PGIM
India Mutual Fund

Market Outlook

October 2022

Equity Market

Markets are supported by government focus on macro stability; corporate earnings are holding on

The Indian markets had a strong month and closed in the green (Nifty50 +5.4%) outperforming most regional markets such as Malaysia, Indonesia, Taiwan, Shanghai and Hong Kong. Expectations that the Federal Reserve might slow its pace of rate increases seemed to be the driver of positive sentiment along with normal monsoon in most parts of the country and in line with corporate earnings growth so far.

Midcap and Small cap indices under-performed during the month closing down by -2.5% and -2.6% respectively. All sector indices closed in the green except Consumer Staples. Sectors such as Banking, I.T., Infrastructure and Automobiles were the key outperformers. In the earnings season till now, Commodity and Energy sectors witnessed margin pressure and reported muted numbers. Financial sector companies reported strong set of numbers driven by better credit growth, margins and improving asset quality. Auto companies reported better volumes and growth while I.T. sector results were mixed as companies reported better margins, but lower revenue growth and highlighted concerns around global macro.

The IMF lowered India's economic growth forecast to 6.8% in its latest World Economic Outlook, compared to 7.4% it had estimated earlier in July, citing the impact of external headwinds. On the economy front, September CPI inflation increased to 7.4% vs 7.0% in Aug led by rising food prices and staying well above the RBI's upper tolerance band for nine straight months. India's WPI inflation fell to an 18-month low in September to 10.7%. We expect inflation to have peaked and to gradually move lower. August IIP contracted by -0.8% compared with 2.2% in July.

The gross GST revenue collected in the month of October 2022 was at Rs 1,51,718 crore (US$ ~19bn), the second highest monthly collection, next only to the collection in April 2022.

In terms of net flows, FIIs and DIIs were both buyers in the month to the tune of US$ ~1bn and US$ 1.1bn respectively.

Going forward

Over the last one year the India equity markets have outperformed and remained resilient compared to most developed and emerging markets. Given healthy growth prospects for both the economy and corporate India, steady government policies and better standing of India in the global arena, we remain positive on India's equity markets over the longer term. Further, we are seeing healthy tax collections, improved savings rate and a stronger balance sheet of India Inc. which call for improvement in investment and expenditure rates. With capacity utilization touching ~75% we can expect gradual revival in capex. over the medium term.

The current valuations for the India equity market are marginally above long term averages. Both, the Central government and the RBI are rightly focused on macro stability as the USD continues to strengthen against most currencies, and our deteriorating trade balance is a worry. There are other risks such as global recession, rising inflation, higher energy prices, tighter liquidity, higher interest rates and geopolitical uncertainties. Also, our economy may be relatively de-coupled from the global economy but financial markets are certainly not. Hence markets could see more volatility in the near-term. However, the risks events playing out should be transitory in nature and we reckon Indian markets present a good long-term investment option. Cooling off a high inflationary environment, lower energy prices and decent earnings growth trajectory are the key for Indian markets.

Debt Market

Central bank actions under watch as inflation remains stubborn

Indian Bonds were rangebound during the month even as global bond yields moved higher. The yield curve remained flat with the shorter end of the curve remaining elevated on expectations of further rate hikes while the long end of the curve was supported by real money investment demand. Currently, the Indian overnight swaps market is pricing in a terminal repo rate of 7.00%.

The RBI, in our view, seems to be concerned about the external account and financial stability given the strength of the US dollar and consequent pressure on emerging market currencies, including the INR.

The CPI Inflation for August (released in September) came in higher than expectations at 7.41% though it's expected to moderate towards 6% by April 2023.

Inflation in the developed economies remained a concern as it exceeded expectations both in US and Europe though the Reserve Bank of Australia and Bank of Canada hiked their policy rates lower than market expectations. This resulted in some softening in global bond yields as markets anticipated that major Central banks like the US Fed and ECB will also slow down the pace of rate hikes. Bond markets across the world will be looking at any signs of dovishness from the US Fed in their November meeting.

The INR weakened by 1.75% against the US Dollar in October to 82.78 from 81.35 at the start of the month. Brent also rose by 7.81% during the month as OPEC announced production cuts.

We expect further rate hikes by the RBI as India will be required to maintain Interest rate differential with the Fed Funds rate in light of our Twin Deficits (Current and Fiscal Deficit). We expect the terminal repo rate to be at 6.50%-6.75% by Feb 2023.

The Credit / Deposit ratio of the banking system continued to widen with credit growth @17.90% and deposit growth@9.60% on a YOY basis, putting pressure on short-term deposit rates and money market yields.

Fixed Income Market

	September 2022	October 2022	Change (in bps)
Overnight rate (NSE MIBOR)	6.17%	6.25%	8
1 yr CD	7.06%	7.50%	44
10 yr GOI Yield	7.40%	7.44%	4
USD/INR	81.35	82.78	143 paise
IIP (Monthly with 2 month lag)	2.40%	-0.80%	-320
CPI (Monthly with 1 month lag)	7.00%	7.41%	41
5 Yr AAA PSU spread (bps)	10	15	5
5 Yr OIS	6.91%	6.91%	0
US 10 Yr yield	3.83%	4.05%	22
CRR	4.50%	4.50%	0
REPO	5.90%	5.90%	0
SDF (Standing Deposit Facility)	5.65%	5.65%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg