PGIM India Mutual Fund

Market Outlook

December, 2019

Equity Market

POLICY FILLIPS WOULD BE NEEDED TO KICKSTART THE ECONOMY

The market that was

In December 2019, Indian markets reached all-time highs (NIFTY up 0.9% in the month) aided by positive global sentiments amidst US-China trade talks moving positively and greater clarity on Brexit. Markets were also buoyant on the back of continued foreign fund flows into India. Metals (up 6.6%), Realty (up 5.3%) and IT (up 4.4%) were outperformers whereas Cement and FMCG were laggards during the month.

Given the slump in GDP in H1FY20, IIP contracted by 3.8% in Oct'19 (-4.3% in Sep'19 and +8.4% in Oct'18). Headline inflation jumped to 5.5% (a 40-month high), on higher vegetable prices even while core inflation remained stable at 3.5%. While MPC members unanimously kept the policy rates unchanged, they indicated a dovish outlook by maintaining an accommodative stance and signalled that there is room for further rate cuts. Trade deficit narrowed to ~$12bn in Nov'19 vs $17.5bn a year ago on account of fall in imports. Fiscal Deficit stood at 114.8% of the budgeted estimate (as of November). The GST council refrained from altering the rates while also extending date to file the annual returns. On the political front, protests have been witnessed for the Citizenship Amendment Act and the proposed pan-India National Register of Citizenship. The BJP lost election in the state of Jharkhand, making it their 5th state assembly loss in last 1 year, the other four being Maharashtra, Chhattisgarh, Rajasthan and Madhya Pradesh.

The divergent trends of FII/DII flows continued but at a decelerated pace with FII buying and DII selling in December coming at +$1bn and -$0.1bn vs +$3.2bn and -$1.1bn in November respectively. YTD net inflows for FIIs and DIIs is now at ~$14.3bn and ~$6bn respectively. Mutual Funds were net buyers of ~$0.2bn in Dec (YTD ~$7.5bn) whereas Domestic Insurance cos were net sellers to the tune of ~$0.3bn (YTD ~ -$1.5bn)

Going Forward

There is a dichotomy that is prevalent in the markets with macros being weak (high fiscal deficit, overall slowdown, inflation inching up, low credit growth) while markets are scaling new highs on the back of continued flows, risk-on sentiment getting stronger and in general loose fiscal policies. We believe either of it must give way for equilibrium to be achieved and hence we reckon that weak macros are more likely to be transient in nature and would gradually improve. However, on its own the recovery may be protracted and policy fillips would be needed to kickstart the economy. Some steps have been taken (corporate tax cuts), however, more measures especially ones which can stimulate demand are the need of the hour. Fiscal prudence, moderate inflation and higher growth is a difficult troika and at best two of these can be achieved at any given point of time. Unfortunately, currently we have none. One of these must take a back seat temporarily and then we can expect normalcy to resume.

There are green shoots emerging. The current account deficit is contained and FDI numbers for first 2 quarters is up 15% yoy. As per CMIE, investment in new projects increased by 37% yoy in December quarter. GST collection in December stood at INR 1.03 tn (up 8.9% yoy). India's manufacturing PMI for December stood at 52.7 (highest in 7 months and 29th straight month of remaining above 50).

We continue to prefer, proven and quality names with good balance sheets in our portfolios.

Debt Market

RBI STEPS IN TO COOL-OFF YIELDS

Macro Review

CPI for the month of November 2019 printed at 5.54% higher than both RBI's target of 4% and market expectation of 5.3%. Core inflation remained flat at 3.50% reflecting continuation of weak pricing power for producers in line with the weak GDP growth. Headline CPI inched up due to increase in food prices, which rose 1.68% on a m/m basis. On an annual basis the increase was 10.09% led mainly by volatile perishable food items and protein rich items. The recent price rise is widely foreseen to be transitory on the back of adverse base effect, erratic weather conditions and supply disruptions. It may be noted that even as food prices have risen, fuel prices and Core-CPI continue to remain soft.

Liquidity and Rates

Liquidity conditions continued to improve in line with the ongoing accommodative stance. Average daily LAF balances for December stood at INR 2.56 trillion compared to INR 2.38 trillion in November. Currency leakage till 20 December was around 15k Cr compared to 1k Cr in the month of November. The Rupee appreciated by 36 paise (0.5%) against the USD over the month of December.

Crude Oil price remained rangebound between 60-69 $/barrel for the month of December and prices could rise due to positive sentiment on account of OPEC led supply cuts, trade deal between US & China and rising geopolitical tension in middle east.

RBI kept rates unchanged in December citing higher inflation and a sluggish transmission; while reiterating an accommodative stance. The Central bank stated that it would prefer to cut rates at an opportune time to push growth, once it is able to view clearer transmission.

CPI projection was been revised upwards to 5.1-4.7% (vs 3.5-3.7%) for H2 FY20 and 4.0-3.8% for H1 FY21 with risks broadly balanced. The GDP growth projections were revised downwards to 5.0% in FY20 as compared with 6.1% earlier.

The yield curve flattened during the month with the shorter end underperforming the longer end due to Operation Twist, which was conducted twice for 10,000 cr each. Under this, RBI bought the 10 Year benchmark bond (6.45% GOI 2029) and sold shorter securities maturing in 2020. Operation twist led to the yields on the longer end declining sharply while the short end curve inched up slightly despite easy liquidity conditions.

Outlook

We expect Operation twist to offset the upward pressure on long end rates from likely extra borrowing. However, given the strong rally witnessed already, we expect further announcements to have a lesser impact on rates going forward.

The combination of challenges from some reversal in CPI and extra borrowing has dampened near term rate cut expectations. We expect liquidity to remain comfortable to help aid rate transmission which is RBI's objective.

We still find the short end of the curve attractive due to attractive term spread over the overnight rate. The outlook on the long end of the curve is clouded due to operation twist and fear of fiscal slippage.

Recommended Products

We recommend short duration products in the average maturity range up to 5 years, given the evolving macro backdrop. We recommend the PGIM India Banking & PSU Debt Fund and PGIM India Premier Bond Fund within this category as suitable investment options for investors seeking moderate duration exposure and a preference for high quality (AAA) portfolio.

PGIM India Dynamic Bond Fund is recommended for Investors with a higher appetite for volatility.

Fixed Income Market

	November 2019	December 2019	Change (in bps)
Overnight rate (NSE MIBOR)	5.25%	5.26%	1.00
1 yr CD	5.79%	6.02%	23.00
10 yr GOI Yield	6.47%	6.56%	9.00
USD/INR	71.74	71.38	-36 paise
IIP (Monthly with 2 month lag)	-4.30%	-3.80%	50.00
CPI (Monthly with 1 month lag)	4.62%	5.54%	92.00
5 Yr AAA PSU spread (bps)	38	48	10.00
5 Yr OIS	5.08%	5.54%	46.00
US 10 Yr yield	1.78%	1.92%	14.00
CRR	4.00%	4.00%	0.00
Reverse REPO	4.90%	4.90%	0.00
REPO	5.15%	5.15%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

Note:
IIP has been revised downwards for the previous reading.
New 10year GSEC Yield is taken instead of Old 10 Year.

Source: RBI & Bloomberg

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Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.