PGIM India Mutual Fund

Market Outlook

September 2023

Equity Market

Optimistic on the long-term outlook for Indian equities

Despite global challenges, Indian equities resumed their upward trajectory in September with the Nifty50 Index rising 2% for the month. Based on our internal analysis, 'lower growth + lower quality' companies have significantly outperformed their 'higher growth + higher quality' counterparts during the month, and on a year-to-date basis as well. Rally in smallcap and midcap indices continued in September due to strong buying by retail and domestic institutional investors. NSE Midcap100 Index and NSE Smallcap100 Index were up 3.6% and 4.1% respectively for the month. Indices for power, metals and capital goods outperformed the broader market while indices for information technology, banking and consumer durables underperformed during the month. In September, Indian equities were amongst the best performing equity markets globally. During September, FIIs were net sellers to the tune of $2.52bn while DIIs remained net buyers to the tune of $2.45bn.

Amongst the key domestic macro-economic datapoints, the August CPI inflation dropped to 6.8% from 7.4% in July, led by moderation in food inflation, July IIP growth came in at 5.7%, and CAD for quarter-ending June widened to 1.1% of GDP. Towards the end of September, JP Morgan announced inclusion of Indian Government Bonds to the GBI-EM (Global Bond Index-Emerging Markets) family of indices, which positively impacted the market sentiment. Other key developments during the month includes, US FED maintaining status-quo on rates, as expected, but signalled that the interest rates will remain higher for longer than expected. Post this, US 10-year yields crossed the 4.8% mark, crude oil touched $95/bb, and Dollar Index (DXY) made a fresh high of 107.

Going forward

The recent announcement of inclusion of Indian Government Bonds to Global Bond Index is a longer-term positive for Indian equities, as it would help lower borrowing costs for corporates, and would reflect India's growing importance in the global markets. This, along with other structural aspects like higher proportion of working-age population, rising household income, and stable government policy, will drive the medium to longer-term growth for the Indian economy.

However, from a short-term perspective, we hold a cautious stance on the market as we expect the near-term corporate earnings growth to moderate due to expected economic slowdown. The probable slowdown is likely due to the expected recession in some of the developed markets, elevated interest rates, and ebbing of pent-up demand from the pandemic period. For India, weak monsoon, spike in inflation, rising crude prices, and slowdown in FII flows are the key near-term risks. As we inch closer to 2024, we would see increased volatility due to the Union Elections scheduled in May 2024. We are of the view that these are transient factors, and we remain optimistic on the long-term outlook for Indian equities.

Debt Market

Rate cutting cycle in India may start only in 2024

September 2023 saw yields continuing their upward trajectory majorly driven by higher global bond yields, even as domestic food inflation concerns abated. Yields went up across the curve, and the yield curve steepened a bit in line with the steepening theme abroad, as the longer-end underperformed the shorter-end of the curve. Concerns on food inflation abated to some extent as rainfall in September improved with sowing almost same as last year, though pulses sowing remains marginally below the previous year. The highlight of the month was the long pending inclusion of Indian Government Securities in the JP Morgan GBI-EM Global Diversified Index from June 28 2024. A total of 23 FAR securities with total outstanding amount of USD 340bn maturing after Dec 31, 2026, with a minimum outstanding of USD 1bn will be eligible for the inclusion. The initial weight will be 1% and will rise incrementally every month to reach 10% by March 2025. Flows on account of this inclusion are expected to be in the vicinity of USD 25bn. This inclusion can be a harbinger for other index providers to also include Indian Government Securities in their respective indices. This is medium-term positive for the structure of Indian markets across fixed income, equity, and FX, as the depth and the diversity of the Indian markets will improve, and at the same time put more responsibility on Indian policy makers to ensure macroeconomic stability. We do not expect a structurally downward shift in the yield curve because of this index inclusion, as markets will continue to be driven by fundamentals. The Indian banking system has excess SLR holdings, and RBI is also holding bonds on its balance sheet which can balance out the demand for bonds resulting from the index inclusion. The Indian 10yr bond yield ended the month at 7.25%, up 8 bps over the previous month. The AAA corporate curve outperformed the sovereign curve in September. The Indian OIS curve is reflecting a long pause and a delayed rate cutting cycle from RBI. The 1yr OIS rose by 12 bps during the month and has risen by 34 bps in the quarter-ending September. The 5yr OIS rose by 9 bps during the month, and 20 bps during the quarter.

Liquidity in the system remained tight despite RBI discontinuing the ICRR, as advance tax and GST outflows coupled with RBI's intervention in the FX market kept liquidity tight. RBI's stance on liquidity will be keenly watched in the upcoming MPC meeting on 6th October 2023, as RBI looks comfortable with tighter banking sector liquidity. In the last policy minutes also, RBI Deputy Governor Dr. Patra had highlighted the concern of liquidity overhang on inflation. Thus, going ahead RBI's stance on liquidity will be the keenly watched as we, and the market, expect a status quo on rates.

CPI inflation moderated by 61 bps to 6.83% in August 2023, against market expectations of 7.10%. The recent rise in CPI inflation is largely driven by food inflation, especially vegetables, which has started to moderate. The core inflation is sustaining below 5%, which is healthy. Government has been managing inflation proactively through fiscal steps and has taken a series of steps to bring down food inflation.

Global bond yields, led by US treasury yields, continued their upward trajectory as the narrative of higher rates for longer period took hold, along with concerns on the US fiscal deficit even as Fed paused for a second time in their rate hike cycle. The surge in US yields has been pretty sharp, as the US 10yr yield has risen by 73 bps in the last three months while the corresponding increase in the Indian 10yr benchmark has been 13 bps. The divergence in the emerging and developed market rate cycle is evident from the narrowing of the interest rate differential between EM's and DM's. Bank of England also paused as inflation came in lower than expected, while the ECB hiked though with an indication that they may be done with rate hikes. The yield curve in the US has steepened on back of fiscal concerns, and the dollar Index (DXY) touched 107. Yen depreciated by 2.6% ending the month at 149.37, even as Japanese yields rose prompting intervention from BOJ. Going ahead, yield movement in the Japanese market and the actions of BOJ will be a crucial factor for all markets across the globe as BOJ has been a major provider of liquidity across financial markets through its monetary policy operations.

Brent crude went up by almost 10% closing the month at USD 95.31 a barrel. In the quarter-ending September 2023, crude has gained 26%. The US crude stocks, including SPRs, are at multi-year lows, and along with the production cuts announced earlier by OPEC+ panel being carried forward, brent can stay elevated even as demand slows. INR crossed the crucial technical resistance level of 83, ending the month, and the quarter-ending September 2023, at 83.04. RBI intervention was seen in the FX markets as INR breached 83. Portfolio flows slowed down in September. Equity flows were negative at USD 1.78bn, while debt flows were marginally positive at USD 113mn.

Indian and global growth looks to be faring much better than anticipated at the start of the year. Given the current growth-inflation dynamics, and the aggressive rate hikes done by global central banks since last year, we believe that we are in the last leg of the global monetary tightening cycle, and central banks are likely to be on a long pause from next quarter onwards.

We believe that RBI will also be on 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 10yr benchmark bond to trade in a range of 7.10% to 7.30% over the next one month.

Fixed Income Market

	August 2023	September 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.69%	6.95%	26
1 yr CD	7.44%	7.50%	6
10 yr GOI Yield	7.17%	7.25%	8
USD/INR	82.78	83.04	26 paise
IIP (Monthly with 2-month lag)	3.80%	5.70%	190
CPI (Monthly with 1-month lag)	7.44%	6.83%	-61
5 Yr AAA PSU spread (bps)	30	33	3
5 Yr OIS	6.56%	6.81%	25
US 10 Yr yield	4.11%	4.57%	46
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