PGIM
India Mutual Fund

Market Outlook

March 2023

Equity Market

Relative underperformance makes risk reward better

For the month of March 2023, as well for the financial year, NIFTY was largely flat. Midcaps too were flat for the month, though slightly up (1.2%) for the financial year, while small caps were down 1.8% for the month, and down 13.8% for the year. Sector-wise, power (+9%), oil & gas (+3%), and FMCG (+2%) gained the most, whereas auto (-3%), IT (-3%), and real estate (-2%) were the only indices to close in the red. Uncertainties fueled by the turmoil in European and US banks, persisting inflation and continuing geopolitical tensions kept the stock markets a mixed bag.

On the macro side, India's CPI inflation in February 2023 slowed marginally to 6.44% while CPI core inflation remains too high. WPI inflation eased to 3.85% YoY, the lowest in over two years, dragged down by a fall in overall input costs. Moody's Investor Service raised India's economic growth forecast to 5.5% in 2023, from 4.8% pegged earlier, due to higher capital expenditure proposed in the Budget and a sustained economic momentum. The gross GST revenue collection in March 2023 stood at Rs 1.60L crore, which is the second highest collection ever. With this, GST collection has crossed Rs. 1.5L Cr four times in the last financial year. The govt has changed taxation of debt MFs under which no benefit of indexation for calculation of LTCG on debt MFs (where equity investment is less than 35%) will be available for investments made on or after April 1, 2023.

FIIs were net buyers in March 2023 to the tune of $1.57bn and DIIs bought to the tune of $3.7bn.

Going forward

We have seen a slowdown in consumption, particularly in Discretionary and on the rural side, that was largely expected in an inflationary and high interest rate regime. Further, possibility of El-Nino and an erratic monsoon does exist, overlayed by possible fallouts of a lengthy election calendar. However, we believe these are at best transitory with them being less a worry with passage of time and/or base effect catching on aided by corrective measures being taken. Amongst these concerns NIFTY too is down 8% from its peak and seems to be factoring them to varying extents.

India has underperformed most of its emerging as well as developed market peers in the near past (i.e. 6 months). While Indian markets valuation has traded at a premium to its peers, with this relative underperformance the premium has come back to historical averages. What this implies is that the valuations on a relative basis are more palatable than before. Further, Indian markets are expected to see strong earnings growth, which makes India one of the few positive real growth markets and hence valuation premium is reasonably justified. On an absolute basis as well, valuations are more palatable at ~17x 1 year forward and several sectors/stocks have seen a reasonable correction are trading close to historical averages thereby improving risk reward. While the risks highlighted above are present, positives too exist in the form of improvement in current account deficit, WPI softening driven by weak commodities and recent weakening in crude. We remain constructive on Indian equities driven by healthy earnings growth, palatable valuations and benign policy regime.

Debt Market

Softened stance after global banking crisis

March 2023 may prove to be a turning point in the rate hike cycle being pursued by Central banks across the globe, as the US and European markets were roiled with a banking crisis, and the regulators had to step in to contain the fallout. Given the aggressive and the frontloaded rate hikes across the world, a bit of stress was expected at some point, and it came in the form of a mini banking crisis. Before the crisis unfolded, yields had risen on better than expected economic data and hawkish comments from the Fed / ECB officials as markets started to price in 50bps rate hike by the Fed. It all changed as the trouble started in US regional banks with the Silicon Valley Bank failing and Credit Suisse being taken over by UBS in a move engineered by the regulator. The US yield curve steepened with the US 2yr bond yield falling by almost 90 bps from its peak even as both the Fed and the ECB hiked rates but sounded dovish by acknowledging that the banking crisis will lead to tightening of financial conditions. The Indian Bond curve also steepened with the 2-5yr segment of the curve outperforming as yields in this segment fell by 20-25 bps whereas the yield on the benchmark 10yr bond fell by12bps.

Taking cognizance of the banking crisis in US and Europe and the need to assess the Impact of the cumulative 250 bps policy rate hikes done since May of last year, the MPC paused in its April 6th Policy meeting while stating that it's not a pivot. The MPC also forecast a favorable inflation /growth dynamic by lowering its average inflation forecast for FY24 to 5.30% and increasing its GDP growth forecast to 6.50%.

Liquidity management will become the focus over the next two quarters as the banking system's liquidity has reduced by almost INR 7 lakh cr over the course of the last one year and we expect that the current surplus liquidity will gradually reduce, bringing the focus back on liquidity management as there can be more instances of the MSF rate getting operational as and when liquidity in the banking system gets reduced. This will have implications for corporate bond spreads going forward as they are running quite tight from a historical spread perspective. We believe that the RBI is in for a long pause and we expect status quo on monetary policy to be retained over the next two quarters with a change in monetary stance to "Neutral "coming in at the August MPC Policy.

The INR appreciated against the US dollar by 0.59% during the month as the Indian trade deficit and BOP came in better than expected and the US dollar also weakened. Brent fell during the month before a surprise production cut by OPEC+ led to a rise in prices in the first week of April.

FPI flows into Indian Fixed Income markets were muted in March with marginal outflow of USD103 Mn taking the net inflow into debt at USD 357Mn on a CYTD basis.

The incremental Credit / Deposit ratio of the banking system continues to be elevated with credit growth @15.00% and deposit growth@9.60% on a YoY basis putting pressure on short-term deposit rates and money market yields. This gap between the deposit and the credit growth rates means that the money market rates will continue to sustain at the current elevated levels with the flatness in the curve persisting.

We expect the 10yr Benchmark bond to trade in a range of 7.10% to7.40% till April end.

Fixed Income Market

	February 2023	March 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.70%	7.79%	109
1 yr CD	7.85%	7.55%	-30
10 yr GOI Yield	7.46%	7.32%	-14
USD/INR	82.67	82.17	-50 paise
IIP (Monthly with 2 month lag)	4.70%	5.20%	50
CPI (Monthly with 1 month lag)	6.52%	6.44%	-8
5 Yr AAA PSU spread (bps)	25	25	0
5 Yr OIS	6.70%	6.30%	-40
US 10 Yr yield	3.92%	3.47%	-45
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