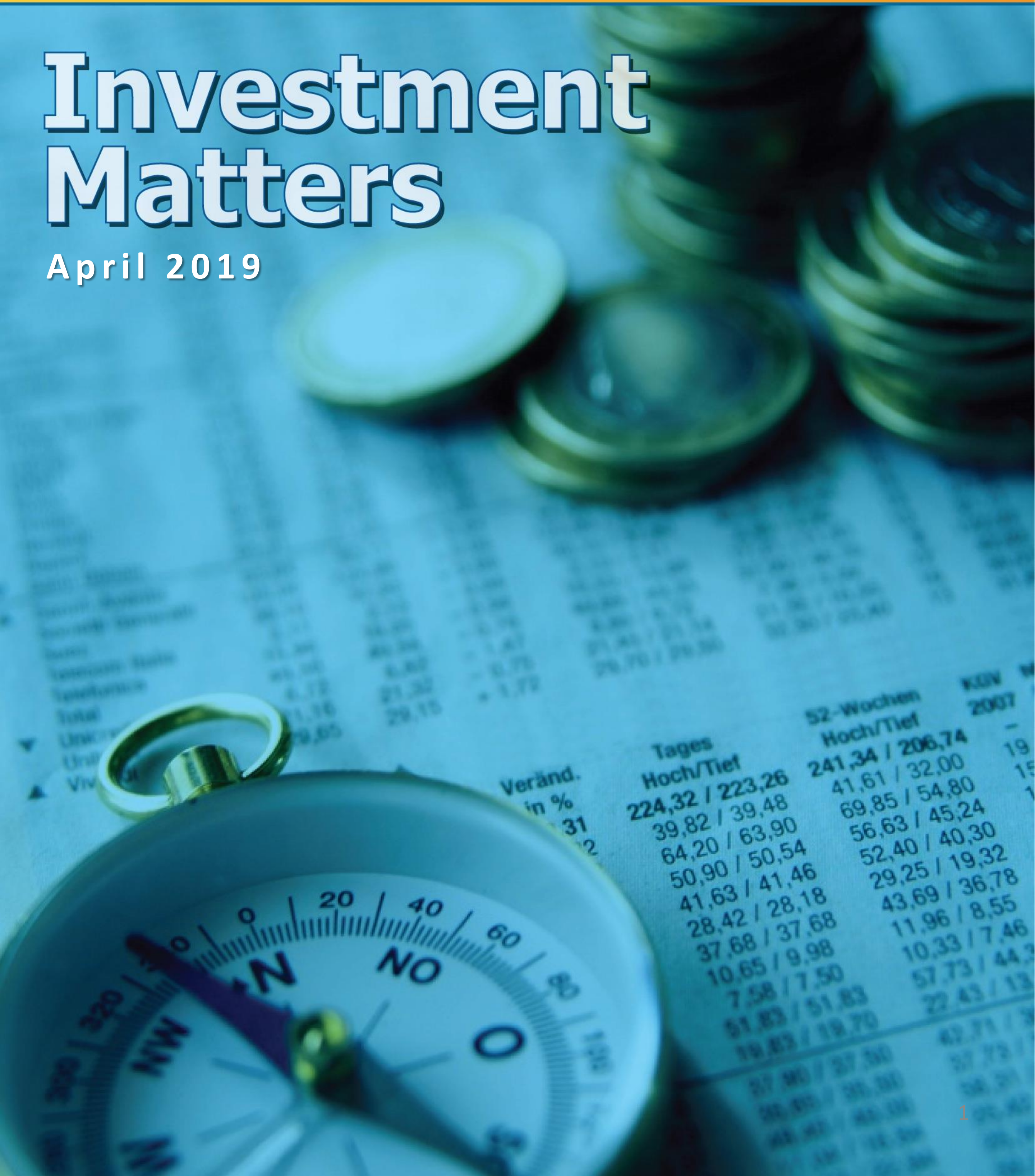
Investment Matters

April 2019



EQUITY OUTLOOK

Market Overview

The Indian economy enters FY20 on a weak note. High frequency indicators like auto sales point to a significant demand slowdown, and this is reinforced by anecdotal evidence from management commentary, especially in the consumer space. We attribute this to four reasons –

- Credit crunch to the NBFC/HFC crisis in Sep-Oct 2018 compounded the problem of multiple PSU banks being under PCA and this choked credit especially to SMEs.
- Sentiment has been affected by the upcoming elections as there has been a postponement of expenditure
- Continued sluggishness in tax collections has forced government to cut expenditure at year-end, driving demand destruction
- Continued agri distress due to low inflation has weakened rural demand and this problem is getting worse each year.

In our view, the weakness may persist for a few months more. The factors listed above are likely to play out for another quarter, at least, before the headwinds start to dissipate. Anecdotal evidence from channel checks and management comments point to continued pressures on demand and overall growth. This makes the market vulnerable in the short term. Corporate earnings are likely to reflect this economic weakness for 1-2 quarters, at least. Markets do not seem to be prepared for this possible bad news. Even a positive political outcome may not mitigate this risk.

The outcome of the elections is likely to be important in the short-term, but may not be a major issue over the medium term (barring a black swan outcome). Policy options for the new government should be to get growth back on track, irrespective of which side of the aisle wins the election. Fears of populism are a bit overdone because the fiscal space for aggressive spending is limited. On the other hand, the low-hanging fruit for the new government will be to

- Cut interest rates and get credit flow back on track
- Undertake structural reforms to get the investment cycle started again.

Given the challenges on growth and unemployment, political consensus on reforms may be forthcoming, irrespective of the election results.

EQUITY OUTLOOK

We remain optimistic about a recovery by end-2019. RBI's change in monetary stance should be a big enabler of a growth recovery, especially if the central bank gets more aggressive with rate cuts and liquidity injection. The economy should also see easier credit flow from FY20 with some PSU banks coming out of PCA and the NBFC crisis blowing over (for the stronger players, at least). The positive impact of GST with smoother product flow and unification of the markets are also likely to come through from FY20. Finally, as we progress through the year, a positive base effect on growth should come through.

The key risk to the second-half recovery remains higher oil prices. The economy should be able absorb the recent rally (Brent Crude up 32% YTD) but any spike above USD 80 per barrel would destabilize the 'current account-inflation-liquidity' equation and take rate cuts out of the equation. The other major risk is a black-swan political outcome that produces a fragmented lower house of parliament which results in a fragile government that is unable to take reforms forward.

Source-Alchemy Research

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