Capital League outlook

May,2020

आत्मनिर्भर भारत अभियान

Indian government has announced an INR 20 Lac Cr multipronged stimulus package (including RBI stimulus) to reboot the Indian economy. Out of the total package (10% of GDP), a part of the package (~4% GDP) is already under implementation through RBI's liquidity measures and a mini package by government announced earlier. A substantial portion of the stimulus is in the form of liquidity and lending support schemes run by entities in the public sector as well as support in form of guarantees by the sovereign. This is intended to incentivize economic lending to various parts of economy. The direct impact of this package on the fiscal is about 1% of GDP.

RBI has actioned certain stimulus measures to provide liquidity and credit support to the banks and NBFCs and who can in turn make financing requirements easier for MSMEs.

Supporting MSMEs – Objective of schemes for MSMEs is to enable continuation of operations under financial backing of Govt. of India. Major reforms include

- redrafting of definition of MSMEs
- INR 3 Lac Cr collateral-free loans for businesses (including MSMEs) with full credit guarantee by the govt.; INR 20,000 Cr subordinate debt to be partially guaranteed for stressed MSMEs.
- dedicated Fund of Funds with corpus of INR 50,000 Crs to provide equity funding.
- global tenders for government contracts will give more opportunity to domestic companies.
- Supporting MSMEs will protect lacs of jobs (laborers will not get furloughed).

Credit Flow to Industry – Banks have been reluctant to lend to even investment grade borrowers, despite being flush with liquidity. The government has initiated number of schemes to take over some degree of credit risk, to restart the lending cycle and bring confidence to the credit markets.

- INR 30,000 Cr liquidity scheme - Banks can buy investment grade debt papers of NBFC, HFC and MFI – fully guaranteed by Government.
- INR 45,000 Cr liquidity – Banks can invest in 'AA' rated papers and below, including unrated papers – partially guaranteed by Government (Up to 20%).

This ensures that cost of borrowing comes down for NBFCs as government guarantee makes the borrowing risk-free.

Creating 'Demand' – Restarting the economy requires both supply and demand to be revived. To create demand, with limited resources, the government has proposed the following to leave cash in hands of consumers.

- TDS / TCS reduced by 25%: will generate about INR 50,000 Cr additional liquidity.
- All pending refunds to Charitable trusts and non-corporate tax payers to be done immediately.

- Ongoing public works – Concessional period to be extended.
- DISCOMs –One-time liquidity infusion to all electricity distribution companies against all receivables.

Migrant workers, Street vendors & Farmers: Measurers announced for subsidized credit, free ration, subsidized housing, employment generation through afforestation and plantation, etc.

Agriculture, Fisheries, Animal husbandry, Beekeeping

- Decades old controls on Farm Sector have been lifted to boost market links and increase farm incomes.
- Several reforms measures have been announced in Essential Commodities Act and funding for infrastructure and capacity building in Agri and related segments (INR 1.6 Lac Cr package) which are very positive from a medium term perspective.

Coal, Minerals, Defense production, Airports – Major structural reforms announced.

- Commercial mining through revenue sharing basis instead of fixed pricing, about 50 blocks to be offered immediately
- Coal Gasification/Liquefaction will be incentivised through rebate in revenue share. Will assist India in switching to a gas-based economy
- Introduce a seamless composite exploration-cum-mining-cum-production regime. Under this regime, 500 Mining blocks would be offered through an open auction.
- Infrastructure development of INR 50,000 Crs.
- Raised the FDI limit for Defence production to 74% from 49%. Make in India for self-reliance in Defence production.
- Reduction in flying cost to the extent of INR 1,000 Crs through efficient Airspace management for Civil Aviation (Only 60% of Indian airspace is freely available.)
- Six more airports have been identified for development.
- Privatise Power departments and Utilities in Union Territories
- DISCOMs to ensure adequate power; load shedding to be penalized. Progressive reduction in cross subsidies. Timely payment of Gencos., DBT for subsidy, smart prepaid metres. A tariff policy laying out reforms will be released.

Government has signalled retreat of PSUs even from 'strategic sectors'. PSEs in non-strategic sectors to be privatised.

No specific measures were announced for the Tourism and Hospitality sector which is the worst sufferer in the current crisis.

Indian Economy

- Zone-wise economic activity relaxations provided by the government to result in improvement in economic activity.
- Agriculture sector remains a bright spot. Encouraging reservoir water levels and expectations of normal monsoon this year provide positive outlook for Agri production.
- Government's measures for Rural sector: direct cash transfers and increase in wages under MGNREGA to boost rural income and consumption.
- India can be a beneficiary of the global supply chain disruption. MNCs are reviewing the supply concentration risk with China. Biggest advantage India has over its competitors

(Vietnam, Thailand, Korea, etc.) is a large domestic market. Low taxation and ease of doing business can be enablers.

- Crude prices below USD 50 entails no additional subsidy cost to government on LPG and Kerosene. Therefore, government will save on approx. INR 26,000 Crs in subsidy in FY21.
- Centre hiked excise duty by INR 10/litre and INR 13/litre on petrol and diesel – which will provide additional revenues of INR 1.4 Tn in FY21.
- Government has expanded borrowing program to INR 12 Tn from INR 7.8 Tn, an increase of around INR 4.2 Tn or ~2% of GDP. This increased borrowing will help to meet the revenue shortfall along with expenses of COVID-19 related measures.
- India's GDP growth is projected at -3% to -5% for FY21.
- External Sector: Will benefit due to low oil, low commodity prices. Also, the lockdown has resulted in sharp fall in 'discretionary' spending – imported electronics & consumer goods and lower import of Gold. Negatives - India will receive less remittances from workers in Middle East. But net effect is expected to be positive to the tune of 1- 1.5 % of GDP.
- India may achieve trade balance (Imports = Exports) this year after nearly two decades.

Outlook

- Atamnirbhar Bharat package has announced a large number of measures and reforms which shall support the economy through liquidity measures and credit guarantees in addition to providing basic income and food grains for the basic survival of the lower strata. The fiscal outlay in this package is small (approx. 1.3% of GDP) due to constraints on managing the Fiscal Deficit and to maintain the country's rating. Even as lockdown norms are relaxed in May, economic recovery will be slow given a large part of economic activity hubs are in red zone, social distancing norms will prolong industrial activity ramp up, labor availability could be a significant challenge, and limited space for aggressive government support along with weak overall investment growth prospects.
- Cheap oil, minerals and global capital are big positives for India.
- India is likely to have negative growth (-3 to -5%) in FY21, but growth should return in FY22 as economy opens up and latent demand is addressed. A large domestic market with favourable demographics will support growth.
- Debt - The fact that government has been fiscally responsible and considering that growth and inflation will remain muted will provide further headroom to RBI to cut rates by further by 75 to 100 basis points in this year. This makes 'Debt Mutual Funds' an attractive asset class. In Debt MFs, investors will earn 'pricing benefit' over and above yield of portfolio. We continue to recommend our chosen high quality 'Short term,' 'Banking & PSU', 'Corporate Bond' Funds. The yield curve continues to remain steep due to high risk aversion, this makes the short and medium segment of the yield curve attractive, as they provide good risk reward benefit.
- Equity – Markets are undervalued. Most valuation matrices are near or below long term averages. Market Cap/GDP is about 64% (much below long term average of 77%). Equity investments through SIPs/STPs are recommended with a 2-3-year time horizon. History has shown that whenever valuations reach these levels, the returns over the next 2-3 years are significantly higher as mean reversion kicks in.