Capital League outlook

January 2020

2019: The year gone by…

INDIAN ECONOMY

- **The Year of Reforms-**
    - Corporate tax lowered to 22% from 30% for firms that do not seek exemptions.
    - Tax lowered to 15% for manufacturing firms incorporated after 1 Aug'19 and commencing production by March'23.
    - GST rates have been reduced and rationalized for various products and services.
    - Surcharge roll back on Capital Gains from sale of equity shares and equity mutual funds.
    - Consolidation of 10 PSU banks in 4 large ones to improve operational efficiency, governance and accountability
    - NBFCs included under IBC mechanism.
    - Creation of INR 1 Lac Cr securitization facility for NBFCs with government guarantee.
    - Implementation of the INR 25,000 Cr Real Estate fund for completion of incomplete projects in affordable and mid-housing segment to boost real estate sector.
- India's rank on 'Ease of Doing Business Index' improved to 63 from 77 in 2018 and 100 in 2017.
- Announcement of INR 102 Lac Cr blue print for infrastructure development from FY20 to FY25.
- Announcement of strategic disinvestment of 23 PSUs (Pawan Hans Ltd., Central Electronics Ltd., Cement Corporation of India Ltd (CCI), Engineering Project (India) Ltd., etc).
- Government approves reducing its stake to below 51% in 5 Central Public Sector Enterprises (CPSEs), including Bharat Petroleum Corporation Limited (BPCL), Shipping Corporation of India and Container Corporation of India.
- **Credit De-growth –** Fund flow to commercial sector fell by nearly 87% from Apr-Sep'18 (INR 7.36 Lac Cr) to Apr-Sep'19 (INR 0.9 Lac Cr). This has been a big contributor to the slowing of the economy.
- The economy contracted through the year. RBI lowered its GDP projection to 5% for FY20. Both Consumption (58% of GDP) and Investments (29% of GDP) slowed down significantly in H1 FY20. Slowdown was in auto sector (especially passenger vehicles), cement, air travel, consumer durables etc. On the other hand, over the past few years most other macro-economic indicators are stable or improving.

Improving macros	FY15	FY17	FY19	FY20E
Real GDP at market price (% YoY)	7.4	8.2	6.8	4.7
Centre's fiscal deficit (% GDP)	4.1	3.5	3.4	3.8
Current Account Deficit (% GDP)	1.3	0.7	2.1	1.5
Balance of Payment (% of GDP)	3.0	0.9	-0.1	1.2
CPI (Average)	6	4.5	3.4	4.2
Forex Reserves (USD bn)	341	370	412	454

Source: Kotak Institutional Equities

- **Equity Markets** – In 2019, Equity markets delivered divergent returns across market caps.

India's Equity Market	Absolute returns Jan-Dec'19 (%)
Nifty 50	11.82
Nifty Midcap 100	-4.51
Nifty Smallcap 250	-8.73

- **FII/DII Flows** - FII inflows were highest in the last 5 years (USD 14.5 Bn) in CY19. DII flows were positive for the 5^{th} consecutive year.
- **Monetary Policy** – RBI cuts 135 bps in policy rates in CY2019, changed its stance from neutral to accommodative in Jun'19 and has maintained the stance since. Rate transmission has been slow due to continuing high rates on small savings instrument. Bank deposit rates and avg. 1-year MCLR has dropped by only 50 -60 bps during the year.

GLOBAL ECONOMY

- US-China trade war turned out to be major source of uncertainty in 2019, hurting sentiments and emerging as a key drag on global trade and capex.
- US Fed cut rates by 75 bps in 2019.
- US Market-cap to GDP ratio remained higher than the long term average. Corporate Profit to GDP ratio also remained high.
- In 2019, currencies showed a mixed trend against US Dollar: Indian Rupee (-2.3%), Chinese Yuan (-1.9%), Pound (+2.5%), Euro (-2.6%), Japanese Yen (+0.2%).
- Brexit was delayed three times and the current deadline is 31 Jan'20. Brexit has taken a toll on companies and consumers costing British economy estimated USD 170 Bn.

2020: Outlook

INDIA

- We expect modest bounce in economy in 2020 helped by:
  - Improvement in credit offtake to the MSME segment over the next 6 months as cost of borrowing drops for banks with higher transmission.
  - Pick up in the real estate sector, especially commercial real estate and affordable housing projects.
  - Availability of easy liquidity
  - Improving exports to the EU region, due to resolution of Brexit and replacement of Chinese goods made uncompetitive due to US tariffs.
  - Corporate earnings revival on the back of pickup in demand.
- Future monetary policy actions will be dependent on incoming data, effective transmission of rate cuts delivered so far, growth-inflation dynamics, revival of investment and consumption demand.
- Growth in earnings should be driven by
  - Normalisation of profits in the corporate banking sector as fresh provisioning reduces and resolutions under IBC come through.
  - Benign commodity prices

    - Lower corporate tax rates
- NIFTY50 profit growth is estimated at 18% CAGR over FY19-22E.
- NIFTY is trading at 15-16X its 1–year forward P/E multiple (in Jan'20). Gap between 10Y Gsec yield and 1Y-Forward NIFTY 50 Earning yield has reduced significantly and is now below 10Y average yield gap indicating that equities are attractively valued relative to current bond yields.
- Low Market-cap to GDP, bond yields nearly equal to earnings yield and recovery in profit growth indicate a case of mean reversion hence an optimistic view on equity markets over medium to long term.

GLOBAL

- The US-China trade truce could boost capital spending and business planning by corporates globally.
- Synchronized monetary easing stance by most global central banks should augment global liquidity.
- The higher tariff on Chinese goods may feed inflation in the US in the coming years leading to global inflation which has so far remained benign.
- The key risk could emanate from crude oil price fluctuations arising out of geopolitical tension in middle-east.
- Extreme climate conditions - fires and floods/cyclones can take a toll on lives, crops, livestock and property with huge economic cost.