PGIM
India Mutual Fund

Market Outlook

October 2023

Equity Market

Broad based weakness

In October 2023, markets went into consolidation mode with the NIFTY 50 index declining 2.8% for the month. The month saw broad based weakness in global markets led by Israel-Hamas conflict, rising US bond yields, and concerns about potential rate hikes dampening the global investor sentiment. NIFTY Midcap 100 index and NIFTY Smallcap 100 index saw a correction of 4.1% and 0.8% for the month respectively. During the month, indices for Healthcare, Metals and Mining, and Financials underperformed the broader market, while indices for Realty, FMCG and Auto outperformed. The RBI MPC, in its October meeting, while maintaining status quo on the repo rates, maintained the withdrawal of accommodation stance, and anchored in its commitment to achieve a medium-term CPI inflation target of 4%, while also supporting growth. IMF raising India's FY2024 GDP forecast to 6.3% from 6.1% earlier, Election Commission of India announcing the schedule for assembly elections in five states were other key developments for the month.

On the macro side, Sept'23 CPI inflation fell by 180bps to 5.02% YoY, out of which 130bps was due to vegetable price reversal. The August IIP registered robust growth at 10.3% compared to an upward revision to 6% in July. Exports in September moderated to US$34.5bn from US$38.5bn in August, led by a fall in oil exports, while September imports fell sharply to US$53.8bn from US$60.2bn in August due to a fall in non-oil imports to US$39.9bn. FIIs remained net sellers in the month of October 2023 to the tune of US$2.61bn while DIIs remained net buyers to the tune of US$3.39bn.

Going forward

We remain cautiously optimistic on the market from a medium-term perspective. Our caution is because markets are trading at a premium to its current fair value. However, this fair value is likely to grow at a strong pace in the medium-term, hence we remain optimistic from a medium to long term perspective. Globally we are seeing growth slow-down in developed markets due to elevated interest rates along coupled with sticky inflation situation. This will have an adverse impact on export-oriented businesses. In India uptick in discretionary demand in the ongoing festive season and measures by the government to boost rural consumption are the key near-term monitorable. As we inch closer to 2024, we would see increased volatility due to the Union Elections scheduled in May 2024. We are of the view that these are transient factors and would advise long-term investors to look beyond these near-term headwinds to benefit from the long-term India story.

Debt Market

The recent rise in yields presents a good opportunity for investors to increase allocation to fixed income

October saw yields continuing their upward trajectory as RBI stuck a hawkish tone in the MPC meeting on October 6, as the RBI governor emphatically reiterated that the inflation target remains 4% which RBI is determined to achieve and it will not be satisfied merely with inflation falling below 6% which is the upper threshold of the inflation targeting framework. Apart from the hawkish tone, RBI also announced that they will be conducting open market sales (OMO) of government securities for liquidity management. Though the bond markets were positioned for a hawkish policy from RBI, the announcement of OMO sales caught the market on the wrong foot and yields went higher across the curve. The benchmark 10yr bond yield went up by 13bps on the day of the policy to touch a recent high of 7.38%. Bond markets stabilised thereafter as the interbank liquidity tightened, which negated any immediate need for RBI to conduct OMO sale of government securities. The benchmark 10yr bond yield ended the month at 7.36%

Yields went up across the curve and the yield curve steepened a bit, with the short end of the curve outperforming the longer end of the curve. CPI inflation came in at 5.02%, lower than market consensus led by moderation in food inflation. Core inflation continued to moderate and came in at 4.57% - the third straight month below 5%. The falling trend of lower core inflation is positive for the bond markets. Government has been managing inflation proactively through series of fiscal steps to bring down food inflation.

Crude oil prices were lower during the month despite conflict erupting in the Middle East. Brent prices ended the month at $87.4 per barrel, compared to the September closing of $95.3. INR depreciated on back of continued strength in the dollar index and portfolio outflows. RBI is believed to have intervened heavily in the FX market to support INR. INR depreciated by 22 paise during October, ending the month at 83.26 per dollar. The Indian OIS curve is reflecting a long pause and a delayed rate-cutting cycle from RBI. The

1yr OIS closed 14 bps lower at 6.94% compared to the September-end closing of 7.08%. The 5yr OIS was also lower by 13 bps during October. The divergence between the OIS and bond yields is on account of offshore flow-based receiving in swaps. Bond yields have reacted negatively after the announcement of OMO sales, whereas the OIS curve has retracted lower from its highs.

Liquidity in the system remained tight on lack of government spending and continuous RBI intervention in the FX market. After the announcement of OMO sales to manage liquidity, we believe that RBI's intent is to keep liquidity tight which means that the operational overnight rate will remain the MSF rate of 6.75% in the near term. Money market rates inched higher on the view of continued liquidity tightness with 1yr CD rates increasing by 15-20 bps.

GST collections went up by 13% to INR 1.70 trn, the second highest collection ever, underlying the good growth momentum. The RBI governor also, in a conference, mentioned that India's GDP growth is likely to surprise on the upside.

Global bond yields, led by US treasury yields, continued their upward trajectory as the narrative of higher-for-longer rates took a firm hold. The higher for longer narrative and the concerns on the US fiscal deficit led to a 36 bps jump in the benchmark US 10yr bond yield, which ended the month at 4.93%, from 4.57% at September-end.

Bank of Japan, did not tinker with its negative rate policy though it changed its language on the yield curve control to imply that it can tolerate a yield higher than 1% on the benchmark 10yr bond. JPY depreciated past 150 after the BOJ's policy. Indonesian and the Philippines central banks surprised with an unexpected rate hike underlying the challenge faced by emerging market central banks who are forced to keep a tight monetary policy stance in face of US dollar strength, and rise in developed market bond yields in order to preserve external macro stability, in spite of relatively good underlying economic fundamentals compared to the developed economies.

Given the current growth inflation dynamics and the aggressive rate hikes done by global central banks since last year, we believe that we are in the last leg of the global monetary tightening cycle and central banks are likely to be on a long pause going ahead.

We believe that RBI will also be on a long pause and the rate cutting cycle in India will start only when the developed market central banks have addressed the challenge of inflation effectively, which in our view will happen from 2024 onwards. The recent rise in yields presents a good opportunity for investors to increase their allocation to fixed income as slowing growth and moderating inflation is likely to lead to rate cuts in 2024.

We expect the 10yr Benchmark bond to trade in a range of 7.20% to 7.50% over the next one month.

Fixed Income Market

	September 2023	October 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.95%	6.84%	-11
1 yr CD	7.50%	7.70%	20
10 yr GOI Yield	7.22%	7.36%	14
INR/USD	83.04	83.26	22 paise
IIP (Monthly with 2-month lag)	6.00%	10.30%	430
CPI (Monthly with 1-month lag)	6.83%	5.02%	-181
5 yr AAA PSU spread (bps)	33	33	0
5 yr OIS	6.81%	6.68%	-13
US 10 yr yield	4.57%	4.93%	36
CRR	4.50%	4.50%	0
REPO	6.50%	6.50%	0
SDF (Standing Deposit Facility)	6.25%	6.25%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: BSE, RBI & Bloomberg