PGIM
India Mutual Fund

Market Outlook

April 2022

Equity Market

Earnings stable despite inflationary pressures

In line with global markets, Indian markets too were weak in April 2022 (NIFTY down 2.1%) on the back of continued tightening in developed markets and geopolitical tensions. Crude remained above the US$100/barrel mark and yields have been firming in India as well as globally. Among sectors, Utilities, Energy and Auto outperformed while IT, Realty and metals underperformed during the month. Midcaps and Smallcaps outperformed the Nifty during the month, returning 0.6% and -1.7% respectively.

On 4th May, RBI in an unscheduled announcement hiked Repo rate by 40 bps, to 4.4% and Cash Reserve Ration (CRR) by 50bps to 4.5% (around Rs 870 bn of liquidity withdrawal). The RBI, however, retained its stance "to remain accommodative while focusing on withdrawal of accommodation to ensure inflation remains within the target going forward, while supporting growth" (same wording as in April policy). While the repo rate hike was being expected and it was only a question of when and not if, the bigger surprise came from the CRR hike, which shows the intent of the RBI to actively withdraw liquidity from the system as well as reducing the money multiplier to affect the money supply.

GST collections for Apr 22 came in at Rs1.68tn (an all-time high and growth of 20% YoY).

India wholesale price inflation rate rose to a four-month high of 14.55% in March 2022 (12th straight month of double digit inflation) from 13.11% a month earlier and above market forecasts of 13%, amid a broad-based price increase due to disruption in global supply chains caused by the Russia-Ukraine conflict. CPI Inflation rose to 6.95% y-o-y in March from 6.1% in February, driven by a steep increase in food & beverages inflation (7.7% from 5.9%), and continued rise in core inflation (6.4% from 5.8%). Underlying inflation is also rising and broadening. Around 70% of the CPI components on a weighted basis are now rising above the RBI's mid-point target of 4%.

IMF cut India's GDP growth forecast for FY23 to 8.2% from 9% citing inflationary headwinds impacting consumption and investments. Bank Credit growth came in at 3-year high of 9.6% for FY22

FII ownership of BSE500 in Mar-2022 fell another 50bp QoQ to 19.4%: -205bp since Dec-2020 and the lowest since 2013. Heavy FII selling (US$13.5bn; continuing in April), was offset by MFs and Retail. MFs now own 8.3% of BSE500, an all-time high.

Capital markets saw 15 deals worth $816mn during the month. FIIs continued their selling spree and sold Indian Equities to the tune of $3.8bn, while DIIs continued the buying in March to the tune of $4bn. MFs and insurance were buyers of $3.1/2bn of equities respectively.

Q4FY22 earnings season is on. So far, 24 out of Nifty 50 companies (with 58% weightage) have reported numbers. Revenue growth came in at 12% YoY (4% above consensus estimates) and Net profit growth came in at 26% YoY (6% above estimates).

At an aggregate level, FY23 PAT estimates of BSE500 companies were marginally downgraded by ~0.4% in Apr-22 (vs. ~0.2% upgrade in Mar-22).A spike in commodity prices owing to the Russia-Ukraine war and persisting international supply chain issues have impacted overall margin estimates.

Going forward

While the markets are taking a breather and valuations seem to be in a corrective mode, inflationary headwinds persist. While we believe it is transitory, if the current scenario gets prolonged, it will keep valuation, profitability and flows under check. On the other hand, strong tax collections, heady pace of investments, stable and benign policy regime augur well for sustained growth realization of the economy. Given the external market scenario of falling liquidity and rising rates, we see limited scope for valuation expansion. However, we believe there is scope for a secular earnings growth scenario once these headwinds see abatement. With the consolidation seen in markets in last six months, P/E valuations have also moderated from a peak of +1 Standard Deviation (of last 10 years) to mean level now, making risk reward neutral if not better. We remain positive throughout this correction in stronger business franchises that can withstand inflationary pressure better.

Debt Market

Bond yields up on expected hike by RBI

Bond yields across the world surged in April as markets started pricing in aggressive rate hikes by developed market central banks and India was no exception to the trend. The MPC meeting on 8th April set the tone for higher bond yields as RBI struck a relatively hawkish tone that was not anticipated by the markets. The RBI raised its Inflation target for FY23 to 5.70% from 4.50% and prioritized inflation over growth. Yields sold off across the curve with a distinct flattening bias.

The 5-yr segment of the curve reacted the most with yields going up by 58bps while the yield on the benchmark 10-yr bond went up by 30bps.

Inflation surprised on the upside, coming in at 6.95% as against the expectations of 6.40%. INR depreciated by 0.68% during the month ending the month at 76.43 from 75.91 at the beginning of the month.

The Monetary Policy Committee (MPC), in an unscheduled meeting during 2-4th May 2022 announced a surprise repo rate hike of 40bp and a CRR hike of 50 bps. The MPC decision to hike rates was unanimous.

The MPC highlighted upside risk to the Inflation Guidance given in their April Policy stating that "Heightened uncertainty surrounds the inflation trajectory, which is heavily contingent upon the evolving geopolitical situation. Global commodity price dynamics are driving the path of food inflation in India, including prices of inflation-sensitive items that are impacted by global shortages due to output losses and export restrictions by key producing countries. International crude oil prices remain high but volatile, posing considerable upside risks to the inflation trajectory through both direct and indirect effects. Core inflation is likely to remain elevated in the coming months, reflecting high domestic pump prices and pressures from prices of essential medicines. Renewed lockdowns and supply chain disruptions due to resurgence of COVID-19 infections in major economies could sustain higher logistics costs for longer. All these factors impart significant upside risks to the inflation trajectory set out in the April statement of the MPC".

On growth, the MPC stated that "the Indian economy appears capable of weathering the deterioration in geopolitical conditions but it is prudent to continuously monitor the balance of risks".

The MPC statement concluded by stating, "MPC is of the view that while economic activity is navigating the vortex of forces confronting the world with resilience on the strength of underlying fundamentals and buffers, the risks to the near-term inflation outlook are rapidly materializing, as reflected in the inflation print for March and the developments thereafter. In this milieu, the MPC expects inflation to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects. Accordingly, the MPC decided to increase the policy repo rate by 40 basis points to 4.40 per cent."

Accommodative stance was retained

Since the last MPC policy in April, global central banks have been aggressive in their communication and action against the surge in inflation. We believe that central banks will be front-loading rate hikes and the RBI will be no exception to this. We expect the RBI to hike the repo rate by 25-35 bps in its June meeting.

Going ahead, we expect the yield curve to flatten more. The spreads between AAA bonds and G-Sec have compressed to historically low levels and we expect them to gradually widen as the surplus liquidity in the system reduces.

We continue to be underweight duration as we expect inflation to surprise on the upside and will look to tactically add duration at yields of 7.50% or higher on the 10-yr bond. We would also continue to be underweight corporate bonds.

Fixed Income Market

	March 2022	April 2022	Change (in bps)
Overnight rate (NSE MIBOR)	3.90%	3.93%	3
1 yr CD	4.73%	5.30%	57
10 yr GOI Yield	6.84%	7.14%	30
USD/INR	75.79	76.43	64 paise
IIP (Monthly with 2 month lag)	1.30%	1.70%	40
CPI (Monthly with 1 month lag)	6.07%	6.95%	88
5 Yr AAA PSU spread (bps)	0	0	0
5 Yr OIS	5.99%	6.62%	63
US 10 Yr yield	2.33%	2.93%	60
CRR	4.00%	4.00%	0
Reverse REPO	3.35%	3.35%	0
REPO	4.00%	4.00%	0
SDF (Standing Deposit Facility)	NA	3.75%	–

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg