

# Market Outlook

December 2022

## Equity Market

### Consolidating yet outperforming

In tandem with most global markets, Indian markets too fell this month, with the NIFTY50 down 3.6%. In the broader markets, mid and small caps, though down, outperformed the large caps, with their respective indices being down 1.7% and 2.5%, respectively. While China's reopening of its borders after three years was sentimentally positive for the markets, rising Covid infections and its impact on the global economy worried the markets.

Sector-wise, all sector indices closed in the red, barring metals which had a tailwind of China easing border controls. IT, Energy and Auto were the key laggards in the month, while Banks, O&G and Industrials relatively outperformed.

In CY22, Indian equity markets emerged as one of the better-performing markets relative to many other emerging market peers. The benchmark Nifty-50 Index delivered positive 4.4% returns, however, the midcaps and small cap indices underperformed the NIFTY with their respective indices returning 3.5% and (-13.8%) for the year. The year had started on a negative note as the Russian invasion of Ukraine constrained supply chains, resulting in a surge of commodity prices and added inflationary pressures. The positives were in-line corporate earnings growth, healthy domestic inflows and macro stability. The key outperforming sectors were Automobile, Banks, FMCG and Metals while IT, Pharmaceutical and Realty sectors lagged. During the year, currency came under pressure vs the USD and depreciated 11% to close at Rs 82.7/US\$. The India 10-year bond yield jumped to 7.4% from 6.5% a year ago. GST collections throughout the year remained above the watermark to meet budgeted targets.

On the macro front, in its December meeting, the RBI MPC hiked rates by 35bps and kept its stance of withdrawal of accommodation unchanged and the commentary had a hawkish tone to it. CPI eased to an 11-month low of 5.88% in November 2022, down from 6.77% in October 2022. India's WPI eased to a 21-month low of 5.85% in November 2022. IIP witnessed a contraction of 4.0% in October. CAD in 2QFY23 widened to US\$36.4 bn (4.4% of GDP) from US\$18.2 bn in 1QFY23 (2.2% of GDP). The GST collections increased by 15% YoY in December 2022 to US\$ 18.1bn.

Deal flows slowed in December with 36 deals worth ~\$1.6bn executed. FIIs were net buyers in December 2022 to the tune of \$263mn and DIIs too were buyers to the tune of \$2.9bn. For the year, FIIs sold to the tune of \$16.6bn, while DIIs bought to the tune of \$35.7bn.

### Going forward

While the Indian market outperformed its peers on a relative basis (on a one-year and three-year basis), on an absolute basis, CY2022 was primarily a year of consolidation after a strong CY21. Such sharp outperformance has widened the gap between the valuations of India vs. its emerging market peers, and now India trades at a significant premium to them. Nonetheless, Indian markets held on their own in turbulent times of high interest rates, inflation and geopolitical issues thanks to healthy earnings growth and good management of macro parameters.

The above highlighted risks persist but are largely known and the probability of incremental surprises is less on those fronts. At the same time, we keep a watch on the trade deficit, which is impacted by higher imports. Further, as inflation sees some toning down, rates too should follow, thereby providing some respite. Valuations at ~19x 1 year forward earnings are not cheap but reflect of macroeconomic stability, relatively resilient EPS growth and a conducive flow environment. We expect a manufacturing push, improving credit growth and rural recovery to provide legs to the economy and earnings growth. The Union Budget should give some insights into the government's thought process on tackling inflation, public spends and popularity measures (if any) before the Union elections in the following year.

The Nifty has seen seven consecutive calendar years of gains (CAGR of 12.4%) and given sharp outperformance. We do not expect a runaway rally and expect stock picking and sector allocations to be prime drivers of returns. Nonetheless, from a long-term perspective we reckon Indian markets to do well, led by earnings growth prospects and macro stability.

## Yields inch up on hawkish stance by Central banks

While the rate hike was in line with market expectations in the December MPC Policy meeting Indian Bond yields traded in a very tight range throughout the month, despite inching up marginally as the RBI sounded a bit more hawkish than what the market expected. The yield curve continued its flattening trend with the short term yields rising more than the long term yields. Other Central banks like the US Fed, ECB also hiked rates in line with expectations, though the guidance was hawkish. The Bank of Japan, towards the end of the year, also expanded the trading range of the 10-year JGB yield from the target level of 0 percent. The range has been modified from around plus and minus 0.25 percentage points to around plus and minus 0.50 percentage points. With this change in policy, the last of the Central banks has increased its rates implicitly just before the year-end when it was least expected.

The hawkish guidance of developed market Central banks, especially the ECB, and the action by the Bank of Japan, led to bond yields rising which had a rub-on impact on Indian Bond yields. The Benchmark 10-yr Bond yield rose by 5 bps while the 2-yr yield rose by 10 bps. Brent was volatile during the month, ending at 85.91, after touching a low of 76.10 during the month. We expect the 10-yr Benchmark bond to trade in a range of 7.20% to 7.50% in this quarter.

The INR depreciated against the US dollar by 1.60% during the month.

The CPI Inflation for November (released in December) came in lower than market expectations at 5.88% and we expect it to fall durably below 6% by April 2023.

Inflation slowed more than expectations in the US as well, while in other developed economies it was in line with expectations.

PFI flows into Indian Fixed Income markets turned positive in the last two months of the year, though for the year 2022, FPI flows remained negative at USD 2.22 Bn.

The incremental Credit / Deposit ratio of the banking system continues to sustain at an elevated level with credit growth @17.40% and deposit growth@9.40% 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.

Incremental rate actions of the US Fed will have an impact on the Indian rate hiking cycle. We expect MPC to hike rates by 25 bps in the next policy meeting in February as India will be required to maintain interest rate differential with the US Fed, which continues to raise rates, in light of our Twin Deficits (Current and Fiscal Deficit).

## Fixed Income Market

	November 2022	December 2022	Change (in bps)
Overnight rate (NSE MIBOR)	5.86%	6.60%	74
1 yr CD	7.50%	7.63%	13
10 yr GOI Yield	7.28%	7.33%	5
USD/INR	81.43	82.74	131 paise
IIP (Monthly with 2 month lag)	3.10%	-4.00%	-710
CPI (Monthly with 1 month lag)	6.77%	5.88%	-89
5 Yr AAA PSU spread (bps)	15	20	5
5 Yr OIS	6.34%	6.45%	11
US 10 Yr yield	3.60%	3.88%	28
CRR	4.50%	4.50%	0
REPO	5.90%	6.25%	35
SDF (Standing Deposit Facility)	5.65%	6.00%	35

Source: RBI Weekly Statistical Supplement & Bloomberg

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

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Source: BSE, RBI & Bloomberg

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