Market Outlook

October 2020

Equity Market

Near term volatility?

The market that was

After a slight dip in the month of September, Indian markets continued their positive run in Oct 2020 and was up 3.5% (NIFTY) on the back of good inflows from FIIs. Globally, markets were a bit choppy as US elections related uncertainty and the re-emergence of lockdowns in Europe weighed on markets. India seems to be returning to normalcy with some monthly indicators indicating more than 90% recovery in economic activity, with case count as well as positivity rate on a decline. Earnings (so far) too are showing resurgence with healthy QoQ growth. Financials and realty were the key outperformers in Oct with the sectoral indices up 11.4% and 7.7% respectively while Pharma and Auto were key laggards in the month.

While IMF cut India's GDP estimates again to -10.3% in FY21, it also noted that India may grow at an remarkable 8.8% in next fiscal, higher than China's projected growth rate of 8.2%. RBI too cut its estimate of GDP to -9.5% for FY21. India's manufacturing PMI for September came in at 56.8 - highest level in over eight years (since Jan'12) as manufacturers saw a sharp pick-up in new orders. September CPI Inflation rose to 7.3% yoy (vs 6.7% in Aug) which was an 8-month high led by a spike in vegetable prices. India's industrial output contracted for the sixth straight month in August (-8% yoy), with mining and manufacturing witnessing a steep fall in output over a year ago. Contracting for the seventh consecutive month, the output of eight core infrastructure sectors dropped by 0.8% in September, mainly due to decline in production of crude and cement.

India's fiscal deficit touched 115% of the budgeted target in the first half of 2020-21 as the Covid-19 pandemic continued to hurt government's revenue while expenditure remained close to the same level last year. India's total goods and services tax (GST) collection stood at Rs. 1.05tn in Oct'20 up 10.2% YoY, after falling to Rs. 323bn in Apr'20, from Rs. 1.05tn in Feb'20.

After being sellers in Sep, FIIs again turned buyers in Oct with net inflows of US$2.5bn with YTD inflows at $6.5bn. DIIs on the other hand, continued to be net sellers of ~$2.4bn reducing their YTD inflows to ~$6.7bn. Both Domestic MFs and Insurance Cos were net sellers during Sep though they have been net buyers YTD of $0.8bn and $5.8bn respectively. MSCI has confirmed that it will implement the new regime on the FOL (Foreign Ownership Limit) changes in the November Review at the close of November 30, 2020, effective December 1, 2020. MSCI India's weight in MSCI EM is expected to increase to ~8.8% from the current level of ~8.1% and India could potentially see passive inflows of ~US$2.5bn.

Going Forward

With US election outcome and resurgence of Covid cases in parts of the world, some volatility can be expected in the short term. Emergence of a reliable cure/vaccine would be a key calming factor for the world as well as Indian markets. From the lows of Q1FY21, earnings bounce back has been healthy in Q2 so far as India adjusts to the new normal. In terms of earnings, while FY21 is likely to turn out to be muted year (primarily because of the pandemic), recovery expectations in H2 and a healthy exit run rate would possibly setup a good base for healthy growth in FY22 both optically as well as realistically. The rural economy, especially, seems to be faring well and is expected to lead the recovery for the overall economy.

As companies and economies are adjusting to a newer normal, structural changes are taking place. While some changes maybe temporary some changes are here to stay. We all are adapting to the same and we are cognizant of the same in our portfolios as well in our endeavour to provide better risk adjusted returns to our investors. We continue to focus on quality businesses with growth visibility and their demonstrated ability to adapt to changing circumstances.

Debt Market

Liquidity, inflation, FX reserves on a high

Macro Review

CPI for September 2020 inched higher touching 7.34% (from 6.69% in August), primarily from pressures on food and vegetable inflation. Supply chain disruptions continued to impact inflation. A large part of the price rise in the first half of the fiscal has been observed in food and agri items such as rice, proteins. Besides, higher safety-related protocols have been adding to costs, compounded by labor shortages, higher cost of medical services and sporadic local lockdowns in many parts of the country.

Prices of veggies are expected to start moderating starting December / January as supply chains normalize gradually. Among non-food articles, gold and fuel prices have remained firm in FY21, pushing up CPI. However, headline CPI in the second half of FY21 is expected to remain elevated given the still positive sequential monthly momentum. CPI forecast for Q3-FY21 is between 5.5-6.0% and likely to moderate to 4.5%-5.0% by the fourth quarter.

Liquidity and Rates

Liquidity conditions remained in surplus mode improving further to a monthly average of INR 4.05 tn in October as against INR 3.31 tn and INR 3.68 tn in September and August, respectively. Positive liquidity balances are consistent with the RBI guidance on easy liquidity stance for the near to medium term.

The year has seen a significant build-up in FX reserves given an improving current account position (from a shrinking trade deficit and strong remittances) and strong FDI flows (helping the Capital account). Balance of Payments for Q1 rose to USD 19.8 bn, being the sixth consecutive positive quarter. For the full year FY21, current account is expected to post a surplus of 0.3% of GDP vs a deficit of 0.9% in FY20.

For, Q1 – FY21, India has also posted a positive current account balance which is expected at +1.2% of GDP in FY21 aided by reasonably strong inward remittances and a shrinking merchandise trade deficit.

RBI has thus far been reluctant to allow an appreciation of the INR in the midst of strong dollar inflows. This has reflected in a rising reserves position (as RBI keeps buying dollars).

Towards the end of October 2020, increase in currency in circulation (CIC) stood at INR 4.57 tn over a year earlier, representing a 20.48% increase over the base last year. A large part of the increase in CIC this fiscal occurred in the April to June quarter, at the peak of the lockdown and the massive migration of labor from urban cities to their villages. The pace moderated in Q2 and barring some spike during the festive season we expect the trend to decline.

Outlook

The first half borrowing (gross / net - INR 7.7 tn / INR 6.4 tn) was executed peacefully, helped by RBI's easing measures, surplus liquidity, regulatory relaxations (higher MTM limits for banks to hold G secs) and yield management measures (Open Market operations – OMOs). Bank investments in Govt bonds, for instance, have seen a sustained rise from 26.2% in Jan 2020 to 29.3% in September 2020. This is well in excess of the 18% SLR threshold. Excess holdings have been possible given the lack of credit demand and the higher MTM dispensation (from 19.5% to 22.5%) until March 2022, which reduces the market risk and losses for banks in the event of adverse rate movements.

The MPC meeting in early October was also highly dovish, with the committee pledging its support to boost growth through keep an accommodative stance for as long as was necessary to revive growth.

We expect the belly of the curve (5-14 years) to remain supported by RBI to push the Govt / SDL borrowing program in a non-disruptive manner. As such, yields are expected to move in a narrow band as OMOs (in Govt bonds and SDLs) could be undertaken to cool off any yields.

Recommended Products

We recommend the PGIM India Banking & PSU Debt Fund along and PGIM India Premier Bond Fund as investment options for investors seeking some duration exposure and a preference for high quality (AAA) portfolio. PGIM India Dynamic Bond Fund and PGIM India Gilt Fund are recommended for investors with a slightly higher appetite for volatility.

Fixed Income Market

	September 2020	October 2020	Change (in bps)
Overnight rate (NSE MIBOR)	3.79%	3.48%	-31.00
1 yr CD	3.94%	3.72%	-22.00
10 yr GOI Yield	6.02%	5.88%	-14.00
USD/INR	73.76	74.10	34 paise
IIP (Monthly with 2 month lag)	-10.80%	-8.00%	280.00
CPI (Monthly with 1 month lag)	6.69%	7.34%	65.00
5 Yr AAA PSU spread (bps)	38	26	-12.00
5 Yr OIS	4.52%	4.32%	-20.00
US 10 Yr yield	0.69%	0.87%	18.00
CRR	3.00%	3.00%	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