PGIM India Mutual Fund

Market Outlook

September 2022

Equity Market

Relatively well placed

In line with global markets, Indian markets corrected in September (Nifty was down 3.7%), though it managed to outperform most of the developed as well as emerging market peers. Global events weighed heavy with the Fed raising rates by 75bps and remaining hawkish.

Midcap and Smallcap indices outperformed the Nifty, however, they were still negative in the month (down 2.6%/1.9% respectively) during the month. Sector-wise, FMCG and Healthcare were positive and outperformed while Energy, Realty, Metals and IT underperformed.

On the global macro front, Central Banks across the globe continued to hike interest rates. Domestically, the RBI MPC too raised repo rate by 50bps (now at 5.9%) with a total 190bps increase since May 22 till now. They also reduced GDP growth forecast to 7% from 7.2% and similar action was seen by other rating agencies as well. The CPI print came in higher at 7% in August (vs 6.71% in July) and this is above the RBI's comfort zone of 2-6%, leading the RBI to maintain its withdrawal of accommodation stance for the time being. WPI inflation eased to 12.41% in August vs 13.9% in Jul.

Goods and Services Tax (GST) collections were up 26% YoY at Rs 1.47tn and were above the Rs 1.4tn run rate for the seventh straight month. Rainfall was 7% above normal this season however distribution was uneven, with several pockets of deficit as well as surplus. CAD in 1QFY23 widened to US$23.9 bn (2.8% of GDP) from US$13.4 bn in 4QFY22 (1.5% of GDP).

In terms of deals in capital markets, 33 transactions worth US$1.7bn were executed. After two months of buying, FIIs turned sellers again to the tune of US$1.6bn, which was offset by DIIs, which turned buyers of US$1.7bn of equities.

Going forward

Given the global monetary tightening and inflation scenario, markets globally have seen a correction, though India's outperformance has been remarkable. Due to the trinity of rising global interest in India, favorable demographics and increased investments, India could see steady growth over a long term.

Cooling off a high inflationary environment (on a high base), lower energy prices and decent earnings growth trajectory augur well for Indian markets. While risks emanating from global events, current account deficit and geopolitical actions are not ruled out, we reckon India is in a relatively good position.

Healthy tax collections, buoyant domestic savings and decent recovery from the Covid-led slowdown bodes well for both investment and consumption, the two main pillars of long term growth. This, along with formalization and increased capacity utilization, implies impetus to all-around economic activity levels.

We therefore remain positive on the Indian economy. With valuations having corrected a tad, risk reward is favorable than before. There are enough legs to the potential long-term growth prospects and we intend to capitalize on the same.

Debt Market

Headwinds of inflation and lower growth remain

The Indian yield curve moved up with a flattening bias in September 2022, with the yields at the shorter end of the curve going up more, relative to the longer end of the curve. The RBI hiked the policy repo rate by 50bps in line with market expectations. The RBI seems to be concerned about financial stability given the strength of the US dollar and the consequent pressure on emerging market currencies including INR. The RBI lowered its GDP growth forecast marginally to 7.00% from 7.20% earlier while retaining its inflation forecast at 6.70%, assuming crude oil at USD100.

Inflation in the developed economies remained a concern as it exceeded expectations both in US and Europe, with Central Banks across the world hiking rates with a hawkish stance. The US and European Bond yields rose by around 70 bps during the month.

In the last week of August, there were unconfirmed news reports of Indian government bonds being included in one of the Emerging Global Bond Indices which supported the long end of the curve through most of September, with the benchmark 10-yr Bond yield touching a low of 7.08%. However, towards the end of the month news reports indicated that the inclusion of Indian sovereign bonds into the global bond indices has been delayed, leading to yields hardening in consonance with rising global bond yields. The INR also broke through the 80 handle to end the month at 81.35 from 79.46 at the start of September. Asian currencies weakened as the US dollar gained strength with DXY touching multiyear highs..

Crude weakened along with other commodities on expectations of slower world growth and the strength in DXY.

Bond Markets in the developed economies have increased their expectations of terminal rates with the US Bond Markets expecting the US Fed rates to top out at 4.50% by the first quarter of CY2023.

We also expect further hikes by the RBI as India will be required to maintain an interest rate differential with the Fed Funds rate in light of our Twin Deficits (Current and Fiscal Deficit). The OIS (Overnight Index Swaps) curve is factoring in a terminal repo rate of 7.00%. We expect the terminal repo rate to be at 6.50-6.75% by April 2023.

The Credit / Deposit ratio of the banking system continued to widen with credit growth @16.20% and deposit growth @9.50% YOY, putting pressure on short-term deposit rates and money market yields.

The CPI Inflation for August (released in September) came in slightly higher than expectations (6.90%) at 7.00%.

After the massive flattening of the curve over the last couple of months, we expect some steepening of the curve incrementally.

Fixed Income Market

	August 2022	September 2022	Change (in bps)
Overnight rate (NSE MIBOR)	5.34%	6.17%	83
1 yr CD	6.73%	7.06%	33
10 yr GOI Yield	7.19%	7.40%	21
USD/INR	79.46	81.35	189 paise
IIP (Monthly with 2 month lag)	12.30%	2.40%	-990
CPI (Monthly with 1 month lag)	6.71%	7.00%	29
5 Yr AAA PSU spread (bps)	10	10	0
5 Yr OIS	6.44%	6.91%	47
US 10 Yr yield	3.20%	3.83%	63
CRR	4.50%	4.50%	0
REPO	5.40%	5.90%	50
SDF (Standing Deposit Facility)	5.15%	5.65%	50

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg

C-89/2022-23