PGIM
India Mutual Fund

Market Outlook

July, 2019

Equity Market

BUDGET DID FALL SHORT OF EXPECTIOTIONS IN REVIVING THE DOMESTIC INVESTMENT CLIMATE AND CONSUMPTION DEMAND

The market that was

Indian markets recorded one of the worst July months in recent history with selling seen across the board. Nifty closed the month down -5.7%, Nifty Mid-cap closed down by -9.8% and Nifty Small-cap moved lower by -10.9%. Biggest losers were Autos and Metal sectors whereas IT, FMCG and Pharma were the sectors which declined the least.

June headline CPI rose to 3.2% YoY in line with expectations and within the RBI target range. Given the uncertainty surrounding domestic growth and overall soft inflation outlook, we could expect another rate cut by RBI in August (despite Repo rate already being at a 9-year low). June trade deficit of US$15.3 bn saw lower imports balancing softer exports. Rising gold prices pushed gold imports to multi-quarter highs at US$11.4bn.

After being net buyers for five months, FIIs turned net sellers in July to the tune of ~US$1.9bn reducing the YTD inflows to ~US$9.4bn. On the other hand, DIIs remained buyers with inflows of ~US$2.9bn during the month.

Gross tax revenue for the April-June period of FY20 grew 1.4% year-on-year to Rs4tn – this is the lowest 1st quarter growth in 10 years. The growth in the corresponding period last year was 22.4%. The slowdown in tax collections comes after the government budgeted an ambitious tax target despite a shortfall last year. India’s fiscal deficit for Q1FY20 stood at Rs 4.32 tn, that’s 61.4% of the budget estimate for FY20.

Going Forward

Budget presented in July post the completion of the general elections, stuck to the path of fiscal prudence and lowered fiscal deficit target to 3.3% of GDP. The budget did fall short of expectations in reviving the domestic investment climate and consumption demand. Some highlights from the Budget include; the increased surcharge on taxable income including FPI investors, one-time six month partial credit guarantee to PSU banks for purchase of high-rated pooled assets of select NBFCs, thrust on infrastructure capex with higher allocation to rail and defence and reduction in maximum promoter holding from 75% to 65% - causing a supply overhang on the market. No major incentives were announced for the Automobile and Aviation sectors. Monsoon trends seem to be normalizing as the month saw above-average rainfall, reducing the shortfall to 9%.

For Q1FY20, the Banks reported mixed set of numbers as some saw lower credit costs and higher recoveries on expected lines whereas others warned of further slippages to come. Auto OEM’s woes aggravated as Government hiked registration charges on purchase of new vehicles. June Auto sales continued their downward spiral with market leader in PVs reporting a double digit decline. IT witnessed challenges of rising visa and employee costs.

The continuing stress in the NBFC sector, progression of monsoons, poor credit flow, slowing global growth, escalation of global trade tensions and muted earnings growth are the key risks to India equity markets. Hence volatility in the near term cannot be ruled out and we continue sticking to high quality companies with strong cash flows, stable margin profile, high corporate governance standards and robust balance sheets.

Debt Market

FALLING CORE INFLATION, GOVT. SPENDING SUPPORT LIQUIDITY AND YIELDS

Macro Review

CPI remained within RBI’s projection for June 2019 (released in July 2019) printing at 3.18%. It was the tenth consecutive reading below 4%, being RBI’s medium term CPI target. The good news was that the Core CPI Inflation moderated further to 4.1%, we expect Core Inflation to moderate further, given the continued weakness in the economy.

Liquidity and Rates

Liquidity conditions improved during the month of July as government spending came back to the system, RBI has also indicated that they are ok with a higher core liquidity surplus in the system. Core Liquidity Surplus stands at INR 1 lac cr. (1 trn)

Crude oil prices fell by 2% during the month of July as excess supplies persisted and trade tensions between US and China took centerstage helped ease the pressure on oil prices, overshadowing the effect of the sanctions on Iranian Oil.

The rupee was stable during the month as crude oil came down and FII flows continued during the month.

Bond yields fell sharply during the month after the budget announcement keeping the fiscal deficit target of 3.3% and also announcing a foreign currency denominated sovereign bond issue. The bond markets caught a bid after that and yields rallied sharply by 50 bps. There were renewed concerns on global growth with bond yields across the globe coming down with the US Fed cutting the benchmark rate by 25bps.

Outlook

The benchmark 10yr Bond yield has come down by 85 bps over the last two months and we expect the market to consolidate now with the 10yr benchmark yield to range between 6.25% to 6.50% over the next couple of months. The curve has steepened a bit over the last fortnight and we expect the curve to steepen further.

We do not expect Government to issue Sovereign Bonds this fiscal year (given the conflicting noises coming form govt) and given the slowdown in the economy, fiscal concerns can re-emerge in the second half of the financial year.

Currently the Core system liquidity is positive to the extent of INR 1 trn which will continue to support the yields.

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 and PSU Debt Fund along with PGIM India Premier Bond Fund for investors seeking moderate duration exposure with 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

	June 2019	July 2019	Change (in bps)
Overnight rate (NSE MIBOR)	5.97%	5.75%	-22
1 yr CD	7.16%	6.86%	-30
10 yr GOI Yield	6.88%	6.37%	-51
USD/INR	69.03	68.8	-23 paise
IIP (Monthly with 2 month lag)	4.30%	3.10%	-120
CPI (Monthly with 1 month lag)	3.05%	3.18%	13
5 Yr AAA PSU spread (bps)	55	70	15
5 Yr OIS	5.67%	5.40%	-27
US 10 Yr yield	2.00%	2.01%	1
CRR	4.00%	4.00%	0
Reverse REPO	5.50%	5.50%	0
REPO	5.75%	5.75%	0

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg