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India Mutual Fund

PGIM India Market Outlook

April 2023

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Index

Executive Summary : Short Term - Slowdown, Long Term - India Stands to Win

- Globally many developed and developing economies are seeing growth slowdown in an inflationary, high interest rate and an uncertain geopolitical scenario
- While India is not totally immune to global growth tantrums and is likely to see some slowdown, it is still one of the fastest growing economies
- At the current juncture we prefer to play the India growth story through more structural growth themes vs cyclical themes given a high interest rate scenario, global macro uncertainty, commodity deflation and weaker near term macro outlook.
- We are neutral across the capitalisation curve. Large caps, Mid caps and Small caps offer similar risk reward pay
- We are constructive on Indian equity markets. We are positive on Financials, Healthcare, Consumer Discretionary while we are cautious on IT, Energy, Materials and Industrials
- We like themes like formalisation, digitisation, consumerism and manufacturing

Global market outlook: IMF expects global growth to moderate in CY23

GDP growth rate (y-y %)

Country	2022	2023E	2024E
World	**3.4**	**2.8**	**3**
Advanced Economies (Aes)	**2.7**	**1.3**	**1.4**
Euro Area	3.5	0.8	1.4
– France	2.6	0.7	1.3
– Germany	1.8	-0.1	1.1
Japan	1.1	1.3	1
UK	4	-0.3	1
US	2.1	1.6	1.1
Emerging market and developing economies (EMDEs)	**4**	**3.9**	**4.2**
Brazil	2.9	0.9	1.5
China	3	5.2	4.5
India	6.8	5.9	6.3
Russia	-2.1	0.7	1.3
South Africa	2	0.1	1.8

Source: IMF World Economic Outlook Database April 2023, Bank of Baroda Research. For India 2023 refers to FY 23 and 2024 refers to FY25.

- IMF expects global growth to slow down to 2.8% in 2023 from 3.4% in 2022, before rising to 3% in 2024.
- While global economy appears poised for a gradual recovery from pandemic and Russia – Ukraine crisis, financial sector instability in major economies along with monetary policy tightening may likely impact growth.

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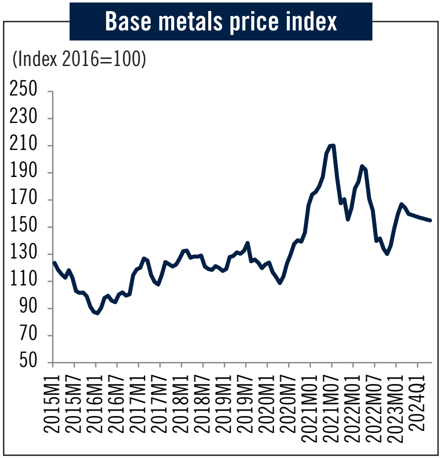
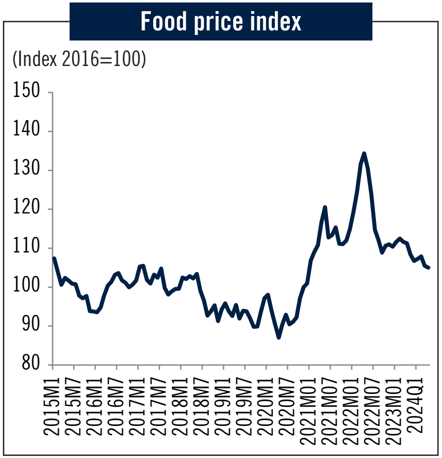
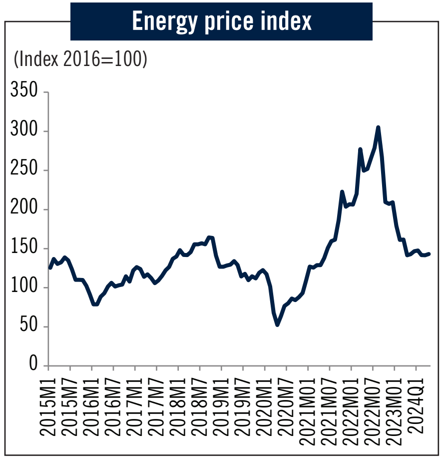
Global market outlook: Commodity inflation is easing from a high base







- Prices of most commodities are easing.
- Still these are up sharply over 3-5year period.

Source: IMF data

Global market outlook: IMF expects Inflation to remain sticky in near term

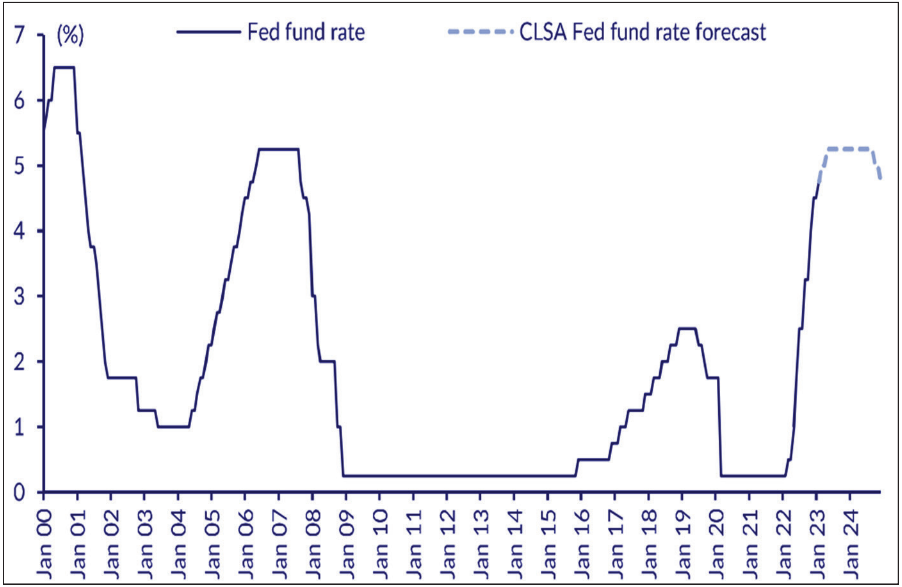
Inflation rate (y-y %)

Country	2022	2023E	2024E
World	**8.7**	**7.0**	**4.9**
Advanced Economies (AEs)	**7.3**	**4.7**	**2.6**
Euro Area	8.4	5.3	2.9
– France	5.9	5.0	2.5
– Germany	8.7	6.2	3.1
Japan	2.5	2.7	2.2
UK	9.1	6.8	3.0
US	8.0	4.5	2.3
Emerging market and developing economies (EMDEs)	**9.8**	**8.6**	**6.5**
Brazil	9.3	5.0	4.8
China	1.9	2.0	2.2
India	6.7	4.9	4.4
Russia	13.8	7.0	4.6
South Africa	6.9	5.8	4.8

Source: IMF World Economic Outlook Database April 2023, Bank of Baroda Research.

- Global inflation has declined as reflected in sharp reversal in energy and food prices. But core inflation, excluding the volatile energy and food components, has not yet peaked in many countries.
- From an average of 8.7%, global inflation is expected to moderate to 7% in 2023.
- Inflation's return to target is unlikely before 2025 in most cases.

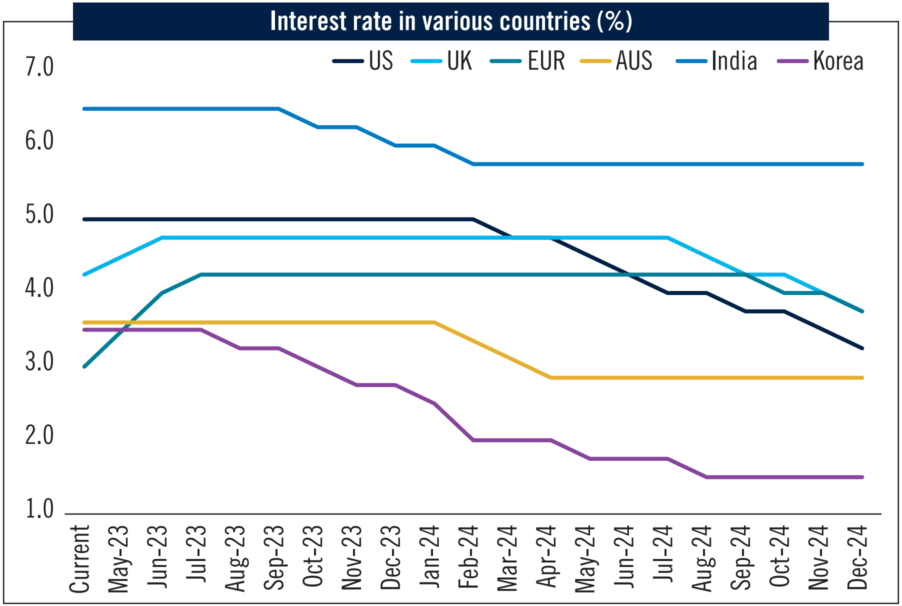
Global market outlook: Fed signalled a pause after 3rd May 25bps rate hike



- On 3rd May, Fed raised the target Fed funds rate by 25bp. The ceiling rate now stands at 5.25%.
- However, Fed has now signalled a long pause to rate hike cycle.

Source: Bloomberg, CLSA

Global market outlook: Interest rate upcycle is near its end



- Except for European Countries and Japan, interest rate upcycle is largely behind.
- After a pause, market expects reversal of interest rate to begin later this year in some countries.

Source: CEIC, Bloomberg and Nomura Global Economics

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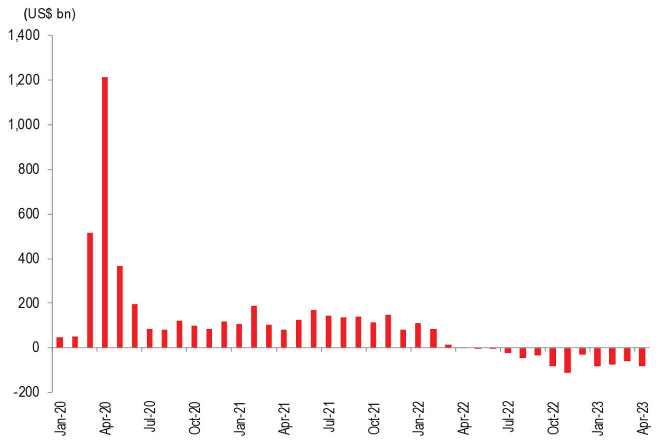
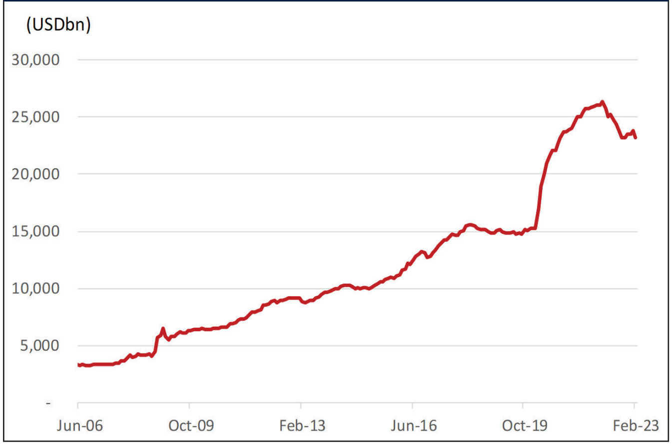
Global market outlook: liquidity remains tight

Reversal of Fed quantitative easing (QE) is continuing



G4 (Bank of Japan, Federal Reserve, ECB and Bank of England) Balance Sheet Size has started reducing



Liquidity in global markets remains tight with Fed continuing to withdraw its quantitative easing.

Source: Bloomberg, PGIM

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India outlook: Getting bigger and better

2002	Countries	2007	Countries	2012	Countries	2017	Countries	2022	Countries	GDP (US$bn)	2027	Countries	GDP (US$bn)
1	United States	1	United States	1	United States	1	United States	1	United States	25,464.48	1	United States	31,091.59
2	Japan	2	Japan	2	China	2	China	2	China	18,100.04	2	China	25,722.41
3	Germany	3	China	3	Japan	3	Japan	3	Japan	4,233.54	3	India	5,153.01
4	United Kingdom	4	Germany	4	Germany	4	Germany	4	Germany	4,075.40	4	Japan	5,077.12
5	France	5	United Kingdom	5	United Kingdom	5	United Kingdom	5	India	3,386.40	5	Germany	4,947.32
6	China	6	France	6	France	6	India	6	United Kingdom	3,070.60	6	United Kingdom	4,015.52
7	Italy	7	Italy	7	Brazil	7	France	7	France	2,784.02	7	France	3,321.71
8	Mexico	8	Spain	8	Russia	8	Brazil	8	Russia	2,215.29	8	Brazil	2,587.52
9	Canada	9	Canada	9	Italy	9	Italy	9	Canada	2,139.84	9	Canada	2,492.36
10	Spain	10	Brazil	10	Canada	10	Canada	10	Italy	2,012.01	10	Italy	2,406.85
11	Korea	11	Russia	11	India	11	Korea	11	Brazil	1,924.13	11	Russia	2,234.73
12	India	12	India	12	Australia	12	Russia	12	Australia	1,701.89	12	Korea	2,033.33

Source: IMF, PGIM

India outlook: India is among the fastest growing countries in the world

India to remain fastest growing large economy in 2023 and 2024, as per IMF

Country	2022	2023E	2024E
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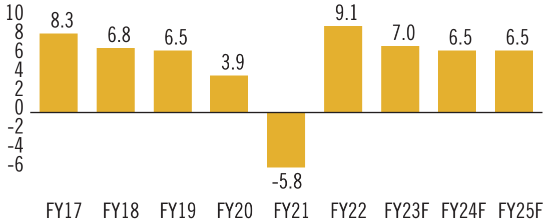
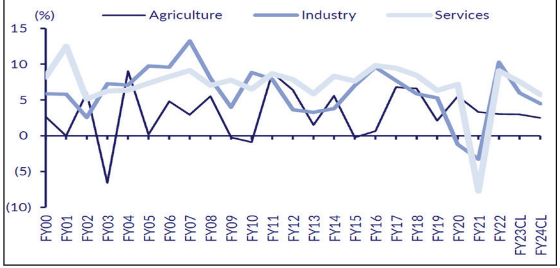
Source: IMF World Economic Outlook Database April 2023, Bank of Baroda Research. For India 2023 refers to FY 23 and 2024 refers to FY25.

RBI expects India to grow at much faster than projected by IMF



India's GDP growth by sector – Services will continue to be key driver



Source: IMF, RBI, PGIM

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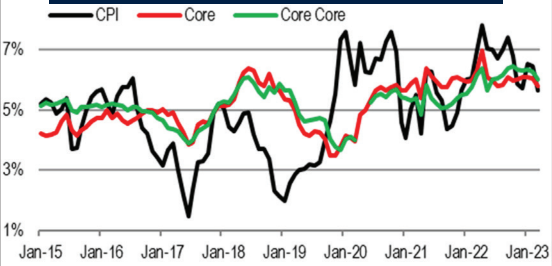
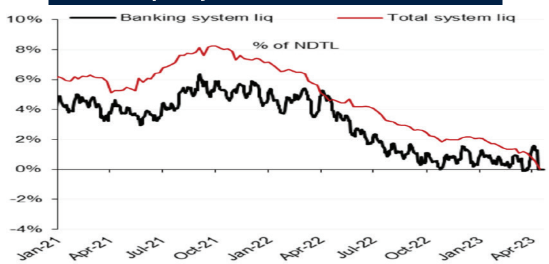
India's monetary policy ahead of curve, Inflation reasonably well behaved, RBI paused rate hike

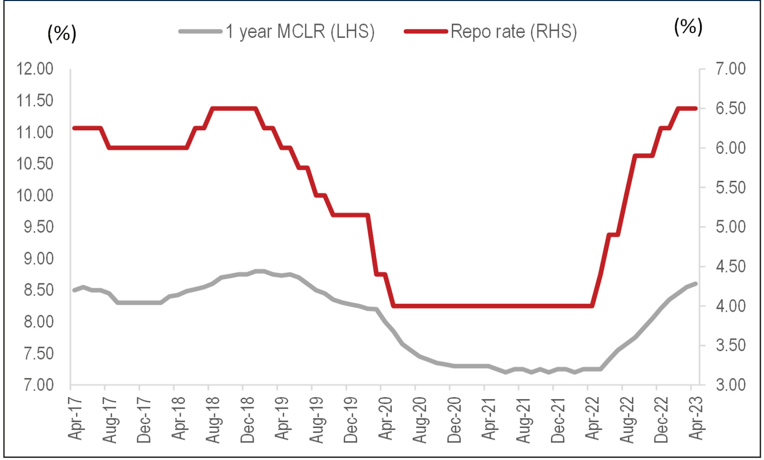
Inflation rate in India



Liquidity withdrawal continues



Extent of policy pass-through



- RBI has been proactive in managing interest rates in a timely manner and has been ahead of the curve in its monetary policy decisions

Source: RBI, Credit Suisse, Nomura

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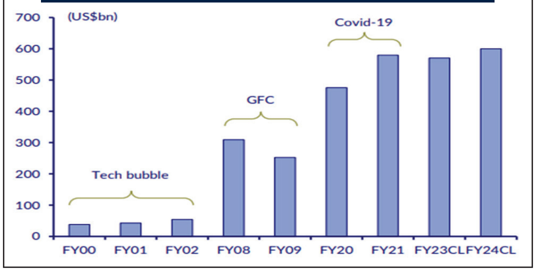
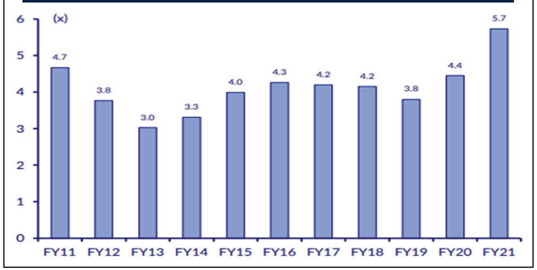
India's monetary policy ahead of curve, High forex reserves are key to India's resilience

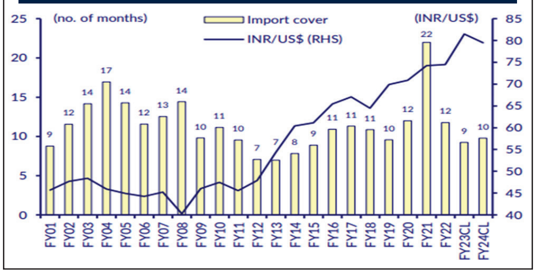
India Forex Reserve Trend



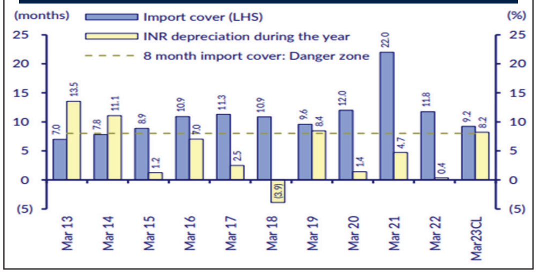
India Forex Reserve/short term external debt



India Forex Reserves Import Cover Versus Currency



India Forex Reserves Import Cover danger zone



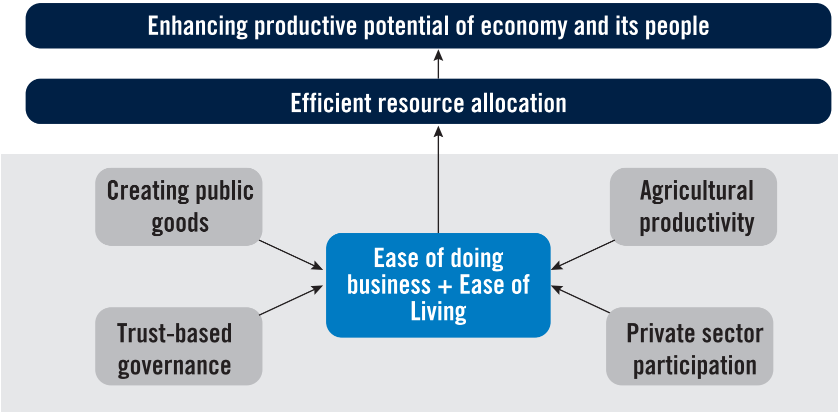
- High forex reserves have expectedly helped the INR to hold out in line with other currencies. This has also limited exchange rate pressures.
- Debt in India is conservative.
- Foreign holding of government securities (3% of forex reserves) and corporate bonds (also 3%) is very low in India.

Source: RBI, CLSA

India outlook: Significant structural reforms have been undertaken

Flexible inflation targeting regime, goods and services taxes, banruptcy code, among others, are some of the reforms undertaken to ensure a stable foundation for growth.

Government's underlying framework for reforms



Key reforms

- Unique identity and JAM trinity
- GST implementation
- Insolvency & Bankruptcy code
- Privatisation
- Rationalisation of tax rates and administration
- Expenditure management reforms
- Ease of doing business reforms PLI scheme for domestic manufacturing
- Public digital infrastructure
- PM Gati Shakti (multi-model connectivity)

Source: Economic Survey 2022-23, Nomura

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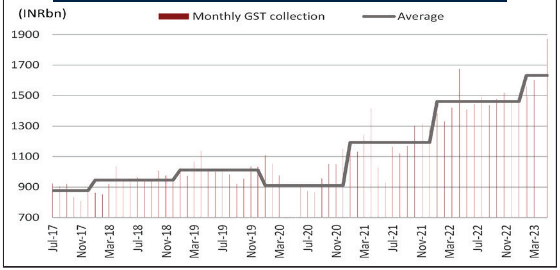
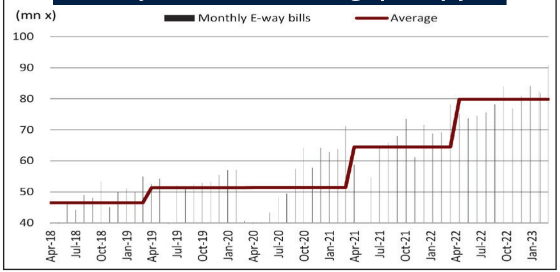
India outlook: GST implementation and UPI are biggest reforms, showing promising result

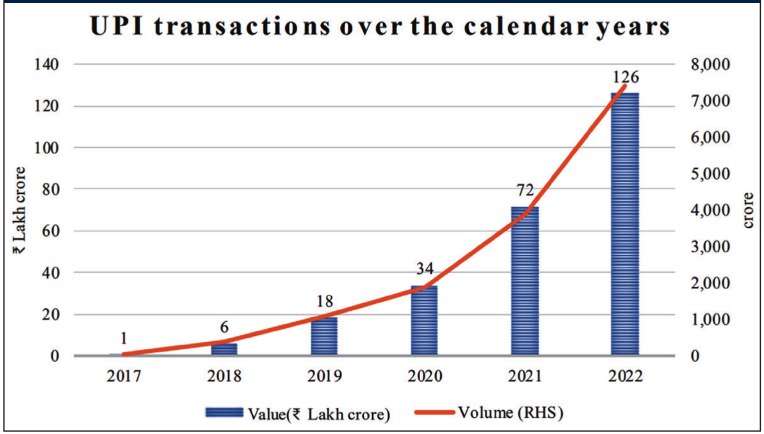
GST collections gradually moving up



E-way bills issuance moving up sharply



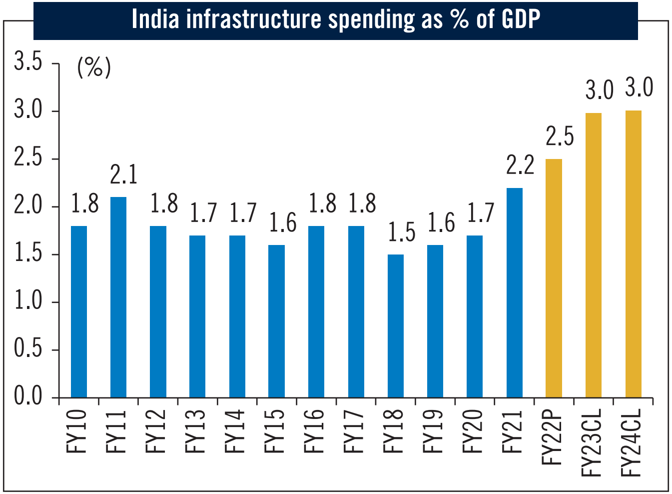
Strong increase in UPI transactions



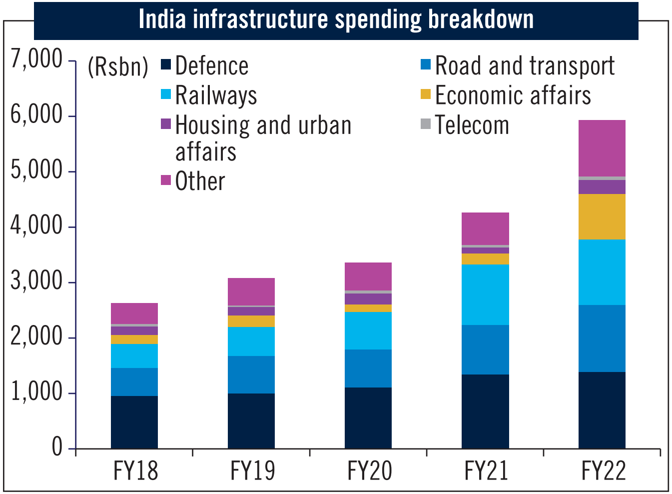
Source: GoI, NPCI, PGIM

- Avg. monthly GST collection in 2023 has increased by whopping 86% to INR1.6tn since 2017.
- Avg. monthly E-way bills issued has increased by 72% in last 5years.
- Phenomenal rise in usage of UPI in the country is a digital revolution in India.

India outlook: Thrust on infrastructure development



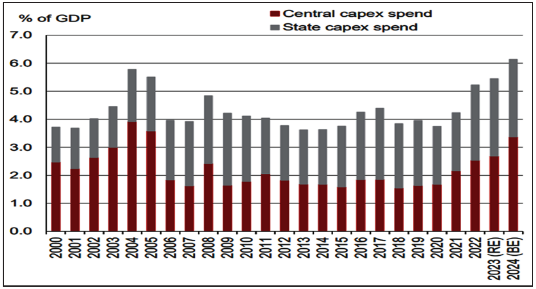
Source: CLSA, Government of India



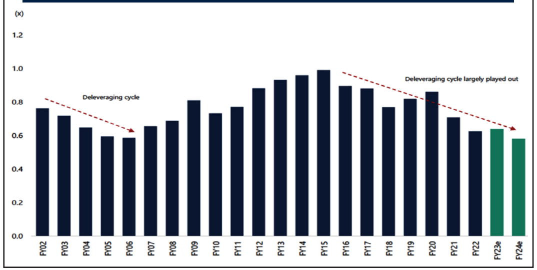
Source: CLSA, Government of India

With thrust on building new India, country's infra spending as a % of GDP is set to increase to 3% of GDP from 1.8% in FY10.

India Outlook – Government capex strong, Private to pick up

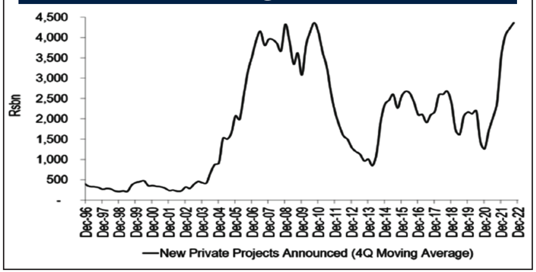


Gross D/E ratio for large listed companies

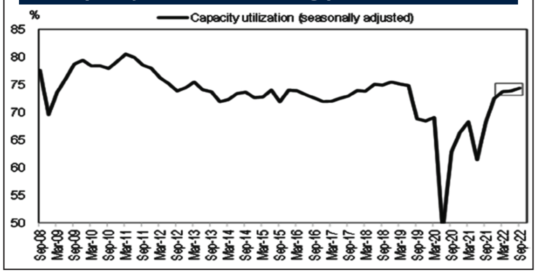


*Analyzed a sample of ~600 that were part of BSE500 at different points of time in the past two decades

New private project announcements highest since 4QFY09



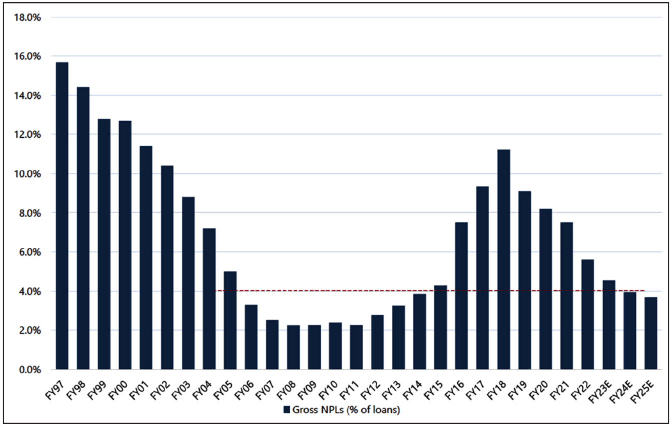
Capacity Utilization nearing pre-covid levels



- Govt. has stepped up its capex from 1.7% of GDP pre-pandemic to 3.3% in FY24.
- Public capex push likely to continue in the pre-election year in 2023.
- Private sector capex could also pick up: Healthier B/S, Falling input prices, rising capacity utilization, supply chain relocation as part of China+1 strategy.

Source: RBI, CEIC, CMIE, AceEquity, Jeffries, CITI

Bank gross NPL continues to trend down, Credit growth pick-up signals robust spending outlook



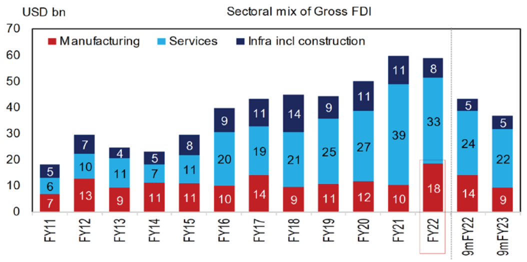
Bank credit growth at 15.7% mid-march

- Banks NPL continues to fall, and asset quality is now way better.
- With healthy B/S, banks are now ready to support consumption and investment growth.
- Credit growth pick-up signals robust spending outlook

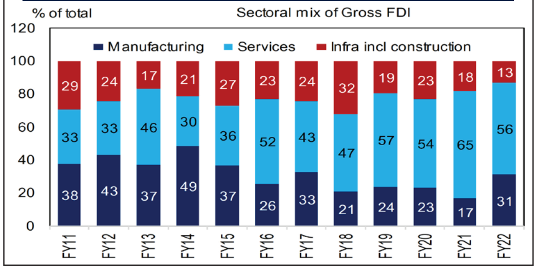
Source: RBI, Jeffries

China+1 and Make in India to drive manufacturing growth in India

FDI in manufacturing more than doubled in FY22

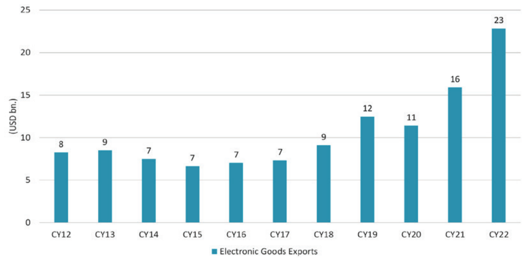


Sharp rise in share of manufacturing

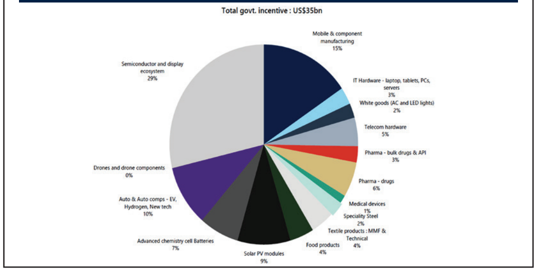


- India manufacturing is gaining momentum.
- With GoI focus on PLI to incentivize "Make in India", manufacturing in India is expected to see strong growth.

India's electronics exports is seeing very strong growth

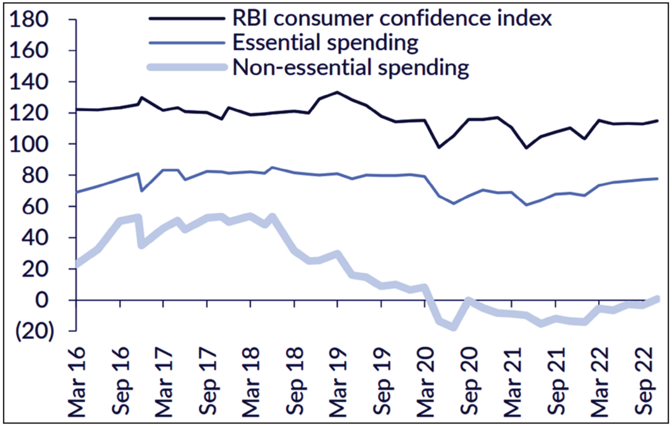


Government commitment in PLI scheme



Source: Citi, Department For Promotion of Industry and Internal Trade, CEIC, CMIE

Consumption: Short term pain, despite long term promise



- While India's consumption story remains promising on the back of rising income and favourable demographics, near term consumption growth remains weak.
- RBI's consumer confidence index points to a sharp slowdown in non-essential spending since mid-2018 and a contraction in 2021 and remains way below pre-Covid levels, even as essential spending has bounced back above pre-Covid levels.
- With interest rates peaking and inflation ebbing, consumption should improve.

Source: RBI, CLSA

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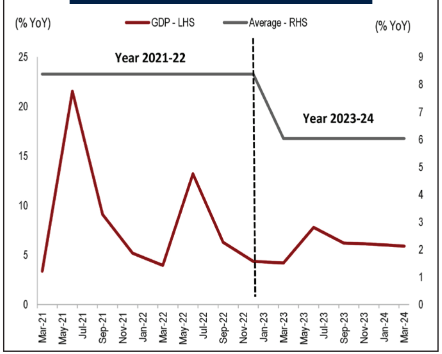
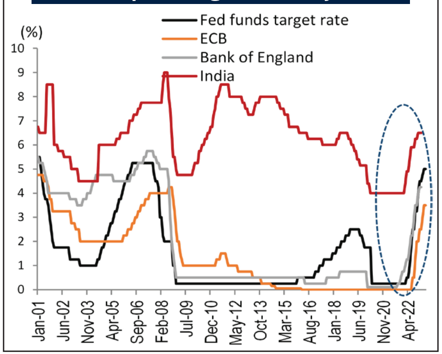
India Outlook: India story remains strong, but some hiccups likely in near term

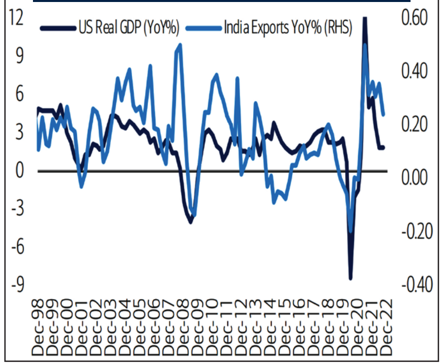
India quarterly GDP growth – Actual and RBI forecast



Interest rates increased sharply, impact on growth likely



India's exports linked to US economy



Source: RBI, Bloomberg, CMIE, BOFA

- While India story remains strong, near- term growth is likely to slow-down as interest rate hikes globally and recession in key economies impact India demand.
- Pent-up demand of last 2-years is also likely to wane.
- We reckon structural stories are better placed than cyclical names during current testing times.

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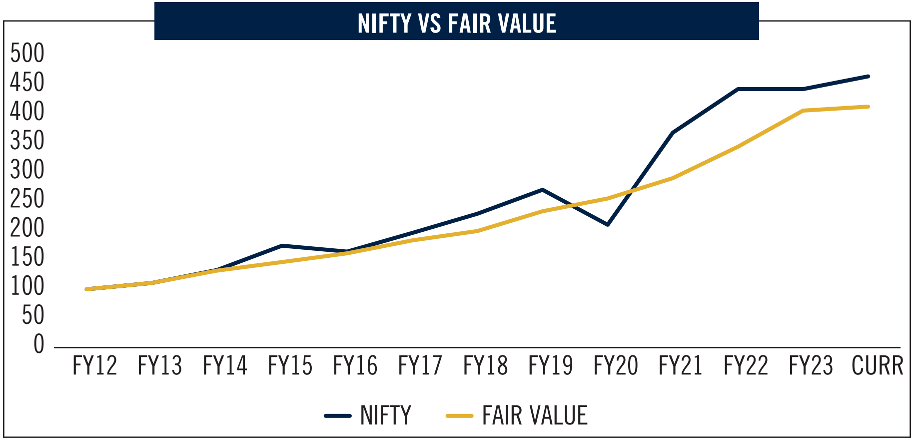
NIFTY is trading at a premium to its fair value, risk reward balanced



Source: PGIM

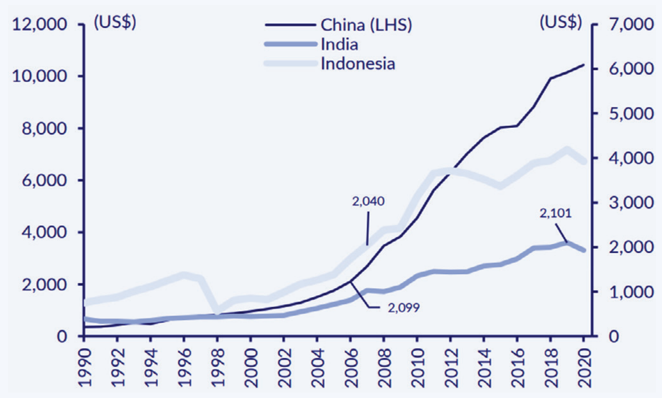
- NIFTY 50 index is trading at a premium to its current fair value based on our estimates
- Over last 10 years (FY14-FY23) Adjusted Nifty (same components as today) has delivered a return of 15% CAGR vs a 14% CAGR in Fair Values
- However, since the Fair Value is expected to grow at a strong pace, the expected returns for markets remain fair over the next 5 year period

Key long term themes that will shape up Indian market

Demographics			Disruption			
Consumption	**Consumer leveraging**	**Financialization**	**Environment**	**Formalization**	**Privatization (indirect)**	**Technological disruption**
Favourable demographics, rising income levels, urbanization will lead to higher penetration of various goods and services	Households to increase debt levels for consumption led by easy availability of retail finance	Financial savings should increase on account of high real interest rate and growing financial inclusion	Clean air and higher share of renewables in India's energy mix	Shift from unorganized to organized will gather pace	Private banks will gain further share from PSU banks (currently have around70% share in deposits & loans); Airlines	Technological advancement will lead to disruption of business models along with increasing productivity
Key beneficiaries: Consumer businesses (durable and non-durable), retail banking, financial saving companies	Key beneficiaries: Automobiles, retail banks, NBFCs, consumer durables	Key beneficiaries: Banks, NBFCs, insurance companies and mutual funds	Key beneficiaries: Natural gas, renewables, pollution control equipment suppliers	Key beneficiaries: Consumer companies in sectors with high share of unorganized sector, private banks, large real-estate developers and organized retailers	Key beneficiaries: Private banks, private airlines	Key beneficiaries: Adaptive businesses, private banks, clean energy companies
		Key losers: Real estate	Key losers: Automobiles (IC-based), coal, oil (E&P and R&M)	Key losers: Building component companies, NBFCs	Key losers: PSU banks, railways	Key losers: Automobiles (IC-based), coal, oil, semi-branded businesses

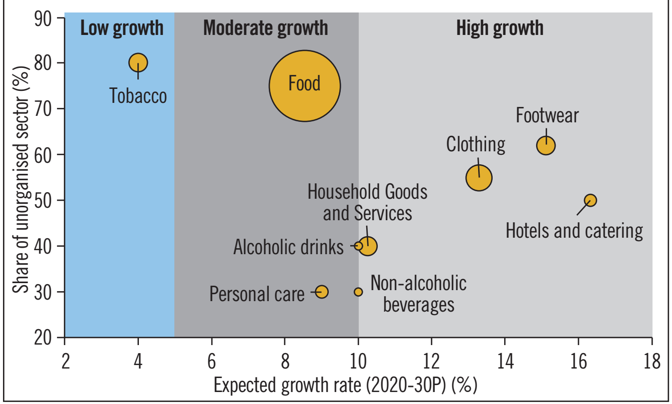
Consumption: Expect a pivotal decade

GDP per capita for India, China, Indonesia



Source: CLSA, Euromonitor

Growth rates in key consumption categories

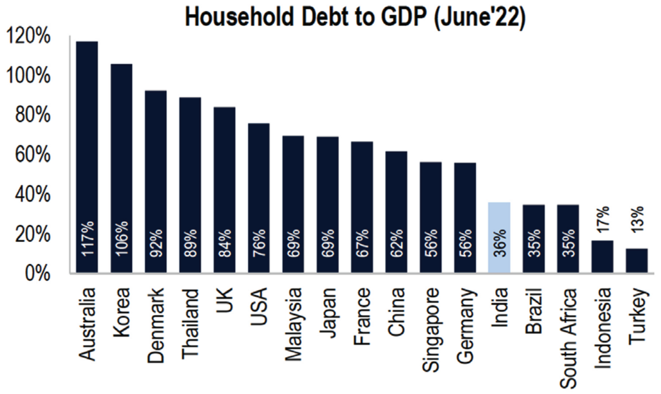


Note: The size of the bubbles represent the size of the category.
Source: CLSA, Euromonitor

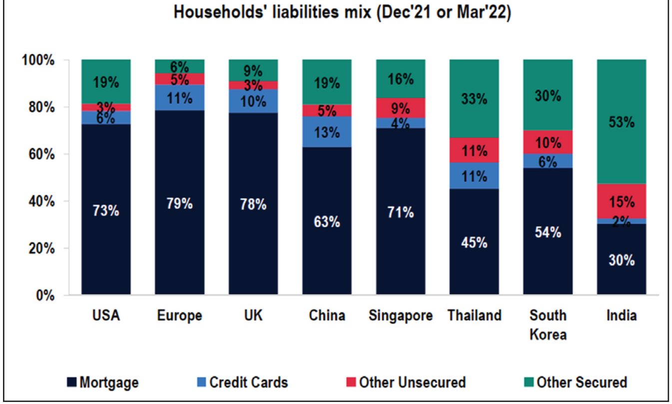
- India's per capita income has reached inflexion point of USD 2,000, expect healthy growth ahead.
- We expect 2020-30 to be a transformational decade for India's consumers as the informal or "unorganised" sector shrinks, and both disposable incomes and demand for discretionary goods rise.
- Expect the discretionary segment to grow at a faster pace than staples in the coming years, driven by a growing middle class, rising incomes and demand for premium products and experiences.

Consumer leveraging – long growth path ahead

Household debt to GDP is low in India



Share of credit card low in India

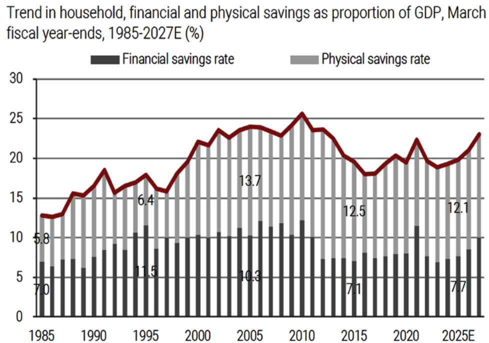


Source: RBI, Central Banks of respective countries, Investec

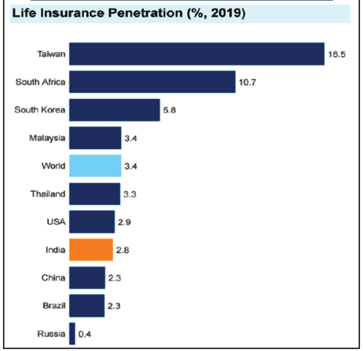
- India's household debt to GDP has not grown much in the past 15 years. It peaked prior to the global financial crisis (GFC) and has stayed below that mark since then.
- As compared to other countries, both developed and developing, household debt to GDP is low in India at around 35%.
- The noteworthy difference is credit card versus other unsecured debt across countries. In other countries credit card forms a larger proportion in household's liabilities versus in India.

Financialization – money shifting from physical to financial assets

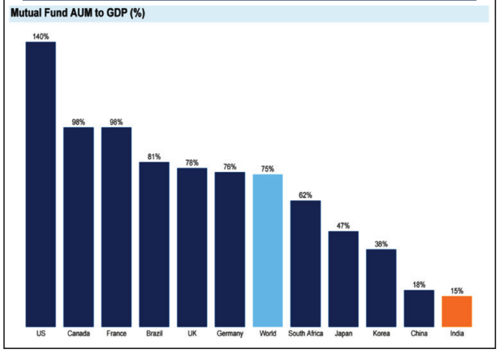
Financial savings rate to remain steady over the next few years



Life Insurance Penetration remains low



India's MF AUM to GDP is much lower than global average

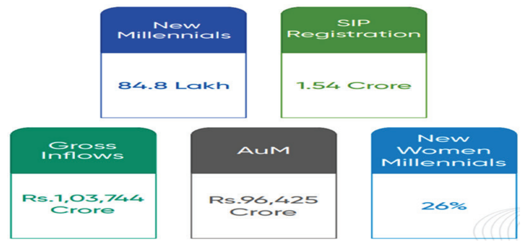


Source: RBI, IMF, IIFA, Swiss Re via IRDA, India Datahub Kotak, Macquarie

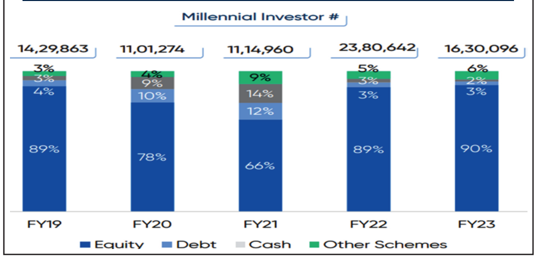
- 'Physical' assets –real estate, gold – today account for ~60% of India's household savings.
- With the insurance density in India less than 20% of the world average and lower than several emerging markets, the quantum of savings being intermediated by life insurance companies can continue to increase.
- Indian MF industry has seen 5x increase over past 10year, long runway to growth as even today the MF industry has approximately 100 million accounts against 2 billion bank deposit accounts.

Millennial Investors: Emerging force is here to stay

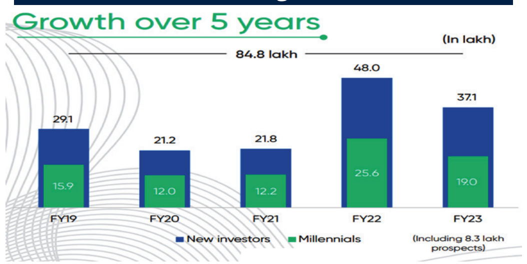
Millennial investors (born between 1981-1996) are an emerging force



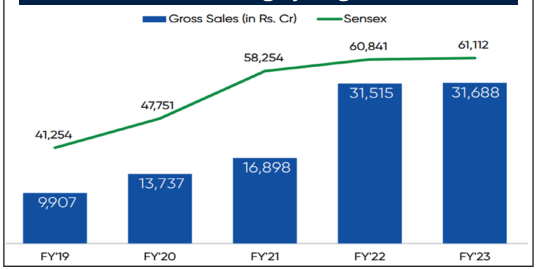
Choice of making first investment in equity fund heightened in FY22-23



Share of Millennials among new investors was highest in FY20



Millennial inflows on rise even as market is largely stagnant



- A staggering 84.8 lakh new millennials joined the Indian Mutual fund industry in last 5yrs, cornering 54% share of the new investor base.
- SIP in equity schemes has been the preferred route to begin the investing journey for two thirds of the new millennials.
- 43% of Millennials have expanded their exposure to more than one fund house.
- In our view, this force is just a beginning, and it is here to stay.

Source: CAMS

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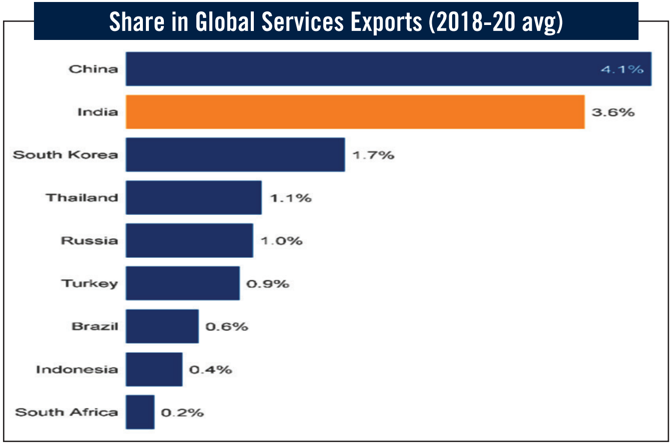
Digital India: India's share in services exports will continue to rise

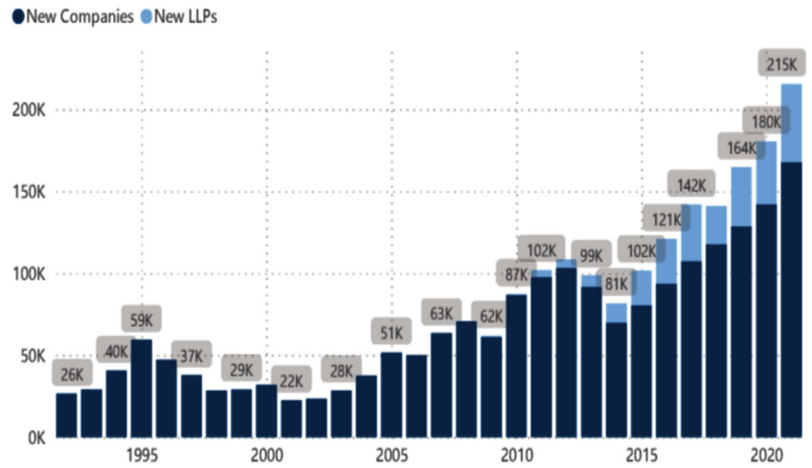


Source: RBI, IMF, IIFA, Swiss Re via IRDA, India Datahub Kotak, Macquarie

- India's share of world services trade has scaled from 1% in 2000 to 4% today.
- India continues to be a hotbed of technical talent, with a strong young cohort of English-speaking graduates adding to the workforce.
- Companies operating in area of Cloud, AI/ML, IOT, edge computing, smart healthcare will continue to drive strong growth.

Formalisation: Government reforms like GST and digitisation key drivers

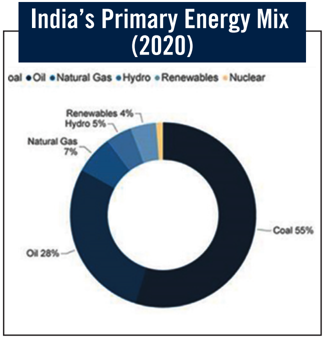
India Annual New Business Registrations – Accelerating momentum

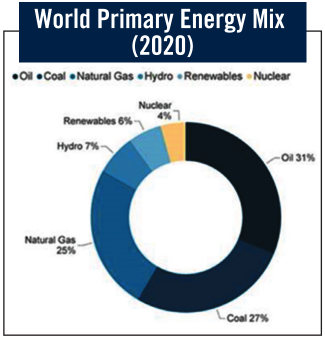


- Pace of formalisation has picked up particularly in Manufacturing sector.
- More and more new business are now getting started through a formal route.
- Key drivers include a) GST implementation b) Accelerated adoption of digital payments c) Reduction in the corporate tax to 25% and for new manufacturing companies to 15% d) Lower friction with registering a company now a fully online process e) Easy availability of risk capital.

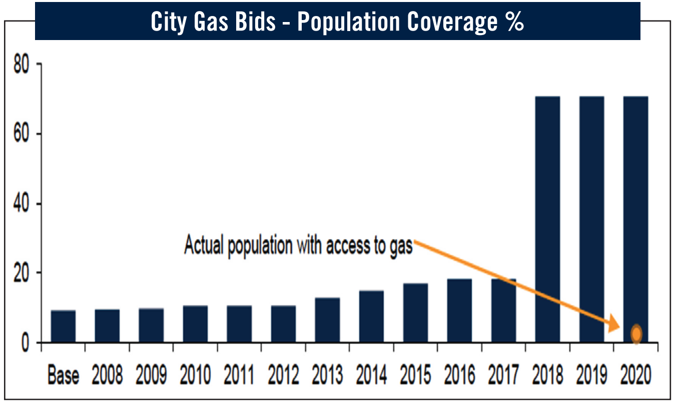
Source: Ministry of Corporate Affairs, IndiaDataHub, Macquarie Research

Environment – Scaling solar and gas key priorities





Source: IEA, MoPNG, Macquarie Research.



- India's reliance on fossil fuels is significantly higher relative to global levels, with coal, oil, and solid biomass accounting for ~85% share versus the global average of ~60%. Over the next 20 years, IEA sees India's CO_2 emissions rising 50% to about 3.7 gigatons CO_2, at which point India would be the second-largest carbon emitter behind China..
- Scaling environment friendly fuels like solar, wind, gas, hydrogen a key priority for India.
- The annual spend on solar PV modules, batteries, wind turbines is set to grow over four times to US$40 billion per year by 2040, at which point India would be 10%-30% of the global market.
- CGD sector is a structural growth story – Both CNG and EV could co-exist, in our view.

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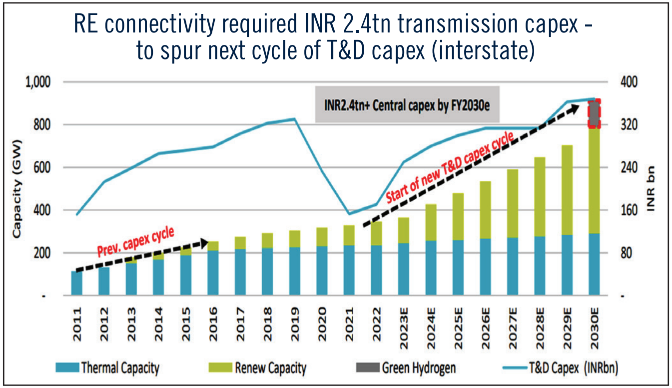
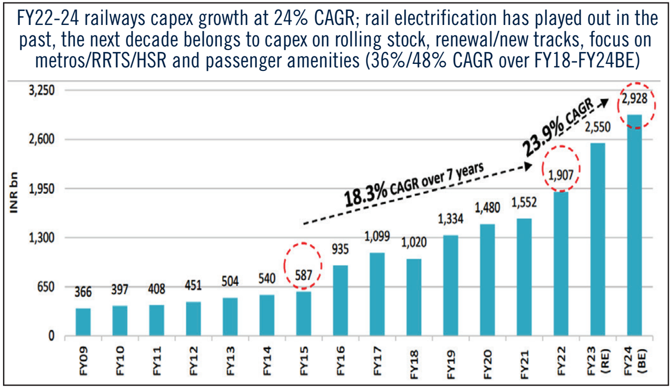
Power transmission and Railway to see Decadal Thrust



Source: CEA, PGCIL, Nuvama Research



Source: Indian Railways, Nuvama Research

- Transmission: The power demand-supply dynamic in India clearly spells out that, if India is to avoid a power deficit by FY28–30, its plan of adding 30–40GW/year of renewable energy (RE) comes to stand as more of 'a need' than 'a choice'. The natural deduction is that this will need to be connected, and to connect RE at this scale an equally large transmission capex is imperative. CEA estimates INR2.4tn to be spent in this area over FY24–30. India plans to add transmission lines/substations in the 400–800KV range, along with four large HVDC projects (worth approx. INR1tn).
- Railways/new age capex: The mega push in rail capex will benefit the entire industrials value chain over this decade. Cyclically strong industrial capex (conventional segment) along with new-age areas such as EV ecosystem, data centres, RRTS/metros, wastewater management, warehouse and logistics, defence, smart infra etc. will continue to drive order inflows especially in low/medium voltage T&D products and relevant equipment suppliers through the next decade

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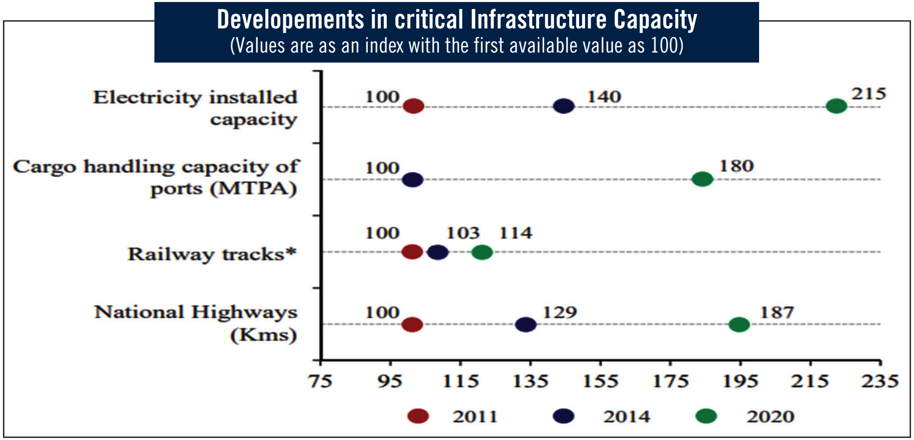
Building & Upgrading India



Source: RBI Report on Currency and Finance 2022
Note: (a) Railway tracks denote Running Track Kilometres
(b) The data for national highways for 2019 is the latest available data and is shown against 2020

- We expect India to spend big on roads, irrigation, power, railways, metro, airports projects in infrastructure building to upgrade India.
- We expect cement demand to grow at 7-8% over next decade.

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It's not India's decade, it's India's century,
says McKinsey's Bob Sternfels

THE ECONOMIC TIMES SEPTEMBER 2ND, 2022

Nomura bullish on India, says it is the most attractive proposition and a long-term compelling growth story

THE ECONOMIC TIMES DECEMBER 22ND, 2022

Thank You!

The world is looking at India as a destination for investment: Gita Gopinath

Livemint
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"India represents a great investment destination to any international business"

THE ECONOMIC TIMES
January 19th, 2022