PGIM
India Mutual Fund

Market Outlook

February 2020

Equity Market

Fear of virus bigger than the virus itself ?

The market that was

In February 2020, all the major global indices closed in the red. With high chances of WHO declaring the coronavirus disease as a pandemic, global markets saw a sharp drawdown (US Markets saw the worst weekly fall since the GFC). In India as well Nifty 50 was down by 6% and Nifty Next 50 closed 6% lower. The broader markets also closed in red, NSE midcap 100 down 6.8% & NSE Small cap index down 8.9%. All the sectoral indices (except Telecom) settled lower. Major selling was seen in PSU Banks (-18%), Realty (-15%), Auto (-15%) & Metal index (-13%) while FMCG & Financial services settled 5% lower. India VIX closed at 9 months high 23.2. Gold gained 2.4% in February & 11% in the last three months as investors possibly rushed for safe havens.

On the macro front, GDP grew by 4.7% yoy in Q3FY20 (lowest in 27 quarters), and 1HFY20 GDP growth was revised upwards by 50bps to 5.3% yoy. However, CSO maintained its full-year advance estimate of 5% for FY20. Headline inflation also inched up to 7.6% in January and core inflation inched up to 4.2% as well. Trade deficit saw a spike to $15.2bn (a seven month high) with exports falling; however, the same is likely to see a moderation with fall in crude prices (down 12% in Feb). RBI kept policy rates untouched while maintaining its accommodative stance but announced measures for troubled sectors which was a welcome positive. Total GST collection was at Rs1.054 tn in Jan’20 vs registering a growth of 8.3% yoy. The fiscal deficit in 10MFY20 (till Jan’20) has reached 128.5% of the FY2020RE.

FIIs were net buyers to the tune of $0.7bn and DIIs bought $2.3bn in Feb taking their CYTD totals to +$2.1bn and +$2.7bn respectively. In Feb 2020, Domestic MFs were net buyers of $0.7bn, whereas Domestic Insurance companies also bought $1.7bn. In the last week of Feb though, there were outflows from FII to the tune of $1.6bn, countered by buying by DIIs to the tune of $2.3bn.

Going Forward

While suddenly markets seem to be in a risk-off mode, the longevity of the coronavirus scare is the key monitorable now. Compared to earlier similar outbreaks, the mortality rate appears to be lower and it seems the fear of the virus is stronger than the virus itself. The continued escalation in the number of infected cases in several countries may result in a synchronized global economic slowdown, however central banks are trying to counter it by further loosening (stimulus) of policy by cutting rates and QE etc. This may help reflate the value of assets but economic activity may take longer to recover.

India appears to be in a relatively sweet spot – i) lower incidence of the virus (at the time of writing the report) – with experts suggesting the less likelihood of the virus spreading in a tropically hot climate, ii) Crude price fall likely to help the fiscal imbalance, iii) Possibility of shift of some business to India as global supply chains look to diversify (impact more likely in the longer term), iv) India being a smaller participant in global trade and more of a domestic consumption economy (unlike China).

We continue to remain positive on long term prospects of Indian economy and equity markets.

Debt Market

Risk off sentiment helping Fixed income markets; we retain positive outlook for bonds

Macro Review

CPI for the month of January 2020 printed at 7.59%, which was higher than RBI’s target of 4% and also higher than market estimates of 7.4%. Core inflation jumped from 3.8% to 4.2% due to pending partial impact of mobile tariff rise. In the coming months, core inflation could face some upward pressures from food prices which have shown an upward trend recently.

Headline CPI inched up due to adverse base effect in spite of m/m decrease of 13bps in headline CPI. There was a fall in consumer food price index on m/m basis and came in at -1.22% whereas y/y basis it was at 13.63% and was mainly due to protein rich items (meat & fish, egg and milk) and oils & fats. The recent price rise in headline CPI is mainly due to adverse base effects and increase in telecom tariffs and will head lower as the adverse base effect wanes off.

Liquidity and Rates

Liquidity conditions continued to remain buoyant in line with RBI’s accommodative stance and the pledge to improve transmission of past rate cuts. Government’s reliance on WMA (overdraft from RBI) funding reduced compared to January. Average daily LAF balances for February stood at INR 2.99 trillion compared to INR 3.16 trillion in January. Currency leakage in the first 3 weeks of February was around INR 46,000 cr compared to INR 40,000 cr in January. The Rupee depreciated by 82 paise (-1.15%) against the USD in February.

Crude oil continued to weaken on worries of falling demand from the coronavirus outbreak. Prices declined in the month closer to USD 50 / bbl from almost USD 60 /bbl a month earlier.

RBI kept rates unchanged in February while retaining its accommodative stance to push growth. RBI revised CPI forecast upwards for Q4 FY20 and H1-FY 21, though expects a declining trend starting H2- FY 21.

RBI has a FY 21 GDP growth forecast of 6.00%. The MPC noted that while the Inflation outlook remained highly uncertain, growth continues to remain weak and the output gap remains negative. The MPC statement reflected that there was adequate policy space for future action. The RBI also announced that it would provide durable liquidity by way of LTROs of 1yr and 3yr maturity for an aggregate size of INR 1 trillion at the Policy repo rate (5.15%). This is an effective step towards transmission of rates than the operation "Twist" done earlier by RBI.

Government bond yield fell on the back of no extra government bond supply for FY 20 (fiscal year ending March 2020) which was widely expected by the market, announcement of LTRO's, fall in crude price and 10yr US treasury yield. The Yield Curve steepened during the month because of cheaper funding available in the 1 and 3 Y tenor with the LTRO's announcement. Government bonds outperformed the corporate bonds due to lack of supply.

Outlook

We expect the bond market to remain positive due to ongoing risk off sentiment and sharp fall in crude oil price. There are also positive sentiments arising from the likelihood of India being included in global bond indices. Further enhancement in the size of the LTRO would further support the bullish bias in bonds. The spreads between corporate bond vis a vis Gsec in 3-5 year segment has widened as there was lack of supply in Gsec and good supply in Corporate bonds.

Given this backdrop, we find the short end of the curve (upto 5 years) attractive due to a attractive term spread over the overnight rate and easy liquidity conditions. The long end of the curve will stay elevated in medium term because of ample supply starting Apr 2020 and higher reliance on funding the fiscal deficit through small saving scheme (INR 2.4 trillion).

Recommended Products

We recommend short and mid duration products in the average maturity range up to 5 years, given the evolving macro backdrop. We recommend the PGIM India Banking & PSU Debt Fund along and PGIM India Premier Bond Fund within this category as suitable investment options for investors seeking moderate duration exposure and 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

	January 2020	February 2020	Change (in bps)
Overnight rate (NSE MIBOR)	4.90%	5.09%	19.00
1 yr CD	5.95%	6.17%	22.00
10 yr GOI Yield	6.60%	6.37%	-23.00
USD/INR	71.36	72.18	82 paise
IIP (Monthly with 2 month lag)	1.80%	-0.30%	-210.00
CPI (Monthly with 1 month lag)	7.35%	7.59%	24.00
5 Yr AAA PSU spread (bps)	35	45	10.00
5 Yr OIS	5.41%	5.00%	-41.00
US 10 Yr yield	1.56%	1.15%	-41.00
CRR	4.00%	4.00%	0.00
Reverse REPO	4.90%	4.90%	0.00
REPO	5.15%	5.15%	0.00

Source: RBI Weekly Statistical Supplement & Bloomberg

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

Source: RBI & Bloomberg