

Market Outlook

January 2023

Equity Market

Prudence over populism

Indian markets declined by 2.4% (NIFTY) in the month of January and underperformed most of its developed as well as developing market peers. The decline was broad-based as the mid and small cap indices fell by a similar quantum. Sector-wise, all sector indices closed in the red, barring metals which had a tailwind of China easing controls. IT, Energy and Auto were the key laggards in the month, while Banks, O&G and Industrials relatively outperformed. FIIs were net sellers in Jan 2023 to the tune of \$3.7bn and DIIs were buyers to the tune of \$4bn.

On the macro front, CPI print in December eased marginally to 5.7%, while WPI declined to 4.95% in mainly due to fall in prices of food articles and crude petroleum. GST collection for Jan 2023 came in at Rs1.55tn (up 10.5% YoY and 24% FYTD). World Bank slashed its growth forecasts for most countries and expects growth of 6.6% for India in FY24 though India is expected to be one of the fastest growing economies.

Union Budget FY24

Government announced the Union Budget for FY24 on Feb 1, 2023. We reckon it is a well-balanced Budget targeting fiscal prudence as well as investment push at the same time. Key highlights of the Budget are:

- FY23 fiscal deficit retained at 6.4% of GDP and for FY24 estimated at 5.9% of GDP; on track to achieve 4.5% fiscal deficit target by FY25.
- Government expects nominal GDP growth to be 10.5%.
- Capital investment increased sharply by 33% to Rs10tn or 3.3% of GDP. The Effective capex of Rs13.3tn up by 30% (4.5% of GDP).
- Highest ever railway capital outlay at Rs2.6tn.
- Affordable Housing - PM Awas Yojana enhanced by 66% to Rs80bn. Allocation of Rs100bn under Urban Infrastructure Development Fund (UIDF) for urban infrastructure in Tier 2 and Tier 3 cities.
- 100 critical transport infrastructure projects, for last and first mile connectivity for ports, coal, steel, fertilizer, and food grains sectors.
- Capital support of Rs300bn for OMCs in FY24E vs nil last year.
- Free food grain to poor / priority households for the next one year worth Rs200bn.
- Strengthening Income Tax eco-system and grievance redressal form.

Government seems to be targeting inclusive growth with a focus on lower and middle class, spurring domestic manufacturing and infrastructure development. We highlight the absence of no major populist measures despite upcoming states as well as union elections, depicting the resolve of fiscal prudence and focus on economic development. Measures to boost rural economy were expected given the rural weakness however instead of giving freebies, government focussed on asset creation and rightly so.

Going forward

The Union Budget continues on its path of consistency and credibility. The government is sticking to its targets, keeping the fiscal math believable, and has not become populist in a pre-election year. The objectives of macro stability and sustained growth are pursued pragmatically.

Q3FY23 results so far have broadly been in line. Banks delivered healthy NIM expansion in the rising interest rate regime, while IT results were mostly in line with estimates. However, certain pockets are seeing signs of slowing down. On an absolute basis, earnings upgrades and downgrades should determine the performance, while on a relative basis performance of other emerging markets and India's valuation premium/EM valuation discount would be a key driver. Domestic demand (especially on the rural side) and export buoyancy are near-term monitorable.

Lower inflation, healthy real GDP growth, and a focus on growth and investments should keep India in good stead. We are reasonably placed with valuations at 18-19x FY24 P/E, and growth expectations of mid-teens in the next two years. We believe we are nearing the

end of the rate hike cycle and hence the cost of capital should see some moderation from now on, which should support equity valuations. However, pockets where valuations are excessive, may see a reality check. Profitable growth, consistency in cash flow generation, and lower leverage would play an important role in alpha generation.

Debt Market

Fixed Income surge with steady flows from FPIs

Indian bond yields continued to trade in a very tight range throughout the month even as inflation came in below expectation for the second consecutive month. There was some anxiety going into the Union Budget but as the fiscal deficit and borrowing numbers were in line with market expectations, bond markets had a relief rally and the yields fell across the curve by 10bps post the Budget. We think the Budget numbers are credible and though the borrowings for FY24 are higher as compared to FY23, it should sail through. Globally the yield curve remains inverted with investors expecting the end of the rate hiking cycle and for central banks to change course before the end of the year. Globally growth has not weakened to the extent anticipated earlier and some of the data coming out has been better than expected and expectations are getting realigned in respect of severity of the slowdown in developed economies. The US Fed, ECB and the BOE all raised rates on expected lines. The Budget has estimated India's nominal GDP growth for FY24 at 10.50% and the OIS curve is expecting rate cuts to start in India before the end of the year. While we expect RBI to pause after hiking the policy rate to 6.50% on 8th Feb, we do not expect rate cuts to commence in India in CY23 as we expect core Inflation to remain sticky.

In the next week's MPC meeting we expect the policy rates to be increased by 25bps and the monetary policy stance to change to Neutral. We think RBI's rate stance will continue to be influenced by the global rate trajectory in light of our twin deficits (fiscal deficit and current account deficit).

Brent was rangebound during the month ending at 84.49 as compared to last month's close of 85.91.

INR appreciated against the US dollar by 1.00% during the month as US dollar weakened.

The CPI Inflation for December (released in January) came in lower than market expectations at 5.72%.

FPI flows into Indian Fixed Income markets remained positive for the third consecutive month in a row with the first month of 2023 witnessing inflows to the extent of USD 204 Mn.

The incremental Credit / Deposit ratio of the banking system has improved over the last couple of months but still continues to sustain at an elevated level with credit growth @16.50% and deposit growth @10.60% 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.

We expect the 10yr Benchmark bond to trade in a range of 7.10% to 7.40% in this quarter.

Fixed Income Market

	December 2022	January 2023	Change (in bps)
Overnight rate (NSE MIBOR)	6.60%	6.50%	-10
1 yr CD	7.63%	7.75%	12
10 yr GOI Yield	7.33%	7.34%	1
USD/INR	82.74	81.92	-82 paise
IIP (Monthly with 2 month lag)	-4.00%	7.10%	1110
CPI (Monthly with 1 month lag)	5.88%	5.72%	-16
5 Yr AAA PSU spread (bps)	20	25	5
5 Yr OIS	6.45%	6.29%	-16
US 10 Yr yield	3.88%	3.50%	-38
CRR	4.50%	4.50%	0
REPO	6.25%	6.25%	0
SDF (Standing Deposit Facility)	6.00%	6.00%	0

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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