PGIM
India Mutual Fund

Market Outlook

May 2022

Equity Market.

Near-term concerns priced into valuations

Indian markets were down 3% in May 2022 on the back of worries over a global economic slowdown amid aggressive policy tightening, lockdowns in China, and ongoing Russia-Ukraine conflict. Broader indices - NSE500/Midcap were down even sharper at 4.5%/5.3% respectively during the month. Sector-wise Auto, Banks and Consumption Staples outperformed while Metals, Energy and Realty underperformed significantly.

The Indian government unveiled a number of measures to control inflation such as (1) reduction in excise duties for auto fuels, (2) increasing export duty for steel and (3) allowing duty free imports of 2 Mn tons of edible oil. The RBI announced an unanticipated interest rate hike of 40 bps in line with the US Federal Reserve which raised rates by 50 bps while suggesting another 50 bps hike in subsequent meetings.

In FY2022, RBI's balance sheet increased by 8.5% to Rs 61.9 Tn over FY2021 (July 2020-March 2021). The RBI transferred a surplus of Rs 303 Bn to the Central government for FY2022 compared to Rs 991 Bn for FY2021. GST collections for May 2022 came in at Rs 1.41 tn, down 15.9% MoM and up 44% YoY. Bank Credit growth in the month of April of 11.3% compares favorably to 4.7% a year ago. Oil prices continue to hover around elevated levels of US$120/bbl and is a key monitorable. March IIP growth remained lackluster at 1.9%.

India Q4FY22 GDP/GVA came in at 4.1%/3.9% YoY, slowing down a tad on account of the effect of the Omicron wave on the manufacturing sector and contact-intensive services. FY22 GDP grew by 8.7% buoyed by Private Final Consumption Expenditure (PFCE) (8% vs -6% in FY21) and Gross Fixed Consumption Expenditure (GFCE) (16% vs. -10.4% in FY21). Overall growth estimate has been revised for FY22 to 8.7 per cent from 8.8%. Moody's cut India's CY2022 GDP growth forecast to 8.8% from 9.1% earlier. FY22 fiscal deficit to GDP came in-line with Revised Estimate at 6.7%. FD/GDP ratio for FY23 is projected at 6.6% vs Budgeted 6.4%.

Q4FY22 has seen YoY growth of Revenue/EBITDA/PAT for Nifty50 at +23%/+16%/+21% YoY. Strong earnings growth was seen in Banks, NBFCs, Metals, Cement and Agri input, while contraction was recorded in Cap goods, EPC, and Oil & gas.

FPIs continued their selling spree in May, pulling out nearly ~US$4.87 billion from domestic markets. This is the eighth straight month of FII selling. DIIs however bought equities worth US$6.6bn thereby offsetting the impact of FII net sales.

Going forward

Currently, Nifty is trading at one-year forward PE of 18x (is at the lowest level since 2016, excluding the brief covid period), compared to a 12-month peak of 23x. With valuations having corrected and earnings growth still reasonably healthy (inspite of inflation), risk reward is more favorable than before. With inflation likely to see a base effect-led moderation in H2FY23 and rate hikes likely to be front-loaded, we believe that the medium-term outlook is positive

The investment cycle driven by higher realizations and improving demand for commodity producers in core sectors, infrastructure push, real estate cycle, energy self-reliance, manufacturing, and the digital infrastructure space appears promising. There can be moderation in broad-based consumption, given the inflation pressure on low-income households. However, discretionary consumption in the higher-income bracket driven by the expansion of the formal workforce pool appears positive.

With nominal GDP growth likely to be upwards of 15% in FY23 (though partly inflation led), India still is one of the better growing economies and offers a good value proposition at the current juncture. Geopolitics, inflation and high rates are risks to the global as well the Indian economy, however the same seems to be getting factored in valuations to some extent.

Debt Market

Yields rise, but will flatten

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI, in an unscheduled meeting on 4th May 2022, announced a surprise repo rate hike of 40 bps and a CRR hike of 50 bps. The MPC decision to hike rates while continuing to retain the accommodative stance was unanimous.

Bond Yields moved higher across the curve with a distinct flattening bias.

Global Central banks have been hiking rates and the move by the MPC just on the eve of the May meeting of the US Fed, highlighted its concern on domestic Inflation as well as its concerns about relative Interest rate differentials. Indian FX reserves have dropped by USD 40 Bn since the middle of last year.

RBI, in the post policy press conference, also mentioned that it will be moving towards a neutral policy rate over a period of time.

The CPI Inflation print for April (released in May) also surprised on the upside, coming in at 7.79% as against a consensus number of 7.40%. We believe that the RBI will be frontloading rate hikes. Currently, the swaps curve is pricing in 200 bps of incremental rate hikes by the RBI through to the end of the year.

The Central Government reduced excise duties on fuel and other products in an effort to bring down inflation but this can have fiscal repercussions as it will cause revenue loss.

INR depreciated by 1.58% during the month as portfolio outflows continued and crude oil prices went up. Brent crude prices went up by 12.35% during the month as the Ukrainian crisis lingered on. FPI outflows continued during the month with debt outflows at USD 779 Mn.

We expect the yield curve to flatten further as the RBI frontloads the rate hikes. The spreads between AAA bonds and G-Sec are very tight and running at historically low levels and we expect them to gradually widen as the surplus liquidity in the system reduces.

We continue to be underweight duration as we expect inflation to continue to surprise on the upside and will look to tactically add duration at yields of 7.50% or higher on the 10-yr bond. We would also continue to be underweight corporate bonds.

Fixed Income Market

	April 2022	May 2022	Change (in bps)
Overnight rate (NSE MIBOR)	3.93%	4.27%	34
1 yr CD	5.30%	6.29%	99
10 yr GOI Yield	7.14%	7.41%	27
USD/INR	76.43	77.64	121 paise
IIP (Monthly with 2 month lag)	1.70%	1.90%	20
CPI (Monthly with 1 month lag)	6.95%	7.79%	88
5 Yr AAA PSU spread (bps)	0	10	10
5 Yr OIS	6.62%	6.98%	36
US 10 Yr yield	2.93%	2.85%	-8
CRR	4.00%	4.50%	50
REPO	4.00%	4.40%	40
SDF (Standing Deposit Facility)	3.75%	4.15%	40

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg