to the ongoing risk off sentiment globally and a sharp fall in crude oil prices and a rate cut of 75bps with further easing of liquidity. With both monetary and fiscal stimulus to support growth in the ongoing health pandemic we expect the steeping bias to continue. Lower end of the curve moving lower with the new lower policy rate whereas longer end will face a lot of volatility with extra borrowing due to fiscal stimulus and further OMO purchase announcement from RBI to support the borrowing program of the government. Corporate bonds spread will lower on the back of the targeted LTRO (TLTRO)push where the banks will have to buy CP/Bonds in primary and secondary market in equal proportion i.e. 50% from both markets using funds borrowed through TLTRO. Given this backdrop, we find the short end of the curve (up to 5 years) attractive due to attractive term spread over the overnight rate and extremely easy liquidity conditions. The long end of the curve will be very volatile with negative push from extra borrowing and positive push from OMO purchase.

Recommended Products

We recommend short and mid duration products in the average maturity range up to 5 years, given the evolving macro backdrop. We recommend PGIM India Banking & PSU Debt Fund along with PGIM India Premier Bond Fund within this category as suitable investment options for investors seeking moderate duration exposure and 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

	February 2020	March 2020	Change (in bps)
Overnight rate (NSE MIBOR)	5.09%	4.81%	-28
1 yr CD	6.17%	5.12%	-105
10 yr GOI Yield	6.37%	6.14%	-23
USD/INR	72.18	75.33	315 paise
IIP (Monthly with 2 month lag)	0.10%	2.00%	190
CPI (Monthly with 1 month lag)	7.59%	6.58%	-101
5 Yr AAA PSU spread (bps)	45	70	25
5 Yr OIS	5.00%	4.70%	-30
US 10 Yr yield	1.15%	0.67%	-48
CRR	4.00%	3.00%	-100
Reverse REPO	4.90%	4.00%	-90
REPO	5.15%	4.40%	-75

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg