Capital League outlook

February, 2019

Indian Economy

- The govt. presented the interim budget focusing on weaker sections of society while maintaining fiscal prudence.
- It announced direct income support scheme for marginal farmers under which farmers owning up to two hectares will get INR 6,000 per year. This will provide some relief to widespread farmer distress due to the deflation in food prices and mounting agriculture debt.
- The govt. also launched a pension scheme to provide cover to people in unorganized sectors with monthly income up to INR 15,000 and assured a monthly pension of INR 3,000 on attaining the age of 60 years.
- It also announced measures to support MSME segment viz. GST registered MSME units will get 2% interest rebate on incremental loan of INR 1 Cr and sourcing from SMEs by Government enterprises to be increased to 25%.
- The govt. widened its fiscal deficit target for the current and next financial year to 3.4% of GDP, giving it more spending power before elections in May'19.
- It shall utilize the undistributed compensation cess fund in FY19 and the interim dividend of INR 28,000 Cr from the RBI to meet the shortfall in revenue. Also the shortfall in GST, telecom receipts and non-financial PSU’s dividend is expected to be offset by higher collection of direct taxes.
- GST Council doubled the exemption limit for registration to INR 40 lacs from INR 20 lacs and raised threshold for availing composition scheme providing relief to MSMEs.
- Corporate earnings saw a dip in 3Q FY19. Companies reported robust growth in sales but the profitability took a knock. Cost of raw materials including oil and interest costs dented operating profit margins.
- IT, Consumer companies and Corporate banks have performed well whereas margins for Automobile companies and NBFCs have declined.
- Index for Industrial production (IIP) for Dec’18 grew higher at 2.4% compared to 0.5% in Nov’18. Capital goods and Consumer Non-Durables performed well while labour-intensive sectors (Textiles, Gems & Jewellery, Leather, etc) are still struggling.
- Retail inflation (CPI) eased further to 2.05% in Jan’19 from 2.11% in Dec'18, a 19-month low, due to continued decline in food prices.
- The RBI monetary policy committee announced a 25 bp rate cut, along with change in stance from ‘calibrated tightening’ to ‘neutral’. This opens up possibility of further rate cuts. Due to soft inflation in food and fuel groups, RBI has lowered its inflation projections to 2.8% for Q4 FY19 from 2.7-3.2% earlier for H2 FY19.

Global Economy

- US Federal Reserve kept its interest rate unchanged. It signaled that it could maintain status quo in coming months on account of mild inflation data and rising economic pressures due to global slowdown and a trade war with China.
- The United Kingdom Parliament has not been able to approve a final deal for the Brexit though the deadline is near.
- Crude Oil prices rose from USD 54 to USD 62 per barrel in Jan’19 as US sanctions on Venezuelan exports lead to tightening of global crude supply. OPEC and its non-members have also agreed to collectively cut production in H1 CY19 in an effort to reduce global supply.

Outlook

- From equity market perspective, budget would be seen positive for the consumption and rural focused stocks with continued focus on income enhancing measures.
- Companies are expected to garner double-digit earnings for next three years with the effect of GST and Insolvency and Bankruptcy Code(IBC) releasing cash which will ensure higher savings and lower cost of capital for companies.
- Markets are trading at a P/E of 16.7x FY20E which appears reasonable, given the low interest rates. However, election related volatility is likely to persist over the next 3-4 months keeping markets in a narrow range.
- Though the near term inflation outlook remains benign due to low food prices and range bound oil prices, considering a modest uptick in growth in FY20, credit growth outpacing deposit growth and likely fiscal pressure we continue to maintain a cautious stance and recommend staggering of investments.
- On the fixed income side we continue to focus on high credit quality Accrual funds, Fixed Maturity Plans (FMPs) and Tax-free bonds to lock-in better yields.