PGIM
India Mutual Fund

Market Outlook

November 2021

Equity Market

Proceeding with Cautious Optimism: Unlocked economy and inflation presents a mixed outlook

The market that was

Indian stocks recorded their first monthly loss since April this year as fears over the Omicron variant added to the concerns about high valuations and potential tightening of liquidity conditions. The benchmark Nifty50 Index fell 3.9% in November–the lowest since March 2020–as a poor equity-market debut for India's largest-ever initial public offering also soured sentiment. The losses come as global investors overseeing billions of dollars are slowly starting to favor China over India - reversing a year-long trend that has pushed their stocks in opposite directions.

BSE Metals (-8.9%), Banks (-8.7%) and Basic Materials (-6.4%) Indices were the key laggards, while Telecom (+6.7%), Power (+3.6%), and IT (+2.7%) outperformed. Globally, almost all markets ended in red except Taiwan (+2.6%), Philippines (+2.1%), US SPX (+1.1%) and Shanghai (+0.5%). Russia posted the biggest loss, falling 10.7% in November, followed by Hong Kong (-7.5%) and Singapore (-4.9%).

A sharp rally in DXY (made new 16m high) too weighed on the EM complex. India continued to witness FII outflows in November (-$0.8bn) despite their healthy participation in the primary market as well as MSCI rebalance-related inflows. DIIs, however, continued to support the market and ramped up the buying to ~$4.1bn, with decent participation from both the MFs and insurance companies. Flows into equity MFs, however, seemed to be slowing down according to the data released in November.

GDP growth moderated to 8.4% YoY in Q2FY22 from 20.1% in Q1 due to base effects, while rebounding sequentially (6.6% QoQ SA in Q2 vs. -8.0% in Q1), reflecting a swift comeback from the second wave lows. GDP stood ~2pp higher than its pre-pandemic level. The rebound was broad-based, although private consumption and the trade & transport sector remain 3% and 9% below their pre-pandemic levels (Q3FY20), respectively. Looking ahead, the outlook is more mixed. Mobility is improving, but supply is bogging down production alongside signs of weakness in demand for mass consumption goods. Continued economic normalization is expected in coming quarters, albeit with lower momentum.

India's fiscal deficit narrowed to INR 5.47 trillion in April-October FY22 from INR 9.53 trillion in the comparable year-earlier period. That was equivalent to 36.3% of the government's estimate for this financial year, compared with 119.7% of the budget aim in the same period last year. Total receipts jumped 80.7% to INR 12.80 trillion as the economy recovered from the pandemic hit, while expenditure was up 9.9% to INR 18.27 trillion.

More than a year of protests led by India's farmers has compelled Prime Minister Narendra Modi into the biggest retreat of his seven years in office – the repeal of his attempt to fundamentally overhaul the way farm goods are produced and sold in the nation of almost 1.4 billion people. New legislation would have opened up a decades-old system of state-run wholesale markets to more private sales. But farmers and political opposition argued it would leave the farmers vulnerable to exploitation. In a country where more than half the people depend on agriculture for their livelihood and with key provincial elections approaching in early 2022, it was a message Modi could no longer ignore.

India is one of the world's fastest-growing markets for cryptocurrency trading, even though the ability to trade Bitcoin and its peers freely and anonymously undermines the country's limits on the convertibility of its currency, the Rupee. The Central Bank is clear that it wants all private cryptocurrencies banned while it creates an official digital currency. The government, however, is open to exceptions to promote blockchain technology. Amid these competing goals, the government is racing to finalize legislation in time for the last parliament session of the year.

The wholesale price inflation rate in India rose to a 5-month high of 12.54% in October 2021 from 10.66% in the previous month, exceeding market forecasts of 10.9%. On a monthly basis, wholesale prices increased by 2.28% in October, reversing from a 0.15% drop in September. This was the 7th consecutive month of double digit WPI inflation for the first time in 23 years. However, the CPI inflation came in at 4.48% - within RBI's comfort zone.

Going forward

Corporate earnings for 2QFY22 exceeded expectations, led by Metals and Oil & Gas. Excluding these two sectors, the aggregates were in-line. The quarter brought to the fore two important trends – (a) an improving demand post the unlocking of the economy and rising rates of vaccinations, and (b) the impact of rising input costs on operating margins. Thus, the operating margins of Specialty Chemicals, Autos, Cement and Consumer Staples contracted.

However, companies in Auto, Building Materials, Cement, Consumer Discretionary, Electricals, Chemicals and Cap Goods generally seem confident of taking price rises to offset RM hit.

Despite this recovery, a large part of market returns was likely due to unprecedented liquidity and record low rates. However, markets are now facing potential of faster Fed tapering along with rising inflation globally posing risk for rate hikes eventually.

We maintain a cautiously optimistic stance and continue our focus on investing in companies with a clear visibility of strong earnings growth and sturdy financials.

Debt Market

Omicron unlikely to impact normalization process, curve to gradually flatten over next two quarters

Indian Bond Yields came down by 5 to 10 BPS across the curve during the month of November 2021 on the back of strong real money demand. The longest end of the curve (more than 30 years) outperformed through growing concerns about Inflation in India and globally. The Monetary Policy Committee is scheduled to meet on 8th Dec 2021 and we expect it to start normalizing the monetary policy by increasing the reverse repo rate by 15 BPS to 3.50% while retaining an accommodative stance. The uncertainty caused by the advent of the Omicron variant is unlikely to prompt the RBI to stop the normalization process just now. We think that the inflationary pressures are very much present with "Core Inflation" remaining solid around 5.80%. We expect the curve to gradually flatten over the course of the next two quarters.

INR depreciated by 0.38% during the month largely because of the strength in DXY and risk aversion after the emergence of Omicron. Brent prices also cooled off by 16.36% towards the end of the month after the risk triggered by Omicron. PFIs continued to pull money out of Indian Bonds with November month outflows at USD 233mn though the equity market saw PFI inflows at USD 202mn, after a big outflow last month.

We are underweight duration as we expect yields to continue rising. We expect inflation to surpass RBI expectations as the economy starts to operate at its pre-covid capacity with vaccination levels increasing rapidly, though we would be closely monitoring the evolution the new Covid-19 variant.

Fixed Income Market

	October 2021	November 2021	Change (in bps)
Overnight rate (NSE MIBOR)	3.42%	3.41%	-1.00
1 yr CD	4.31%	4.39%	8.00
10 yr GOI Yield	6.39%	6.33%	-6.00
USD/INR	74.88	75.16	28 paise
IIP (Monthly with 2 month lag)	11.90%	3.10%	-880.00
CPI (Monthly with 1 month lag)	4.35%	4.48%	13.00
5 Yr AAA PSU spread (bps)	15	20	5.00
5 Yr OIS	5.68%	5.29%	-39.00
US 10 Yr yield	1.58%	1.46%	-12.00
CRR	4.00%	4.00%	0.00
Reverse REPO	3.35%	3.35%	0.00
REPO	4.00%	4.00%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg