Investment Matters

May 2019

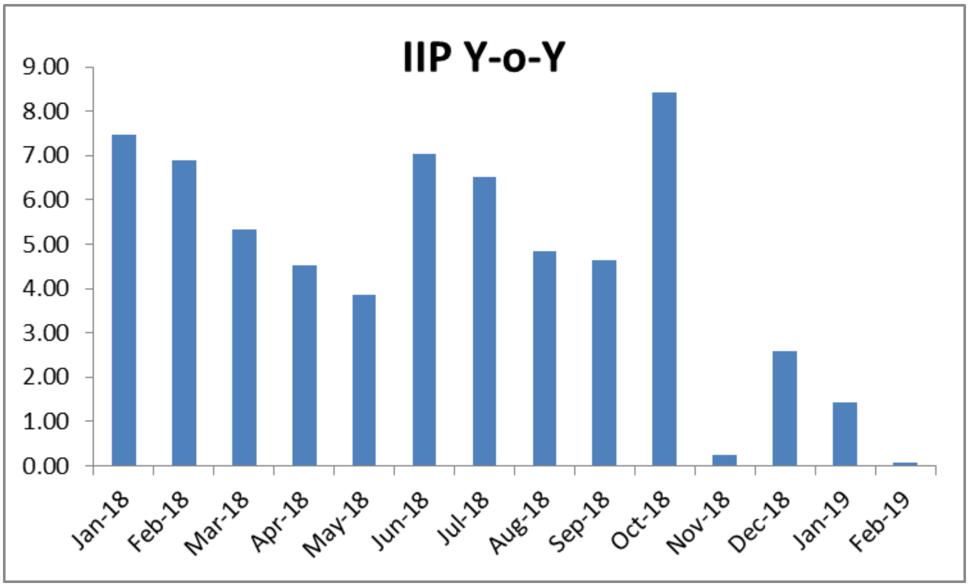
EQUITY OUTLOOK

Market Overview

The economy remains on a weak wicket with more data points confirming that trend every passing week. High-frequency indicators like auto sales and industrial production continue to be weak, and the earnings releases from large consumer companies reinforce that trend. This was anticipated and is an outcome of multiple factors:

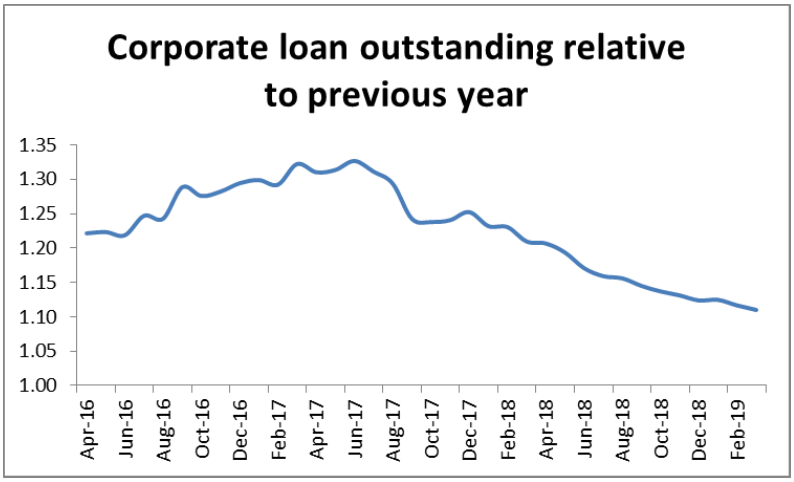
a) Slow credit growth as NBFCs continue to struggle for funding
b) Uncertainty around the upcoming elections
c) Slow tax collections leading to expenditure cutbacks by the government and
d) Continued weakness in the farm economy leading to weaker rural demand

We expect the Apr-June 2019 quarter to show similar weakness, as many of the factors listed above will still be in play.



Source: Bloomberg

A near-term worry is the fragility of the debt markets. There are continued concerns over the exposure of mutual funds to stressed groups, especially on loan against shares to some promoter entities. The worry is of an extreme event which could cause sudden outflows from debt mutual funds – that would cascade into other areas of the financial markets and exacerbate the tightness in credit markets. Stakeholders need to be mindful of the systemic risk and work towards a soft-landing of the stressed exposures.

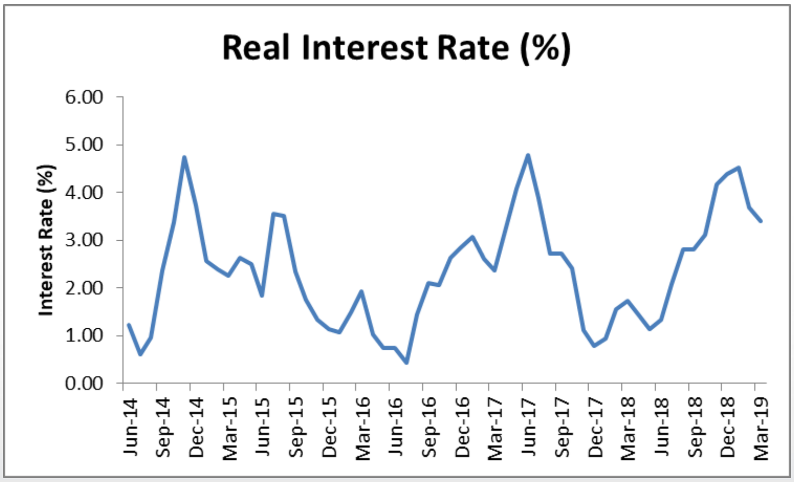


Source: Bloomberg

We continue with the view that many of these issues are transient and will start to dissipate from the July-Sep quarter of 2019. The consumption recovery would be driven by multiple factors; some of them dependent on decisive policy action.

First, the elections would be done by June, so the negative sentiment impact would be over. The new government would also be able to step up spending after the full budget is presented in July, though fiscal constraints would limit that upside. Also, the election-related spending would stimulate demand, albeit with a lag.

Second, we expect the RBI to continue on the path of monetary easing, as real rates remain elevated and banks are struggling for liquidity and deposits. We believe that policy rate cuts need to be accompanied by accommodative liquidity to enable transmission by the banks.



Source: Bloomberg

Third, PSU banks are coming out of PCA and they would start lending. This would help ease some of the credit constraints in the economy. It is likely that the PSUs would focus on the retail and SME segments, which would have an immediate impact on consumption demand. PSU banks are relatively less constrained for liquidity, so it would be easier for them to step up lending.

Fourth, the new government is expected to address the stress in the farm economy. Any direct liquidity injection into the farm economy, in whatever form, would have an immediate impact on the overall demand. FMCG companies, in their earnings commentary, have mentioned that the weakness was more pronounced in rural demand than in urban.

Fifth, we do expect the stress in the NBFC sector to ease by end of 2019. Not all NBFCs would be able to bounce back, but the stronger ones with a high exposure to retail loans and strong promoters would start to see an easing of funding strengths. NBFC finance flows to hard-to-reach niches and would have a positive impact on demand. We reiterate that it would need some decisive action by all stakeholders to avoid inertia in the credit markets.

Conclusion:

Markets would remain volatile in the immediate future, in the context of the pulls and pressures mentioned above. Clarity on the contours of the new government, followed by decisive policy measures would be the enablers for the market to resume any upward trend in the latter half of the year. However, strong companies with resilient business models, fortress balance sheets and proven track record of execution would bounce back sooner than others.

Source-Alchemy Research

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